Although it may initially appear that the only decision to be made about costs is related to their incurrence, cost behavior patterns make any cost decision more complex. For example, curtailing library operations without properly analyzing cost patterns may result in overstating any anticipated cost savings.

This chapter describes most of the cost terms that are introduced in this book and provides examples of why cost analysis is important in nonprofit managerial decision making. Managerial decision making encompasses both future costs and historical costs. Future costs are most important in making decisions about equipment purchases, whereas historical costs are important in evaluating past performance.¹

Before beginning an analysis of cost concepts, a definition must be provided for the term cost and distinctions made among assets, costs, and expenses. The term cost is defined as net resources used or consumed to achieve specific organizational objectives. Net resources are the cash or other assets remaining after those amounts owed are paid. Although the resources consumed may consist of assets, it is not always necessary for assets to be consumed to incur costs, as costs can increase when liabilities are incurred. We are all faced with the choice between asset consumption or liability incurrence when we choose how to pay our monthly credit card bill. If we pay with cash, we experience the expiration of an asset. If we don’t pay a credit card bill at the end of the month, we increase the amount we owe—
our liability. The effect of a decrease in assets or an increase in liabilities is the same—it is a reduction of net resources available for future use.

Expired or consumed assets are assigned to the proper fiscal periods for financial reporting purposes and are called expenses on an income statement. Expenses are costs incurred with no recognizable future benefit beyond the current time period, and therefore they become deductions on a current income statement. In other words, expenses are the costs of operating a library in a time period when specific library services are rendered. Yet the incurrence of some costs does not always create an immediate increase in expenses in the current time period. Expense recognition can be deferred to later time periods. For example, when cash is expended on a new library building, the building’s cost is not an immediate expense, but it is still referred to as the cost of the building. The cost becomes part of the cost of a property or an asset that will provide a future benefit to the organization. For that reason, the costs of a building are recorded as the building’s services are received.

The term cost is referred to when net resources are either used to construct a building or to pay for photocopying services, for example. Although both cases involve cost incurrence, photocopying services are considered an expense of the current time period; building costs result in a long-lived asset that expires and turns into an expense as the building is used. The building has the potential to provide services for a long time, but the photocopying services are received in the immediate time period.

In some cases, costs that are usually considered an expense of the current period may not be recorded as such because of special circumstances. For example, if a large percentage of a library manager’s work time was devoted to planning and supervising the construction of a new library building, charging a portion of that manager’s salary to the cost of the building, as overhead, might be appropriate. This action is justified because the library manager’s efforts are contributing to the future value of the building, and the cost of the effort should not be recorded as an expense of the current period. This manager’s contribution will provide services for a long-term period in the same manner as other construction costs. Thus, the amount of salary expense recorded in the current period is reduced, and the asset value of the building is increased by an equal amount.

To expand on this recognition concept, consider how the cost of a building is handled. The building’s cost is not immediately recorded as an expense because it has a useful value that is assumed to benefit a number of future periods. Instead, the costs of the building are reasonably allocated to the future periods that will receive benefits from building use. The process of allocating the building’s costs to future time periods is called recording
depreciation expense. Depreciation expense is an allocation procedure that assigns the costs of a long-term asset to future fiscal periods based on the assumed estimated wear or obsolescence of that asset. Figure 2-1 highlights the relationship between assets, costs, and expenses.

As costs are incurred, they either become expenses or create property—an asset or a productlike asset. Over time this property is turned into an expense as it loses its usefulness.3 Depreciation gradually transfers property values into an expense by the allocation of cost to time periods.4

COST CONCEPTS FOR MANAGERIAL DECISION MAKING

In a review of cost concepts, a time period for analysis needs to be assumed. Without a time-period assumption, it is difficult to develop concise cost definitions. For example, in a long-run time frame all costs vary, but as time periods become shorter, some costs begin to vary less. For this review of cost concepts, a twelve-month time period is assumed.

As initially stated, it may not be a simple matter of eliminating departmental functions in order to cut costs. Some costs may behave in a manner that shows little change even when departmental services are reduced. An organization chart for a typical medium-sized public library is shown in Figure 2-2. This organization chart will be used to illustrate the cost concepts highlighted here.
Actual Cost

What are the actual costs involved in decision making? Actual costs are costs incurred at the time a transaction takes place. A service is received or goods are purchased, and in return the organization either incurs a debt or makes a payment. The usefulness of this information for managerial decision making depends on the analysis under way. For some managerial decisions, cash flow is the only information that is important. The importance of cash flows will be explained in chapter 6. For other managerial decisions, however, actual costs need to be used together with other data to arrive at the correct decisions. For example, will the actual cost of operating a bookmobile determine the total cost per unit of services—miles traveled or books loaned—provided by the vehicle? The answer is, not with actual costs alone. It is only
when a portion of actual costs are mingled with costs that must be allocated over time that the full cost of services can be determined on a per-unit basis. Of course, a number of limitations to intermingling these costs need to be understood, and they are discussed later.

