The **internal rate of return (IRR)** or **economic rate of return (ERR)** is a rate of return used in capital budgeting to measure and compare the profitability of investments. It is also called the discounted cash flow rate of return (DCFROR). In the context of savings and loans the IRR is also called the effective interest rate. The term *internal* refers to the fact that its calculation does not incorporate environmental factors (e.g., the interest rate or inflation). The internal rate of return on an investment or project is the "annualized effective compounded return rate" or "rate of return" that makes the net present value (NPV as NET*1/(1+IRR)^year) of all cash flows (both positive and negative) from a particular investment equal to zero. It can also be defined as the discount rate at which the present value of all future cash flow is equal to the initial investment or in other words the rate at which an investment breaks even.

In more specific terms, the IRR of an investment is the discount rate at which the net present value of costs (negative cash flows) of the investment equals the net present value of the benefits (positive cash flows) of the investment.

IRR calculations are commonly used to evaluate the desirability of investments or projects. The higher a project's IRR, the more desirable it is to undertake the project. Assuming all projects require the same amount of up-front investment, the project with the highest IRR would be considered the best and undertaken first.

			Variable		Additional	
Year	Depreciation	Fixed cost	cost	Income	revenue	Cash flows
0		138000				-138000
1	27600	11600	24000	72000	14000	78000
2	27600		24000	72000	14000	89600
3	27600		24000	72000	14000	89600
4	27600		24000	72000	14000	89600
5	27600		24000	72000	14000	89600
					IRR =	55%

Cash flow = Income + Additional revenue + Depreciation - Fixed Cost - Variable cost