

CA



THE INSTITUTE OF  
**CHARTERED** ACCOUNTANTS  
OF SRI LANKA

# **SUGGESTED SOLUTIONS**

**KE2 – Management Accounting Information**

**September 2018**

## SECTION 1

### Answer 01

1.1

**Relevant Learning Outcome/s: 1.1.2**

Explain the nature, scope and purpose of cost classifications (direct/indirect, fixed/variable/semi-variable, production/period, controllable/non-controllable, relevant/non-relevant costs).

Study text reference: Page 98

**Correct answer: C**

1.2

**Relevant Learning Outcome/s: 2.2.1**

Calculate variations under addition, subtraction, multiplication and division. Estimate maximum error in profit when price, quantity, variable cost per unit and fixed costs are subject to error.

Study text reference: Page 28

**Correct answer: C**

1.3

**Relevant Learning Outcome/s: 3.1.3**

Prepare profit statements under both absorption and marginal costing, and the profit reconciliation statement.

Study text reference: Pages 378 and 383

**Correct answer: D**

1.4

**Relevant Learning Outcome/s: 4.1.1**

Calculate simple and compound interest, effective rate of interest, the yield amount when the rate of interest changes with time, regular investment interest, and amortisation schedule.

Study text reference: Pages 420 – 422

**Correct answer: B**

1.5

**Relevant Learning Outcome/s: 4.2.3**

Calculate payback, ARR, NPV and IRR under simple cash flow projects.

Study text reference: Page 445

**Correct answer: B**

1.6

**Relevant Learning Outcome/s: 5.1.1**

Define standard costing (should compare standards vs budgets) and types of standards.

Study text reference: Page 481

**Correct answer: C**

1.7

**Relevant Learning Outcome/s: 5.2.1**

Calculate and interpret basic variances on direct material cost, direct labour cost, variable production overheads, fixed production overheads, and sales.

Study text reference: Page 499

**Correct answer: C**

1.8

**Relevant Learning Outcome/s: 6.1.1**

Identify linear and quadratics functions related to revenue, costs and profit in the algebraic, and graphical forms.

Study text reference: Page 549

**Correct answer: B**

1.9

**Relevant Learning Outcome/s: 7.1.1**

Discuss the purposes of budgeting

Study text reference: Page 589

**Correct answer: B**

1.10

**Relevant Learning Outcome/s: 7.2.2 and 7.2.3**

7.2.2 Demonstrate regressed relationship and its correlation of a simple regression scenario through scatter diagram method, and least square method.

7.2.3 Demonstrate regressed relationship and its correlation of a simple regression scenario through scatter diagram method, and least square method.

Study text reference: Page 650

**Correct answer: A**

**(Total: 20 marks)**

## Answer 02

2.1

<b>Relevant Learning Outcome/s: 1.2.2</b>		
Explain material control systems and calculate EOQ, reorder levels, maximum and minimum levels, valuation of stocks and the issues using FIFO, LIFO and AVCO and calculate profit under each stock valuation method.		
Study text reference: Page 143		
	<b>Working</b>	<b>Qty/ Amount</b>
(i)	$\text{EBQ is } \sqrt{\frac{2C_o D}{C_h(1-D/R)}}$ $= \sqrt{\frac{2*500*60,000}{40*(1-60,000/180,000)}}$	<b>= 1,500 packs</b>
(ii)	<p><b>Total holding cost and set-up cost saving</b>            = <math>\text{EBQ}/2 * C_h * (1-D/R)</math> + Rate per set-up * No of set-ups</p> <p><u>Present case</u>            = <math>\{5,000/2 * 40 * (1 - 60,000/180,000)\} + \{60,000/5,000 * 500\}</math>            = 66,667 + 6,000</p> <p><u>At EBQ level</u>            = <math>\{1,500/2 * 40 * (1 - 60,000/180,000)\} + \{60,000/1,500 * 500\}</math>            = 20,000 + 20,000</p> <p>Expected saving = Rs. 72,667 - Rs. 40,000</p>	<p><b>= Rs. 72,667</b></p> <p><b>= Rs. 40,000</b></p> <p><b>= Rs. 32,667</b></p>

