

**CFP BOARD**

# **CFP BOARD PRACTICE QUESTIONS**

We've collected some questions from the CFP Board Practice Exam to add to your study preparation. We encourage you to make the full Practice Exam part of your preparation for the upcoming exam.

## QUESTIONS

### CFP® CERTIFICATION PRACTICE EXAM: QUESTION 1

Maria, age 43, and Julio, age 35, have a combined annual income of \$96,000. They are new parents to Samuel and plan to invest \$2,000 per year for his college education. They both graduated from an expensive private college and would like Samuel to go there as well. They want to save in a way that maximizes tax efficiency and Samuel's chances of qualifying for financial aid. Which strategy would best meet their needs?

- A** Invest in Samuel's name using a Uniform Transfer to Minors Act (UTMA) account.
- B** Invest in a Coverdell Education Savings Account for Samuel.
- C** Make contributions to Maria's Roth IRA.
- D** Make contributions to Julio's Roth IRA.

### CFP® CERTIFICATION PRACTICE EXAM: QUESTION 2

A client is a financially sophisticated 32-year-old stock market watcher. She works as a computer consultant and expects her earnings to fluctuate significantly over her lifetime. Which of the following life insurance products best suits the client's needs?

- A** Variable whole life.
- B** Variable universal.
- C** Universal.
- D** Whole life with paid-up additions rider.

### CFP® CERTIFICATION PRACTICE EXAM: QUESTION 3

Gary and Meghan, both 60 years of age, have a combined estate of \$30,000,000, including a home and a \$1,000,000 whole life insurance policy on Gary. The couple has two children. Gary wants Meghan to receive the income from the policy if he dies, but he does not want the proceeds of the policy to be included in his or Meghan's taxable estate. He wants the proceeds ultimately to go to their children. Gary and Meghan have recently executed Wills establishing bypass trusts which utilize their applicable exclusion amounts. Who should be the owner of Gary's life insurance policy?

- A** An irrevocable life insurance trust (ILIT).
- B** The couple's two children.
- C** A qualified terminable interest property (QTIP) trust.
- D** Gary's bypass trust.

### CFP® CERTIFICATION PRACTICE EXAM: QUESTION 4

One reason a CFP® professional should recommend dollar cost averaging is to

- A** Encourage disciplined investing.
- B** Take advantage of a rising market.
- C** Increase return and decrease market risk.
- D** Outperform the lump-sum strategy.

### CFP® CERTIFICATION PRACTICE EXAM: QUESTION 5

A client is considering investing \$50,000 in bonds for an addition to her portfolio. She is concerned about the timing of the cash flows from the portfolio and wants to maximize annual cash flows. Which of the following bonds would accomplish her goal?

- A** A zero coupon bond priced at a yield to maturity of 6% over 20 years.
- B** A 5% coupon bond priced at a yield to maturity of 4% over 20 years.
- C** A 5% coupon bond priced at a yield to maturity of 6% over 20 years.
- D** A 4% coupon bond priced at a yield to maturity of 5% over 20 years.

### CFP® CERTIFICATION PRACTICE EXAM: QUESTION 6

A client borrowed \$15,000 at 10% interest. She immediately used \$8,000 to purchase shares in a stock mutual fund and put the remainder in her savings account, which bears no interest. Later that year she used funds in her checking account to pay off credit card debt to avoid an 18% finance charge. Without taking into account the investment interest limitation rules, which of the following is the maximum interest expense deduction that she can claim?

- A** None of the interest paid is deductible.
- B** Interest on the \$8,000 paid for the mutual funds.
- C** Interest on the \$8,000 paid for the mutual funds and the 18% credit card interest.
- D** Interest on the \$15,000 loan.

### CFP® CERTIFICATION PRACTICE EXAM: QUESTION 7

A 68-year-old client who plans to continue working for several years has substantial assets in a traditional IRA and his employer's 401(k) plan. If the primary objective is to minimize the amount of required minimum distribution (RMD), which of the following should the client do?

- A** Convert the 401(k) assets to a Roth IRA.
- B** Convert the traditional IRA assets to a Roth IRA.
- C** Convert the 401(k) assets to a Roth 401(k).
- D** Purchase a qualified annuity with the IRA assets.

