## CONTENTS

Preface to Seventh Edition xiii

LEARNING
STAGE 1

## THE FUNDAMENTALS

Chapter 1	Foundations of Engineering Economy	2
•	1.1 Engineering Economics: Description and	
	Role in Decision Making	3
	1.2 Performing an Engineering Economy Study	4
	1.3 Professional Ethics and Economic Decisions	7
	1.4 Interest Rate and Rate of Return	10
	1.5 Terminology and Symbols	13
	1.6 Cash Flows: Estimation and Diagramming	15
	1.7 Economic Equivalence	19
	1.8 Simple and Compound Interest	21
	1.9 Minimum Attractive Rate of Return	25
	1.10 Introduction to Spreadsheet Use	27
	Chapter Summary	31
	Problems	31
	Additional Problems and FE Exam Review Questions  Case Study—Renewable Energy Sources for Electricity Generation	35 36
	Case Study—Refrigerator Shells	37
	Case Study—Reinigerator Sheris	37
Chapter 2	Factors: How Time and Interest Affect Money	38
	Progressive Example—The Cement Factory Case	39
	2.1 Single-Amount Factors $(F/P \text{ and } P/F)$	39
	Uniform-Series Present Worth Factor and Capital Recovery Factor $(P/A \text{ and } A/P)$	43
	2.3 Sinking Fund Factor and Uniform-Series Compound Amount Factor $(A/F \text{ and } F/A)$	46
	2.4 Factor Values for Untabulated <i>i</i> or <i>n</i> Values	48
	2.5 Arithmetic Gradient Factors $(P/G \text{ and } A/G)$	50
	2.6 Geometric Gradient Series Factors	58
	2.7 Determining <i>i</i> or <i>n</i> for Known Cash Flow Values	61
	Chapter Summary	64
	Problems	64
	Additional Problems and FE Exam Review Questions	69
	Case Study—Time Marches On; So Does the Interest Rate	70
Chapter 3	Combining Factors and Spreadsheet Functions	72
•	3.1 Calculations for Uniform Series That Are Shifted	73
	3.2 Calculations Involving Uniform Series and Randomly Placed Single Amounts	76
	3.3 Calculations for Shifted Gradients	80
	Chapter Summary	86
	Problems	86
	Additional Problems and FE Exam Review Questions	92
	Case Study—Preserving Land for Public Use	93
Chapter 4	Nominal and Effective Interest Rates	94
	Progressive Example—The Credit Card Offer Case	95
	4.1 Nominal and Effective Interest Rate Statements	96
	4.2 Effective Annual Interest Rates	99
	4.3 Effective Interest Rates for Any Time Period	105
	4.4 Equivalence Relations: Payment Period and Compounding Period	106
	4.5 Equivalence Relations: Single Amounts with $PP \ge CP$	107

/iii	Conte	ents	
	4.6	Equivalence Relations: Series with PP ≥ CP	109
	4.7	Equivalence Relations: Single Amounts and Series with PP < CP	112
	4.8	Effective Interest Rate for Continuous Compounding	114
	4.9	Interest Rates That Vary over Time	116
		Chapter Summary	117
		Problems	118
		Additional Problems and FE Exam Review Questions	122
		Case Study—Is Owning a Home a Net Gain or Net Loss over Time?	124
LEARNING STAGE 2	BAS	IC ANALYSIS TOOLS	
Chapter 5	Droce	ent Worth Analysis	128
Chapter 3	PE	Progressive Example—Water for Semiconductor Manufacturing Case	129
	5.1	Formulating Alternatives	129
	5.2	Present Worth Analysis of Equal-Life Alternatives	131
	5.3	Present Worth Analysis of Different-Life Alternatives	133
	5.4	Future Worth Analysis	137
	5.5	Capitalized Cost Analysis	138
		Chapter Summary	142
		Problems	142
		Additional Problems and FE Exam Review Questions	147
		Case Study—Comparing Social Security Benefits	149
Chapter 6	Annı	ual Worth Analysis	150
	6.1	Advantages and Uses of Annual Worth Analysis	151
	6.2	Calculation of Capital Recovery and AW Values	153
	6.3	Evaluating Alternatives by Annual Worth Analysis	155
	6.4	AW of a Permanent Investment	157
	6.5	Life-Cycle Cost Analysis	160
		Chapter Summary	164
		Problems	164
		Additional Problems and FE Exam Review Questions	169
		Case Study—The Changing Scene of an Annual Worth Analysis	171
Chapter 7	Rate	of Return Analysis: One Project	172
	7.1	Interpretation of a Rate of Return Value	173
	7.2	Rate of Return Calculation Using a PW or AW Relation	175
	7.3	Special Considerations When Using the ROR Method	179
	7.4	Multiple Rate of Return Values	180
	7.5	Techniques to Remove Multiple Rates of Return	184
	7.6	Rate of Return of a Bond Investment	190 193
		Chapter Summary Problems	193
		Additional Problems and FE Exam Review Questions	193
		Case Study—Developing and Selling an Innovative Idea	200
Chapter 8	Rate	of Return Analysis: Multiple Alternatives	202
Chapter 0	8.1	Why Incremental Analysis Is Necessary	203
	8.2	Calculation of Incremental Cash Flows for ROR Analysis	203
	8.3	Interpretation of Rate of Return on the Extra Investment	206
	8.4	Rate of Return Evaluation Using PW: Incremental and Breakeven	207
	8.5	Rate of Return Evaluation Using AW	213
	8.6	Incremental ROR Analysis of Multiple Alternatives	214

