



CERTIFIED FINANCIAL PLANNER BOARD OF STANDARDS, INC.

## CFP Board Practice Exam

March 2019 Edition

Errata No.: PRA-19-01

The Council on Examinations notes the following errors in the 2018 edition of the CFP Board Practice Exam.

1. The answer key for the question related to *G.57. Other tax-advantaged retirement plans* is incorrect. Multiple choice options have also been updated.

**Revised:**

A 45-year-old client, who is a teacher, will earn \$66,000 this year. Which of the following amounts is the maximum allowed contribution the client can make to a tax-sheltered annuity?

- (A) \$13,200
- (B) \$18,500
- (C) \$21,500
- (D) \$24,500

**Key: B**

<b>Incorrect: A</b>	20% of salary, which is SEP limit but not applicable to TSA.
<b>Correct: B</b>	This is the maximum amount of contribution.
<b>Incorrect: C</b>	This contribution level includes the \$3,000 catch-up contribution for employees with 15 years of service with the same employer. The client does not qualify for this catch-up contribution.
<b>Incorrect: D</b>	This amount is only for age 50 and over.

2. The rationale and answer choice for option (B) are incorrect for the question related to *E.38. Bond and stock valuation concepts.*

**Revised:**

ABC Co. will pay dividends of \$2, \$0, and \$1 respectively, at the end of each year. The future dividends will grow at 5% annually. A client has a required rate of return of 9%. What is the value per share of ABC if the client uses the dividend growth model?

- (A) \$18.60
- (B) \$22.88
- (C) \$26.25
- (D) \$28.86

**Key: B**

<b>Incorrect: A</b>	This option does not consider irregular dividends.
<b>Correct: B</b>	<p>To determine the present value of the stock (PV), the PV of the irregular dividends (Years 1-3) must be determined, as well as the PV of the future dividends that will grow at a constant rate (years 4 and later).</p> <p>The present value of the irregular dividends must be calculated individually as follows:</p> <p>PV of Year 1 Dividend = <math>\\$2 / (1 + 9\%)^1 = \\$1.84</math></p> <p>PV of Year 2 Dividend = <math>\\$0 / (1 + 9\%)^2 = \\$0.00</math></p> <p>PV of Year 3 Dividend = <math>\\$1 / (1 + 9\%)^3 = \\$0.77</math></p> <p>Therefore, the PV of the irregular dividends is \$2.61</p> <p>The value of the future dividends can be determined by using the constant dividend (Gordon) growth model, which is represented by the following formula:</p> <p>PV of future dividends = <math>[\text{Dividend} \times (1 + \text{Growth Rate})] / (\text{Required Rate of Return} - \text{Growth Rate})</math></p> <p>PV of future dividends = <math>[\\$1 \times (1 + 5\%)] / (9\% - 5\%)</math></p> <p>PV of future dividends = <math>[\\$1 \times (1.05)] / (.04)</math></p> <p>PV of future dividends = <math>\\$1.05 / .04</math></p> <p>PV of future dividends = \$26.25</p> <p>The constant dividend growth model calculates the value of the stock TODAY based on NEXT YEAR's dividend. Since the \$1.05 dividend represents next year's dividend, which is the dividend at the end of year 4, that means the stock value of \$26.25</p>

	<p>represents the value of the stock at the BEGINNING of year 4 (which is essentially the end of year 3). As a result, the \$26.25 value must be discounted by 3 years to determine the present value today.</p> $PV = \$26.25 / (1 + 9\%)^3 = \$20.27$ <p>The value of the stock today represents the sum of the PV of the irregular dividends and the constant-growth dividends.</p> $\text{Value of stock} = \$2.61 + \$20.27$ $\text{Value of stock} = \$22.88$
<b>Incorrect: C</b>	Using DGM formula without discount and no current dividend.
<b>Incorrect: D</b>	Using DGM formula without discount.

3. Credit for selecting the correct answer for the question related to E.34. *Types of investment risk* is not being calculated by the software. The correct answer is B. The review screen should indicate that the test taker answered the question correctly if B is selected.

Which of the following investments owned by the Phillips have the greatest interest rate risk?

- (A) Treasury strip & Treasury bond
- (B) Treasury strip & State Hospital Revenue bond
- (C) Treasury bond & Insured short/intermediate term municipal investment trust
- (D) State Hospital Revenue bond & Insured short/intermediate term municipal investment trust

Key: B

<b>Incorrect: A</b>	Interest rate risk is higher for fixed income investments with longer maturities. Although Treasury bonds can have maturities up to 30 years, the Treasury bond owned by the Phillips matures in three years.
<b>Correct: B</b>	<b>The Treasury strip matures in eight years, and the State Hospital Revenue Bond matures in 30 years, resulting in the greatest interest rate risk of their investments.</b>
<b>Incorrect: C</b>	Although Treasury bonds can have maturities up to 30 years, the Treasury bond owned by the Phillips matures in three years, which would result in lower interest rate risk than their longer-term investments.
<b>Incorrect: D</b>	The short/intermediate term municipal investment trust would generally have a relatively short duration, resulting in low interest rate risk when compared to longer-term investments.