Note that the actual costs provide the raw data for the accounting system, the basis for financial reports. These financial reports are only one part of managerial reports that are used for decision making. Accounting rules must be followed for external reporting purposes, but the only reporting rule that has to be used for managerial decision making is to provide reports that are useful to management.

Allocated (Indirect) Costs

For cost data to be useful for managerial decision-making purposes, *service objectives* must be identified. The library’s service objectives are related to the various departmental units, such as those shown in Figure 2-2. The services provided directly to the public by the library are found in Circulation, Children’s Library, Special Collections, the Extension Department, and the Reference Department. These departments have direct contact with patrons, and for that reason they are called *program departments*. The rest of the activities performed within the library support the library’s program departments. Departments that provide supporting services are called *service departments*.

The costs of the service departments are usually allocated to the program departments. Examples of allocated service department costs are depreciation on service department equipment, salaries and wages paid in the service department, and the cost of materials used there. This allocation procedure, which will be discussed in chapter 3, determines the full cost of operating each program department, as well as the per-unit cost of the service objectives within a program department. For example, in determining the unit cost of specific service objectives, the full cost of program operations are divided by a service unit, such as the number of books loaned, to determine the per-unit cost of this service. Allocation procedures are followed because service department costs are difficult to trace directly to specific patron services provided by the library.

In the organization chart, Technical Services, Human Resources, Public Relations, the Business Department, and the salaries being paid to the library director and assistant director represent service department operating costs. These costs, also referred to as indirect or overhead costs, are allocated in a “reasonable” manner to the program departments in order to determine the full costs of operating each program. The main benefit from collecting this infor-
mation is that full-cost comparisons can be made on a year-to-year basis within a library, as well as with annual periods. Additionally, full-cost data may be required to receive reimbursements on work performed under grant agreements.6 

Yet, the question remains: How useful is allocated cost information to managerial decision making? Before answering, several problems with allocated cost should be noted. First, the methods for allocating overhead costs will vary widely from one library to another. Even within the same system, different individuals could select different allocation methods. This variation occurs because allocation methods are usually required to be “reasonable” rather than “uniform.” A number of reasonable methods can be adopted to allocate costs. Therefore, full-cost data calculated on a per-unit basis should only be used to make intralibrary cost comparisons because comparable or uniform full-cost data are not likely to be available among libraries.

A second problem with full-cost data from a managerial perspective is its misleading effect on the performance evaluations of managers. Allocated costs have little bearing on actual manager performance because the manager has no managerial control over costs allocated to his or her unit. Therefore, there is little relationship between actual performance and full costs. In fact, performance evaluation based on full costs can hide poor performance if the reported results are strongly influenced by the method used to allocate overhead costs rather than actual performance. For this reason, full-cost data should not be used for making performance evaluations.

Therefore, the answer to the question of how useful allocated cost information is to managerial decision making can only be answered within the context of the circumstances in which it is used. Generally, the usefulness of allocated cost information to managerial decision making is somewhat limited. Clearly, it must be used with caution whenever it is employed for analysis purposes as it can easily lead to incorrect conclusions.

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**Exercise 2-1**

**Thinking about Overhead Costs**

In the Moreover Library, the Human Resources Department is responsible for handling hiring, promotion packages, and health and other benefit issues that relate to the entire library.

1. How do you think the costs of running the Human Resources Department should be allocated to the Reference Department? (All answers to the exercises are found in appendix C, at the end of the book.)
Standard Costs

Unlike allocated costs, standard costs can be useful in evaluating efficient performance. Standard costs are predetermined future costs set at efficient levels that are attainable by employees. Through past experience or the use of time and motion studies, it is possible to determine how long it should take to efficiently perform many routine activities. Activities such as shelf reading and book processing readily lend themselves to the determination of time/cost standards. The standards for time spent or materials used are established as cost performance criteria to be met by employees. The evaluation of efficient operations requires that actual cost be at least equal to standard costs. It is also possible to evaluate service objectives and determine if they are being achieved efficiently. If actual costs do not meet the attainable standard, the differences need to be investigated so that corrections can be made to reach efficient levels of operations.