214

	Contents	ix
	8.7 All-in-One Spreadsheet Analysis (Optional)	218
	Chapter Summary	219
	Problems	219
	Additional Problems and FE Exam Review Questions	225
		226
	Case Study—ROR Analysis with Estimated Lives That Vary Case Study—How a New Engineering Graduate Can Help His Father	227
	Case Study—now a New Engineering Graduate Can help his Father	221
Chapter 9	Benefit/Cost Analysis and Public Sector Economics	228
	Progressive Example—Water Treatment Facility #3 Case	229
	9.1 Public Sector Projects	230
	9.2 Benefit/Cost Analysis of a Single Project	235
	9.3 Alternative Selection Using Incremental B/C Analysis	238
	9.4 Incremental B/C Analysis of Multiple, Mutually Exclusive Alternatives	242
	9.5 Service Sector Projects and Cost-Effectiveness Analysis	246
	9.6 Ethical Considerations in the Public Sector	250
	Chapter Summary	251
	Problems	252
	Additional Problems and FE Exam Review Questions	258
	Case Study—Comparing B/C Analysis and CEA of Traffic Accident Reduction	259
LEARNING STAGE 2	EPILOGUE: SELECTING THE BASIC ANALYSIS TOOL	
LEARNING STAGE 3	MAKING BETTER DECISIONS	
Chapter 10	Project Financing and Noneconomic Attributes	266
	10.1 MARR Relative to the Cost of Capital	267
	10.2 Debt-Equity Mix and Weighted Average Cost of Capital	269
	10.3 Determination of the Cost of Debt Capital	271
	10.4 Determination of the Cost of Equity Capital and the MARR	273
	10.5 Effect of Debt-Equity Mix on Investment Risk	275
	10.6 Multiple-Attribute Analysis: Identification and Importance of Each Attribute	278
	10.7 Evaluation Measure for Multiple Attributes	282
	Chapter Summary	283
	Problems	284
	Additional Problems and FE Exam Review Questions	289
	Case Study—Which Is Better—Debt or Equity Financing?	290
Chapter 11	Replacement and Retention Decisions	292
Chapter 11	Progressive Example—Keep or Replace the Kiln Case	293
	11.1 Basics of a Replacement Study	293 294
	11.1 Basics of a Replacement Study 11.2 Economic Service Life	294
	11.3 Performing a Replacement Study	302
	11.3 Performing a Replacement Study 11.4 Additional Considerations in a Replacement Study	302
	11.5 Replacement Study over a Specified Study Period	307
		307
	*	
	Chapter Summary Problems	312 313
	Additional Problems and FE Exam Review Questions	313
	Auditional Florichis and F.E. Exam Review Questions	319

Case Study—Will the Correct ESL Please Stand?

321

x	Contents	
Chapter 12	Independent Projects with Budget Limitation	322
	12.1 An Overview of Capital Rationing among Projects	323
	12.2 Capital Rationing Using PW Analysis of Equal-Life Projects	325
	12.3 Capital Rationing Using PW Analysis of Unequal-Life Projects	327
	12.4 Capital Budgeting Problem Formulation Using Linear Programming	329
	12.5 Additional Project Ranking Measures	332
	Chapter Summary	334
	Problems	334
	Additional Problems and FE Exam Review Questions	338
Chapter 13	Breakeven and Payback Analysis	340
•	13.1 Breakeven Analysis for a Single Project	341
	13.2 Breakeven Analysis Between Two Alternatives	345
	13.3 Payback Analysis	348
	13.4 More Breakeven and Payback Analysis on Spreadsheets	352
	Chapter Summary	355
	Problems	355
	Additional Problems and FE Exam Review Questions	361
	Case Study—Water Treatment Plant Process Costs	363
LEARNING STAGE 4	ROUNDING OUT THE STUDY	
Chapter 14	Effects of Inflation	366
Chapter 14	14.1 Understanding the Impact of Inflation	367
	14.2 Present Worth Calculations Adjusted for Inflation	369
	14.3 Future Worth Calculations Adjusted for Inflation	374
	14.4 Capital Recovery Calculations Adjusted for Inflation	377
	Chapter Summary	378
	Problems	379
	Additional Problems and FE Exam Review Questions	384
	Case Study—Inflation versus Stock and Bond Investments	385
Chapter 15	Cost Estimation and Indirect Cost Allocation	386
Chapter 15	15.1 Understanding How Cost Estimation Is Accomplished	387
	15.2 Unit Method	390
	15.3 Cost Indexes	391
	15.4 Cost Estimating Relationships: Cost-Capacity Equations	394
	15.5 Cost Estimating Relationships: Factor Method	395
	15.6 Traditional Indirect Cost Rates and Allocation	397
	15.7 Activity-Based Costing (ABC) for Indirect Costs	401
	15.8 Making Estimates and Maintaining Ethical Practices	403
	Chapter Summary	404
	Problems	404
	Additional Problems and FE Exam Review Questions	410
	Case Study—Indirect Cost Analysis of Medical Equipment Manufacturing Costs	411
	Case Study—Deceptive Acts Can Get You in Trouble	412
Chapter 16	Depreciation Methods	414
C. Speci 10	16.1 Depreciation Terminology	415
	16.2 Straight Line (SL) Depreciation	418
	16.3 Declining Balance (DB) and Double Declining Balance (DDB) Depreciation	419