2.2

<b>Relevant Learning Outcome/s: 1.3.1</b>		
Explain types of remuneration (time based, piece based and incentive schemes) and accounting for cost of labour (including flexible working and labour turnover).		
Study text reference: Page 177		
	<b>Working</b>	<b>Amount (Rs.)</b>
(i)	<p><u>Guaranteed minimum wage (Rs.)</u></p> <p>Basic pay = 100*8 hours = 800</p> <p>Overtime = 100*150%*2 hours = <u>300</u></p> <p>Total amount = <u>1,100</u></p>	<b>Rs. 1,100</b>
(ii)	<p><u>Conversion cost (old system) (Rs.)</u></p> <p>Total wage = 1,100</p> <p>Overhead cost = <u>1,200</u></p> <p>Total cost = <u>2,300</u></p> <p>Cost of conversion per unit = 2,300/50</p>	<b>Rs. 46</b>
(iii)	<p><u>Conversion cost (piece work system) (Rs.)</u></p> <p>Piecework rate (25*60) = 1,500</p> <p>Overhead cost = <u>1,200</u></p> <p>Total cost = <u>2,700</u></p> <p>Cost of conversion per unit = 2,700/60</p>	<b>Rs. 45</b>

## 2.3

**Relevant Learning Outcome/s: 2.1.1**

Calculate mark-up and margin, and arrive at the amount in rupees for given mark-up/margin percentages in scenarios (including VAT, income tax and discounts)

Study text reference: Pages 18 and 20

<b>Working</b>	
(i)	<u>Standard error of the mean</u> $SEM = \frac{\sigma}{\sqrt{n}}$ $SEM = 30 / \sqrt{225}$ $= 2 \text{ minutes}$
(ii)	<u>True mean time at 95% confidence level</u> $90 \pm (1.96 * 2)$ $(90 + 3.93) - (90 - 3.92)$ <b>93.93 - 86.08</b>

## 2.4

**Relevant Learning Outcome/s: 2.4.2**

Calculate simple and conditional probabilities using multiplicative and additive rules, expectation and variance of discrete probability distribution (special discrete probability distribution such as Binomial and Poisson distributions are not expected), and probability estimates using normal distribution.

Study text reference: Pages 292 and 294

<b>Working</b>	
(i)	<u>New profit margin</u> Cost per packet = $1,140 / (1,000 / 40)$ = (45.60) Selling price per packet = $69 / 115\%$ = <u>60.00</u> Profit per packet = <u>14.40</u> Profit margin = $14.4 / 60$ = <b>24%</b>
	<u>Original profit margin</u> Original supplier price per kg = $1,140 / 1.2$ = 950 Cost per pack = $950 / (1,000 / 50)$ = (47.50) Selling price per pack (ex. VAT) = $69 / 115\%$ = <u>60.00</u> Profit per packet = <u>12.50</u> Profit margin = $12.5 / 60$ = <b>20.83%</b>
(ii)	Original profit % per 1kg of cost = $12.5 * 20 = 250 / 950$ = 26.31% New profit % per 1kg of cost = $14.4 * 25 = 360 / 1,140$ = <u>31.58%</u> % change in profit earned (positive) = <b>5.27%</b>

2.5

<b>Relevant Learning Outcome/s: 2.5.1</b>	
Demonstrate a basic understanding of sampling (simple random sampling and large samples only), sampling distribution of sample mean and sample proportion, and the use of confidence intervals in business including their interpretation.	
Study text reference: Page 324	
<b>Working</b>	
Daily expected demand = $2,000 \times 0.3 + 2,500 \times 0.5 + 3,000 \times 0.2$	2,450
Expected variable cost per pack = $70 \times 0.5 + 75 \times 0.4 + 80 \times 0.1$	Rs. 73
	<b>Rs.</b>
Sales income = $2,450 \times 120$	294,000
Variable cost = $2,450 \times 73$	<u>(178,850)</u>
Contribution	115,150
Fixed fee	<u>(7,500)</u>
<b>Expected daily profit</b>	<b>107,650</b>