An example of standard costs is the standard labor cost per book processed, which can be established based on attainable time and labor rates. These costs include the standard labor costs per hour for activities such as sorting, affixing labels, stamping and attaching pocket and date due slip, inserting Tattle Tape Strips, and sorting for distribution. The standard labor costs allow for determining if there is a dollar variance between the number of books actually processed and the number of books that should have been processed within the standard labor hours allowed for the task. In other words, for the number of books processed, how many hours should have been used? This number should be compared with the actual number of hours used. It is assumed that these tasks or activities are similar from one library to another; therefore, work standards allow for more comparability between libraries as well as within the same library system.

It may appear that the dollar variances between actual work performed and standards are similar to the differences between actual dollars expended and budget appropriations, but they are not. When standard costs are determined, efficiency is the primary consideration. With standards, an attempt is being made to determine if the staff is performing work at an efficient level. This comparison is used to evaluate management performance.

When the differences between budget appropriations and actual expenditures are determined, efficient work performance is not a concern. The difference between budget and actual expenditures is made to highlight deviations from board-approved spending levels only, which is a quasi-legal concern, not an efficiency consideration per se.
Controllable and Noncontrollable Costs

For managerial decision-making purposes, it is important to separate controllable and noncontrollable costs. Without this cost separation, managers may be held accountable for costs over which they have no control or responsibility, such as allocated costs. A controllable cost is a cost that can be changed by a specific manager taking a specific action. An example of a controllable cost is the amount of overtime incurred within a manager’s department. If such costs are not controllable by a manager, they are called noncontrollable costs.

The definition of a controllable cost will vary at different organizational levels within a library. For example, in the organization chart in Figure 2-2, the business manager may be directly responsible for the incurrence of maintenance costs, but to the department head of the children’s library, any maintenance costs allocated to that department are not controllable. As another example, consider the costs that are controllable by the library board. One cost controllable by the board is the library director’s salary, but if a portion of that salary is allocated to departments within the library in determining the full costs of their operations, those individual department heads will view that allocated cost as noncontrollable.

Cost responsibility and cost controllability for a manager should coincide. Therefore, a manager’s performance evaluation should include consideration of how well controllable costs are kept within cost limits. If a cost is noncontrollable, however, a manager’s performance should not be evaluated based on its incurrence.

Although allocated costs are generally associated with noncontrollable costs, unallocated costs may also be noncontrollable. For example, the price of supplies is an unallocated cost. Although the technical services manager does have control over the efficient use of supplies, he or she is likely to have little control over the price paid for those supplies by the business office. The price of supplies is an unallocated cost that is noncontrollable by the manager of technical services, but it is likely to be directly traced to the department. This example illustrates that care must be exercised in determining who has responsibility for costs.

When full costs, including allocated costs, are determined, it is helpful to separate controllable costs from noncontrollable costs in managerial reports. Managers need to realize that they are responsible only for those costs over which they exercise control. The separation of costs into controllable and noncontrollable classifications will highlight this fact.
Exercise 2-2

Why Am I in Trouble?

As head of the Reference Department, you are presented with the following Cost Report from accounting.

Nicer Library
Reference Department
Annual Cost Report
January 1, 20xx

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personnel</td>
<td>$95,000</td>
</tr>
<tr>
<td>Equipment purchases</td>
<td>100,000</td>
</tr>
<tr>
<td>Telephone</td>
<td>6,000</td>
</tr>
<tr>
<td>Supplies</td>
<td>10,000</td>
</tr>
<tr>
<td>Building</td>
<td>15,000</td>
</tr>
<tr>
<td>Administration</td>
<td>15,000</td>
</tr>
<tr>
<td><strong>Total Cost</strong></td>
<td><strong>$241,000</strong></td>
</tr>
</tbody>
</table>

You are shocked to find out that the one phone in the Reference Department is costing $500 per month and that your section of the library is charged $15,000 in building charges. Finally, you also do not understand why you are charged $15,000 of the director’s salary when the director has only talked to you during nonlibrary events.

Explain why the Reference Department’s Cost Report is showing charges for telephone, building, and administration costs.