Modified Accelerated Cost Recovery System (MACRS)

Determining the MACRS Recovery Period

16.4 16.5 422

426

		Contents	xi
	16.6	Depletion Methods	427
		Chapter Summary	429
		Appendix	430
	16A.1	Sum-of-Year Digits (SYD) and Unit-of-Production (UOP) Depreciation	430
	16A.2	Switching between Depreciation Methods	432
	16A.3	Determination of MACRS Rates	435
		Problems	438
		Additional Problems and FE Exam Review Questions	442
		Appendix Problems	443
Chapter 17	Afte	r-Tax Economic Analysis	444
-	17.1	Income Tax Terminology and Basic Relations	445
	17.2	Calculation of Cash Flow after Taxes	448
	17.3	Effect on Taxes of Different Depreciation Methods and Recovery Periods	450
	17.4	Depreciation Recapture and Capital Gains (Losses)	453
	17.5	After-Tax Evaluation	456
	17.6	After-Tax Replacement Study	462
	17.7	After-Tax Value-Added Analysis	465
	17.8	After-Tax Analysis for International Projects	468
	17.9	Value-Added Tax	470
		Chapter Summary	472
		Problems	473
		Additional Problems and FE Exam Review Questions	481
		Case Study—After-Tax Analysis for Business Expansion	482
Chapter 18	Sens	itivity Analysis and Staged Decisions	484
	18.1	Determining Sensitivity to Parameter Variation	485
	18.2	Sensitivity Analysis Using Three Estimates	490
	18.3	Estimate Variability and the Expected Value	491
	18.4	Expected Value Computations for Alternatives	492
	18.5	Staged Evaluation of Alternatives Using a Decision Tree	494
	18.6	Real Options in Engineering Economics	498
		Chapter Summary	503
		Problems	503
		Additional Problems and FE Exam Review Questions	509
		Case Study—Sensitivity to the Economic Environment Case Study—Sensitivity Analysis of Public Sector Projects—Water Supply Plans	510 511
		Case Staty—Sensitivity Analysis of Fubile Sector Projects—water Supply Flans	311
Chapter 19	More	e on Variation and Decision Making under Risk	514
	19.1	Interpretation of Certainty, Risk, and Uncertainty	515
	19.2	Elements Important to Decision Making under Risk	518
	19.3	Random Samples	523
	19.4	Expected Value and Standard Deviation	526
	19.5	Monte Carlo Sampling and Simulation Analysis	533
		Chapter Summary	540
		Problems Additional Problems and EF Event Proving Operations	540 542
		Additional Problems and FE Exam Review Questions  Cose Study Living Simpletion and Three Estimate Sensitivity Analysis	543 544
		Case Study—Using Simulation and Three-Estimate Sensitivity Analysis	344
Appendix A		g Spreadsheets and Microsoft Excel <sup>©</sup>	547
	A.1	Introduction to Using Excel	547
	A.2	Organization (Layout) of the Spreadsheet	549
	A.3	Excel Functions Important to Engineering Economy	550
	A.4	Goal Seek—A Tool for Breakeven and Sensitivity Analysis	558
	A.5	Solver—An Optimizing Tool for Capital Budgeting, Breakeven, and Sensitivity Analysis	559 560
	A.6	Error Messages	560

xii	Contents	
Appendix B	Basics of Accounting Reports and Business Ratios	561
	B.1 The Balance Sheet	561
	B.2 Income Statement and Cost of Goods Sold Statement	562
	B.3 Business Ratios	563
Appendix C	Code of Ethics for Engineers	566
Appendix D	Alternate Methods for Equivalence Calculations	569
	D.1 Using Programmable Calculators	569
	D.2 Using the Summation of a Geometric Series	570
Appendix E	Glossary of Concepts and Terms	573
	E.1 Important Concepts and Guidelines	573
	E.2 Symbols and Terms	576
Reference Materials	579	
Factor Tables	581	
Credit	610	
Index	611	