2.6

<b>Relevant Learning Outcome/s: 4.1.1</b>	
Calculate simple and compound interest, effective rate of interest, the yield amount when the rate of interest changes with time, regular investment interest, and amortisation schedule.	
Study text reference: Page 407	
<b>Working</b>	
<u>Value of the FD in 10 years</u> $= 25,000,000 \times (1.08)^3 \times (1.10)^5 \times (1.12)^2$ $= 25,000,000 \times (1.259712) \times (1.61051) \times (1.2544)$ $= \text{Rs. } 63,622,502$	
<u>Net benefit</u> $= \text{Rs. } 65,000,000 - \text{Rs. } 63,622,502$ $= \text{Rs. } 1,377,498 \text{ (net positive benefit)}$	

2.7

<b>Relevant Learning Outcome/s: 4.2.3</b>	
Calculate Payback, ARR, NPV and IRR under simple cash flow projects.	
Study text reference: Pages 445 – 449	
	<b>Rs. million</b>
PV of cash inflows (Rs. 20 million) = $2.6900 \times 20$	53.8
NPV	16.85
PV of capital outlays	36.95
DF (Year 0 + Year 1)	1.8475
Capital expenditure per year	20
<b>Total capital expenditure</b>	<b>40</b>

**Relevant Learning Outcome/s: 5.1.2**

The applicability of standard costing to organisations (with special reference to the difficulties involved in implementing standard costing to service organisations and modern organisations)

Study text reference: Page 483

Critics of using the standard costing method

- (i) It has limited applicability to the modern business environment as it needs immediate availability of products, shortening of product life cycles and higher quality standards.
- (ii) It has traditionally been associated with labour intensive operations, but currently most industries are capital intensive.
- (iii) Standard costing relies on the existence of repetitive operations and relatively homogeneous outputs. However, in modern businesses outputs and operations are not so repetitive.
- (iv) Variance analysis concentrates only on a narrow range of costs and does not give sufficient attention to issues such as quality and customer satisfaction.
- (v) Standard costing systems were developed when the business environment was more stable and less prone to change, but the current business environment is more dynamic.
- (vi) The standard costing system assumes that performance to standards is acceptable, however today's business environment is more focused on continuous improvement.

**Relevant Learning Outcome/s: 5.2.1**

Calculate and interpret basic variances on direct material cost, direct labour cost, variable production overheads, fixed production overheads and sales.

Study text reference: Page 494

Labour rate variance = (Std rate – Act rate) \* Act hours

220,000 = (500 – 480) \* Actual hours

Actual hours = 11,000

Labour efficiency variance = (Std hours – Act hours) \* Std rate

= (13,200 – 11,000) \* 500 = **1,100,000 Favourable**

**Relevant Learning Outcome/s: 7.4.1**

Prepare budgetary control statement (fixed/flexed/actual/variance)

Study text reference: Page 616

Item	Working	Actual results (Rs.)
Sales revenue	= 160,000 – 18,000	142,000
<u>Cost of sales</u>		
- Material cost	= 48,000 + 3,500	(51,500)
- Labour cost	= 35,000 – 8,000	(27,000)
- Variable production overhead	= 7,000 – 900	<u>(6,100)</u>
		57,400
Fixed cost	= <u>15,000 + 2,500</u>	<u>(17,500)</u>
<b>Profit</b>		<b><u>39,900</u></b>

(Total: 30 marks)

## SECTION 2

### Answer 03

**Relevant Learning Outcome/s: 2.3.1 and 2.4.2**

2.3.1 Calculate and interpret mean, standard deviation and coefficient of variation.

2.4.2 Calculate simple and conditional probabilities using multiplicative and additive rules, expectation and variance of discrete probability distribution (special discrete probability distribution such as Binomial and Poisson distributions are not expected), and probability estimates using normal distribution.