Fixed, Variable, and Mixed Costs

The separation of costs into fixed, variable, or mixed costs is important in analyzing cost behavior patterns and in making managerial decisions. Cost behavior patterns affect decisions about the savings or cost increases that are likely to occur from changes in activities or service levels. Remember that the time period under which these costs are being defined is one year. This somewhat arbitrary designation of a one-year time frame means that care should be exercised when separating fixed and variable costs in this manner. For example, a cost recognized as a fixed cost in a one-year time frame may be the most rapidly changing, or variable, cost in a two-year time frame.

A fixed cost is a cost that does not change as the level of services within a library changes. Rent and insurance are examples of fixed costs. The
salaries of all contract employees are fixed and will not change directly with the level of library services provided. If a cost changes as the volume of services provided changes, it is a variable cost. Some costs may vary, but they must vary directly with volume levels to be considered a variable cost. Supplies used in the Technical Services Department in Figure 2-2 are an example of a variable cost. Hourly salaries are another example of variable costs because as service levels increase, so do hours worked and wage costs.

Some costs, however, may be variable or fixed depending on how they are calculated. For example, depreciation on a bookmobile may be a fixed amount every year, or the expense could vary with the number of miles logged on the bookmobile. Depreciation expense may vary with time periods, but unless it varies directly with services—hours of use and mileage—it is not a variable cost.

Figure 2-3 provides three illustrations of variable costs. Graph A in Figure 2-3 is the typical example of a variable cost—a 45-degree line between total variable cost and volume or level of services. Graphs B and C are also examples of variable costs, but they change at decreasing and increasing rates, respectively, with volume of service. Both graph B and graph C are illustrations of variable costs because they vary with the volume level of services provided. If the horizontal axis were changed to a measure of time instead of a volume level, none of these costs would be considered a variable cost.

Although it may be useful to separate all costs into fixed and variable costs, this practice may ignore actual cost behavior. Some costs do not exhibit all the characteristics of either a fixed or variable cost. These costs can be called mixed costs because they have characteristics of both variable and fixed costs. An example of a mixed cost is found in the way total salaries for supervisors behave when the span of control is taken into consideration. One supervisor can efficiently handle a specific number of employees, but as employees are added beyond a certain number, other supervisory personnel

<table>
<thead>
<tr>
<th>Total $</th>
<th>Volume</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td></td>
</tr>
<tr>
<td>B</td>
<td></td>
</tr>
<tr>
<td>C</td>
<td></td>
</tr>
</tbody>
</table>

**FIGURE 2-3** Illustrations of variable costs
must be added to help with the supervision tasks. The salary cost pattern for total supervisors’ salaries behaves as illustrated in Figure 2-4, graph A. As the end of an efficient span of control is reached, a new supervisor is added and total salary costs increase in a stair-step fashion. This mixed cost remains fixed for only a limited change in volume of service. Therefore, it is not fixed per se, but it does not exhibit all the characteristics of a variable cost either.

Another example of mixed costs is illustrated in Figure 2-4, graph B. This cost pattern begins as a fixed cost and changes to a variable cost after a specific volume level is reached. Utility rates that begin with a flat charge and change to a variable rate per unit after a certain usage figure is reached are an example of this cost pattern.

These cost patterns show that it is important to know cost behavior before assumptions about future cost reductions can be made. In a library facing budget curtailments, knowledge of cost behavior patterns assist the library manager in initiating cost cuts with a minimum reduction in services. The decision involves more than simply curtailing activities or instituting across-the-board percentage budget cuts.

**Exercise 2-3**

**Some Simple Cost Patterns**

For each of the following descriptions, develop a cost pattern similar to those shown in Figures 2-3 and 2-4.

1. Assuming a budget purchase plan is not in effect, draw the seasonal cost pattern of electrical cost usage for a library in Minnesota.

2. At the initial change, draw the cost pattern, to the library, of switching from printed periodicals to online periodicals.
Direct and Indirect (Allocated) Costs

Direct costs are directly traceable to the cost of a service or department. Examples of direct cost are the cost of labor and materials that go into a library’s in-house bookbinding operations, the labor costs of running branch libraries, or the labor and material costs of processing interlibrary loans. Indirect costs or allocated costs cannot be easily traced to an organizational objective, program, or department. Allocated costs have already been described, but they need to be compared here with direct costs.

A direct cost is a controllable cost if a specific manager can control it; however, identification as a direct cost does not necessarily mean that cost is controllable by a department manager. Indirect costs are similar to noncontrollable costs. But, again, a cost may be controllable by a manager even though it is an indirect cost. Therefore, these definitions may overlap, but they do not implicitly overlap.

