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An asset's present value is the equivalent value of an asset in today's dollars, given its value at a specific time in the future. The equation for computing present value is:

PV = FV / (1 + R) ^n

Where,

PV = present value

FV = future value

R = assumed interest rate

n = number of years into future

The interest rate chosen has a profound effect on a future amount's present value.

For example, assume you expect to receive an inheritance of $100,000 in 10 years and you want to know what the equivalent bequest would be in today's dollars in terms of buying power. Based on an assumed annual inflation rate of 4% per year, the present value of the $100,000 bequest is:

PV = 100,000 / (1 + .04)^10 = $67,556

In contrast, if you wish to adjust the $100,000 for the opportunity cost of having to wait 10 years before you can invest it, you will want to use a present value rate that reflects the annual net rate of return you expect the assets to earn over the 10 years. This rate might be 8% per year after accounting for management and administrative costs, for example. Using 8%, the present value of the $100,000 bequest is:

PV = 100,000 / (1 + .08)^10 = $46,319

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