Study text reference: Pages 36, 40 and 295

(a)

(i) Sugarcane =  $(30 \times 30\% + 35 \times 45\% + 40 \times 25\%)$   
 Expected revenue = Rs. 34.75 million  
 Expected profit = Rs. 34.75 million – Rs. 27 million = **Rs. 7.75 million**

Cotton =  $(30 \times 30\% + 45 \times 45\% + 40 \times 25\%)$   
 Expected revenue = Rs. 39.25 million  
 Expected profit = Rs. 39.25 million – Rs. 31 million = **Rs. 8.25 million**

(ii) **Sugarcane**

Probability (p)	x	$(x - \bar{x})$	$(x - \bar{x})^2$	$p(x - \bar{x})^2$
30%	3	(4.75)	22.5625	6.77
45%	8	0.25	0.0625	0.03
25%	13	5.25	<u>27.5625</u>	<u>6.89</u>
			<u>50.1875</u>	<u>13.69</u>

Standard deviation =  $\sqrt{\sum p(x - \bar{x})^2} = \sqrt{13.69} = \text{Rs. } 3.7 \text{ million}$

**Cotton**

Probability (p)	x	$(x - \bar{x})$	$(x - \bar{x})^2$	$p(x - \bar{x})^2$
30%	(1)	(9.25)	85.56	25.67
45%	14	5.75	33.06	14.88
25%	9	0.75	<u>0.56</u>	<u>0.14</u>
			<u>119.18</u>	<u>40.69</u>

Standard deviation =  $\sqrt{\sum p(x - \bar{x})^2} = \sqrt{40.69} = \text{Rs. } 6.38 \text{ million}$

(b) Coefficient of variation (COV) = Std deviation/Expected value

Sugarcane =  $3.7/7.75 = 48\%$   
 Cotton =  $6.38/8.25 = 77.3\%$

When the COV is high, the risk is also high. Therefore it is less risky to cultivate sugarcane.

**(Total: 10 marks)**



**Answer 04**

**Relevant Learning Outcome/s: 3.2.2**

Explain the steps involved in ABC

Study text reference: Pages 389 – 394, 396

(a)	Computation of factory overheads	Rs.
	Product A = 100*25,000 =	2,500,000
	Product B = 200*32,500 =	6,500,000
	Product C = 300*20,000 =	<u>6,000,000</u>
	Total overheads	<b><u>15,000,000</u></b>

Cost pool	Activity level	%	Cost (Rs.)	Cost per cost driver (Rs.)
No. of machinery set-ups	300	40%	6,000,000	20,000
No. of purchase orders	1,600	40%	6,000,000	3,750
No. of customers	500	20%	<u>3,000,000</u>	6,000
			15,000,000	

	Product A	Product B	Product C
Material cost per unit (Rs.)	200	300	500
Labour cost per unit (Rs.)	50	100	150
<b>Subtotal (Rs.)</b>	<b>250</b>	<b>400</b>	<b>650</b>

Overhead absorption	Product A	Product B	Product C
<u>No. of machinery set-ups</u>			
Activity utilisation	20	80	200
Relevant cost (Rs.)	400,000	1,600,000	4,000,000
<u>No. of purchase orders</u>			
Activity utilisation	100	500	1,000
Relevant cost (Rs.)	375,000	1,875,000	3,750,000
<u>No. of customers</u>			
Activity utilisation	5	105	390
Relevant cost (Rs.)	30,000	630,000	2,340,000
Total overhead cost (Rs.)	805,000	4,105,000	10,090,000
Output	25,000	32,500	20,000
Overhead cost per unit (Rs.)	32	126	505
Full cost per unit (Rs.)	282	526	1,155
20% profit mark-up	56	105	231
<b>Selling price (Rs.)</b>	<b>339</b>	<b>632</b>	<b>1,385</b>

(b)

- As ABC focuses on the nature of cost behaviour, it provides a meaningful product cost.
- ABC uses multiple cost drivers to allocate overhead costs to activities and then to products instead of using a meaningless direct labour hour recovery rate or machine hour recovery rate which assumes that overhead costs are related to volume of activity only. ABC recognises that many overhead costs arise due to the diversity and complexity of operations.
- The complexity of manufacturing has increased with wider product ranges, shorter product life cycles, more importance attached to quality, and more complex processes. ABC recognises this complexity with its multiple cost drivers.
- ABC facilitates a good understanding of what drives overhead costs.
- ABC takes into consideration all overhead costs thereby taking management accounting beyond its “traditional” factory floor boundaries.

**(Total: 10 marks)**

### Answer 05

**Relevant Learning Outcome/s: 6.2.1**

Demonstrate the use of differential calculus in maximisation and minimisation decisions (using profit function or marginal functions with necessary and sufficient conditions).