Only direct costs can be eliminated. Therefore, separation of direct costs from indirect or allocated costs is important if future costs savings from curtailing department operations are to be accurately determined. If the library director reviews full costs in determining the future cost savings from curtailing activities, the amount of savings will be overestimated because a high percentage of indirect or allocated costs is likely to remain when service is reduced. An analysis of direct and indirect costs to determine the cost savings from reducing services is important to sound managerial decision making.

Discretionary Costs, Sunk Costs, and Differential Costs

Distinctions between discretionary costs, sunk costs, and differential costs are important because only differential costs have an effect on managerial decision making.

The decision to incur discretionary costs is usually made as part of the annual appropriation. Discretionary costs are expenditures based on the discretion of management rather than on managerial analysis. These costs are easy to change; managers need only change their minds about the expenditures to increase or decrease amounts expended.

Management may believe that discretionary expenditures are important, but their value to the organization is difficult to measure. Examples of discretionary costs are seminar training for employees in technical services, training for reference personnel on a new database, setting aside amounts for travel to professional meetings, and promoting library programs. It is difficult
to determine the direct increase in service to the library that is being received from making these expenditures.

Another cost classification is *sunk cost*. Unlike discretionary costs, sunk costs are costs that cannot be changed. The organization has made a commitment to their continuation. Examples of these costs are depreciation, long-term contract payments, and liability insurance payments. Identifying these costs will allow them to be separated from those costs that influence managerial decisions. As an example of a sunk cost, consider the calculation of depreciation. Depreciation is calculated by assigning the cost of an asset to the time periods in which the asset is used. Although the future amount to be paid for an asset is an important consideration in decision making, after the purchase price has been paid, its accounting disposition is of little importance to managerial decision making. The yearly depreciation charges based on the price paid for an asset are not useful for future decision making as long as the asset is in use. For this reason, the sunk cost or purchase price of an asset acquired yesterday has no bearing on the decision to replace that asset today. Many managerial decision-making questions are oriented toward the future, not the past, and historical cost allocations have no effect on those decisions.

*Differential costs* are another cost classification. Unlike discretionary or sunk costs, differential costs are important for managerial decision-making purposes. Differential costs are sometimes called *incremental costs*. These costs are the dollar differences between the costs of alternative future actions that can be taken by a manager. For example, if the purchase prices of two vehicles are $10,800 and $10,000, the differential or incremental cost is $800. If the cost of license plates for each vehicle is $35, this is not a differential because the charge is the same. Therefore, the cost of license plates should not be a consideration in determining which of the two vehicles to purchase.

Consider the decision to close a branch library as another example of differential cost analysis. The costs of operating the branch are shown in Figure 2-5. The total cost of operating the branch is $36,500, and initially it may appear that this is the amount saved if the branch is closed.

However, to determine the actual amount of savings that will occur if the branch is closed, the costs of operating the branch need to be individually analyzed. The salary of an administrator within the Extension Department is allocated to this branch based on the time spent assisting with branch functions. As shown in Figure 2-5, $6,500 of the administrator’s salary is allocated to the branch. This is an example of an indirect or allocated cost. The administrator would not be released if the branch were closed; therefore, this
administrative salary would not be reduced. A technician working at the branch who receives a salary of $10,000 would be laid off if the branch were closed. Approximately one-half of the book purchases and video rental costs would still have to be paid for by the main library. The differential cost savings from closing the branch are $26,000—the costs that change as a result of closing the branch, not the total costs of operating the branch. Figure 2-5 shows that the cost savings from closing the branch are less than the branch’s full operating cost—costs of $10,500 will continue to be incurred regardless of whether the branch is closed ($36,500 – $26,000). These costs are unavoidable and should not enter into the decision-making process. Only costs that will differ as a result of alternative future choices—the differential costs—should be allowed to influence such a decision.

### Exercise 2-4

**Budget Cuts**

Use the Cost Report from Exercise 2-2 to answer the questions below.

To save money, the director of the Nicer Library has been forced to cut the budget by 10 percent. As head of the Reference Department, your portion of the reduction is equal to $24,100 (.10 × 241,000).

1. Can you explain to the director why the level of this reduction may not be possible without seriously curtailing reference services?
2. And, further, can you explain how much of the 10 percent across-the-board budget cut should be taken out of your department?
Life Cycle Costs

Costs associated with an asset over its entire life or life cycle are called life cycle costs. These costs are used in determining which of several similar assets to purchase. Life cycle costing goes beyond the initial acquisition price in selecting which asset to purchase; it includes a projection of the asset’s operating and maintenance costs over its entire life. This information may have to be estimated from a number of sources. Besides the future operating and maintenance costs, another factor in this analysis is the estimated salvage value of the asset at the end of its useful life. All these variables affect the overall cost of asset ownership. A complete discussion of this topic is presented in chapter 6.