Study text reference: Page 568

	Working
(a)	Revenue function = Price * Quantity = $(850 - 0.006X) * X$ = <b><math>850X - 0.006X^2</math></b>
(b)	Marginal revenue = First derivative of revenue function = <b><math>850 - 0.012X</math></b>
	Marginal cost = First derivative of total cost function From $TC = 2,000,000 + 50X + 0.01X^2 \rightarrow$ <b><math>50 + 0.02X</math></b>
	Profit maximises when, Marginal cost = Marginal revenue MC = MR $850 - 0.012X = 50 + 0.02X$ $-0.012X - 0.02X = 50 - 850$ $-0.032 X = -800$ $X = -800 / -0.032$ $X = 25,000$ <b>Optimal production level is 25,000 dolls a month.</b>
	Working <u>Optimal selling price</u> $P = 850 - 0.006X$ $P = 850 - 0.006 * 25,000$ $P = 850 - 150$ $P = 700$ <b>Maximum selling price of a doll is Rs. 700</b>

(c)	<p><u>Total profit at the current production level</u></p> <p>Current selling price (P) = <math>850 - 0.006 * 12,000</math>  <math>P = 850 - 72</math>  <b>= Rs. 778</b></p> <p>Current revenue = <math>778 * 12,000</math> = Rs. 9,336,000</p> <p>Current cost = <math>2,000,000 + 50*12,000 + 0.01(12,000)^2</math>  <math>= 2,000,000 + 600,000 + 1,440,000</math> = <u>(Rs. 4,040,000)</u></p> <p><b>Current total profit = Rs. 5,296,000</b></p>
	<p><u>Total profit at the optimal production level</u></p> <p>New revenue = <math>25,000 * 700</math> = Rs. 17,500,000</p> <p>New cost = <math>2,000,000 + 50*25,000 + 0.01*(25,000)^2</math>  <math>= 2,000,000 + 1,250,000 + 6,250,000</math> = <u>Rs. 9,500,000</u></p> <p><b>New total profit = Rs. 8,000,000</b></p>
	<p><u>Expected total profit increase</u></p> <p>= New profit – Current profit  = Rs. 8,000,000 – Rs. 5,296,000  = Rs. 2,704,000</p> <p><b>The profitability of the company is expected to increase by Rs. 2,704,000 with the expansion of operations.</b></p>

(d)

- The optimal production level was assessed considering the extra revenue (marginal revenue) generated by each additional item sold by the company.
- When the production level exceeds the above level, the additional cost of making an extra doll should exceed the additional revenue generated from an extra sale.
- In such situations, if the company increases the production capacity over 25,000 units a month, the profit that is earned will be lower than that earned at the optimal level.
- Since the company exists to maximise profits, the optimal production level must be at the level where the marginal cost equals the marginal revenue of the company.

**(Total: 10 marks)**

**Answer 06**

**Relevant Learning Outcome/s: 7.3.1**

Prepare functional and cash budgets (only understanding of master budget is expected)

Study text reference: Page 591, 596

(a)

(i)

Working	Qty/ Amount	Qty/ Amount
<u>Production required</u>		
Oct (60%) 14,400		
Nov (40%) 9,600		
<b><u>Material purchases budget</u></b>	<b>A</b>	<b>B</b>
For sales = $14,400 \times 2 = 28,800$ $14,400 \times 0.3 = 4,320$	28,800	4,320
For loss = $(28,800 / 0.96) \times 0.04 = 1,200$ $(4,320 / 0.90) \times 0.1 = 480$	<u>1,200</u>	<u>480</u>
<b>Total for the month's production</b>	<b>30,000</b>	<b>4,800</b>
+ Closing inventory $[(9,600 \times 2) / 0.96] \times 0.25 = 5,000$ $[(9,600 \times 0.3) / 0.9] \times 0.25 = 800$	5,000	800
- Opening inventory $(30,000 \times 0.25) = 7,500$ $(4,800 \times 0.25) = 1,200$	<u>(7,500)</u>	<u>(1,200)</u>
Total purchasing requirement	27,500	4,400
Cost per unit (Rs.)	50	100
<b>Total purchase cost budget (Rs.)</b>	<b>1,375,000</b>	<b>440,000</b>
<b>Total cost</b>	<b><u>Rs. 1,815,000</u></b>	

(ii) Labour cost budget

Category	Total hours	Rate per hour (Rs.)	Total cost (Rs.)
Semi-skilled	$1.5 \times 14,400 = 21,600$	$1,200 / 8 = 150$	$21,600 \times 150 = 3,240,000$
Skilled	$0.5 \times 14,400 = 7,200$	$1,800 / 8 = 225$	$7,200 \times 225 = 1,620,000$
	<u>28,800</u>		<b>4,860,000</b>

(b)

Usefulness of cash budgets

- They enable management to make any forward-planning decisions that may be needed, such as advising their bank, estimating overdraft requirements, strengthening their credit control procedures to ensure that customers pay more quickly.
- It is one of the most important planning tools that an organisation can use. It shows that cash affects all the plans made within the budgetary process. Hence its preparation can lead to a modification of budgets if it shows that there are insufficient cash resources to finance the planned operations.
- It can give management an indication of potential problems that could arise and provides them the opportunity to take actions to avoid such problems.

**(Total: 10 marks)**

## SECTION 3

### Answer 07

**Relevant Learning Outcome/s: 1.4.2**

Demonstrate job, batch, contract (contract account preparation and recognising profit), process (losses, gains, scrap value, disposal cost, closing WIP and opening WIP based on AVCO method) and service costing under appropriate business situations.

Study text reference: Pages 261 and 268

(a)		Units	Value (Rs.)
(i)	Opening materials	5,000	2,000,000
	Purchased during month	95,000	38,950,000
	<b>Total</b>	<b>100,000</b>	<b>40,950,000</b>
	<b>Normal loss (5%)</b>	<b>(5,000)</b>	
	Expected output	95,000	
	Actual output	93,000	
	<b>Abnormal loss</b>	<b>2,000</b>	
(ii)	Material cost of Process 1		40,950,000
	Conversion cost		10,000,000
	<b>Total process cost</b>		<b>50,950,000</b>
	Less: Scrap sales (5,000*500)		(2,500,000)
	<b>Total cost of Process 1</b>		<b>48,450,000</b>
	Expected output		95,000
	Actual output		93,000
	<b>Cost of output transferred to Process 2 (Rs.)</b>		<b>47,430,000</b>
(iii)	Abnormal loss		2,000 units
	Value of abnormal loss (Rs.)		1,020,000
	Scrap sales (2,000*500) (Rs.)		1,000,000
	<b>Impact/net loss from abnormal loss (Rs.)</b>		<b>20,000</b>

(b)	<b>Loss analysis (units)</b>		
	Opening stock	10,000	
	Output of Process 1	93,000	
	Closing stock	<u>(8,000)</u>	
		<u>95,000</u>	
	Completed output	90,000	
	Normal loss	5,000	

<b>(c) Statement of equivalent units</b>						
		<b>Cost (Rs.)</b>				
		<b>Opening WIP</b>	<b>Current month</b>	<b>Total</b>		
Previous process cost		5,000,000	47,430,000	52,430,000		
Material added		600,000	5,966,000	6,566,000		
Conversion cost		1,600,000	15,132,000	16,732,000		
		<b>Units</b>				
		<b>Completed</b>	<b>Closing inventory</b>	<b>Total</b>	<b>Cost per unit (Rs.)</b>	
Previous process transfer		90,000	8,000	98,000	<b>535</b>	
Material added		90,000	8,000	98,000	<b>67</b>	
Conversion cost		90,000	4,000	94,000	<b>178</b>	
<b>Unit cost of finished goods</b>					<b>780</b>	
<b>Selling price (40% profit margin)</b>					<b>1,300</b>	

<b>(d) Value of closing work-in-progress</b>						
		<b>Units</b>	<b>Completion</b>	<b>Unit value (Rs.)</b>	<b>Value (Rs.)</b>	
Previous process transfer		8,000	100%	535	4,280,000	
Material added		8,000	100%	67	536,000	
Conversion cost		8,000	50%	178	712,000	
<b>Value of closing work-in-progress</b>					<b>5,528,000</b>	

**(Total: 20 marks)**



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