Future operating and maintenance costs are not reflected in the acquisition price and may differ significantly between two assets. Therefore, in making asset purchase decisions, total ownership costs need to be compared. These costs are important because maintenance costs of an asset may equal more than half the asset’s original cost, and with an aging asset, these costs tend to increase.

For management to select the most cost-effective asset for use in the organization, the total ownership costs of an asset must be estimated. If the initial acquisition price is the major criteria used for the selection of an asset, the asset acquisition process is likely to be misguided. This is especially true with assets that have longer lives.

Historical Costs and Current Costs

The historical cost of an asset is the price that was originally paid for that asset and is recorded in the accounting records when that asset is acquired. This is the only cost that can be shown directly on the financial statements.

Yet, as inflation continues, the purchase cost of the same type of asset increases. For example, a desk may have cost $225 ten years ago, and today the market price of that same desk is $650. This amount is not recorded in the books, but for managerial decision making, the current cost of $650 is more important because it shows the resources that will have to be used to acquire a new desk. Current cost adjustments will be used in chapter 3.

SUMMARY

This chapter provides a background to specific cost terms and concepts that will be used in later chapters. It is not the purpose of this chapter to deal in
great detail with these concepts or to cover all the cost terminology that will be introduced in the book but, rather, to provide an overview of cost concepts and indicate how these concepts affect managerial decision making.

The chapter has highlighted cost terms that are useful to managerial decision making. A total of sixteen cost terms were introduced: actual, allocated, standard, controllable, noncontrollable, fixed, variable, mixed, direct, indirect, discretionary, sunk, differential, life cycle, historical, and current.

Gaining a familiarity with these cost definitions is important because they will be used throughout the remainder of the book. Terms such as controllable, noncontrollable, and allocated costs; variance analysis and variable and fixed costs; and life cycle costing techniques and differential cost analysis will be covered in future chapters.

In managerial decision making, there is an emphasis on making future-oriented decisions, and therefore the anticipated costs associated with these decisions are also important. In evaluating managerial performance, historical cost information provides a measure of feedback on past performance.

The cost classifications described in this chapter are not available in budget reports. Budget reports classify all costs together on budget lines to ensure that appropriated budget dollars have not been exceeded. As a result, budget reports cannot be used for most managerial decision-making issues. Also, most budget reports do not provide for cost control except on a total expenditure basis.

Additionally, the cost classifications described here cannot be found on the financial statements prepared for a library. As constructed, financial statements do not provide cost information that is required by operating managers for decision making. Therefore, library managers have a special need for the preparation of managerial reports containing this specific cost information.

Notes

1. It was stated in chapter 1 that it is more useful for a manager to know the amount of deferred maintenance on an asset than the amount of accumulated depreciation on that asset. This is still true. Many managerial decisions have a future orientation, and for those decisions only costs that affect the future are important. Historical cost information does have a place in managerial decision making, but the allocated purchase price of an asset does not. A manager is responsible for the costs that he or she can control, and managerial performance is evaluated on that basis. But, in neither decision making nor performance evaluation is depreciation expense important.

2. For managerial decision making, it is not important how these costs are assigned to the financial statements. From a managerial decision-making perspective, the primary concern is when the cash flow related to the transaction occurs, not how it was allocated on the financial statements. Cash flow analysis will be discussed in chapter 6.
3. In a corporation, product costs are eventually recorded on the income statement as the cost of units sold. Libraries usually do not record the cost of sales on their financial statements.

4. The terms costs and expenses are based on accrual accounting methods. The term expenditures is based on modified accrual accounting methods. Cash accounting methods do not record true expenditures, expenses, or costs, but they record disbursements instead. For additional explanations of these accounting methods, see *Accounting for Libraries and Other Not-for-Profit Organizations* (Chicago: American Library Association, 1999), by G. Stevenson Smith. As the financial report for non-profits becomes similar to corporate financial reporting (a current trend), the terms costs and expenses will replace the term expenditures more commonly found in modified accrual methods.

5. The term allocated cost is often used as a synonym for indirect costs or overhead costs.

6. Under federal grants where costs may be reimbursed, the allocation of overhead is closely regulated.