### CFP® CERTIFICATION PRACTICE EXAM: QUESTION 8

Frank is self-employed and has decided to save for his retirement in 3 years. Frank has a consistent Schedule C net income of \$220,000, and he contributes \$30,000 into a money purchase plan on the last day of each year. How much will his retirement account be worth at his retirement if he achieves 8% growth on his investments?

- A** \$97,216
- B** \$97,392
- C** \$105,183
- D** \$142,841

### CFP® CERTIFICATION PRACTICE EXAM: QUESTION 9

A high income, self-employed CFP® professional owns a considerable amount of tax-exempt securities and dividend-paying securities. Which of the following debts should the CFP® professional pay off first?

- A** Qualified residence.
- B** Trade or business.
- C** Investment.
- D** Consumer.

# SOLUTIONS

## CFP® CERTIFICATION PRACTICE EXAM: SOLUTION 1

Maria, age 43, and Julio, age 35, have a combined annual income of \$96,000. They are new parents to Samuel and plan to invest \$2,000 per year for his college education. They both graduated from an expensive private college and would like Samuel to go there as well. They want to save in a way that maximizes tax efficiency and Samuel's chances of qualifying for financial aid. Which strategy would best meet their needs?

- A Invest in Samuel's name using a Uniform Transfer to Minors Act (UTMA) account.
- B Invest in a Coverdell Education Savings Account for Samuel.
- C Make contributions to Maria's Roth IRA.**
- D Make contributions to Julio's Roth IRA.

### RATIONALE

- A **INCORRECT:** UTMA's are subject to FAFSA. UTMA will impact Samuel's ability to qualify for financial aid.
- B **INCORRECT:** A Coverdell account will impact Samuel's ability to qualify for financial aid.
- C CORRECT:** At 61, Maria can withdraw any amount from her Roth IRA tax-free. A parent's retirement plan is exempt from FAFSA.
- D **INCORRECT:** At age 53, Julio would only be able to withdraw his basis from his Roth IRA tax-free.

## CFP® CERTIFICATION PRACTICE EXAM: SOLUTION 2

A client is a financially sophisticated 32-year-old stock market watcher. She works as a computer consultant and expects her earnings to fluctuate significantly over her lifetime. Which of the following life insurance products best suits the client's needs?

- A Variable whole life.
- B Variable universal.**
- C Universal.
- D Whole life with paid-up additions rider.

### RATIONALE

- A **INCORRECT:** Variable whole life insurance is not an appropriate option because it does not offer flexible premium payments.
- B CORRECT:** Variable universal life insurance is appropriate because it offers flexible premium payments and variable underlying subaccounts that offer more investment options than traditional or universal life.
- C **INCORRECT:** While universal life insurance offers flexible premium payments, the cash value is invested in the general account of the insurance company (primarily fixed income) and variable subaccounts are not permitted.
- D **INCORRECT:** This option does not offer flexible premium payments and the cash value is invested in the general account of the insurance company (primarily fixed income) and variable subaccounts are not permitted.

## CFP® CERTIFICATION PRACTICE EXAM: SOLUTION 3

Gary and Meghan, both 60 years of age, have a combined estate of \$30,000,000, including a home and a \$1,000,000 whole life insurance policy on Gary. The couple has two children. Gary wants Meghan to receive the income from the policy if he dies, but he does not want the proceeds of the policy to be included in his or Meghan's taxable estate. He wants the proceeds ultimately to go to their children. Gary and Meghan have recently executed Wills establishing bypass trusts which utilize their applicable exclusion amounts. Who should be the owner of Gary's life insurance policy?

- A An irrevocable life insurance trust (ILIT).**
- B The couple's two children.
- C A qualified terminable interest property (QTIP) trust.
- D Gary's bypass trust.

### RATIONALE

- A CORRECT:** An irrevocable trust does not create ownership; therefore, no inclusion in the gross estate.
- B INCORRECT:** This will not ensure that income goes to Meghan.
- C INCORRECT:** Insurance proceeds would be includable in Meghan's gross estate.
- D INCORRECT:** This will not remove insurance proceeds from taxable estate due to recent funding of the bypass trusts and utilization of their applicable exclusion amounts.

## CFP® CERTIFICATION PRACTICE EXAM: SOLUTION 4

One reason a CFP® professional should recommend dollar cost averaging is to

- A Encourage disciplined investing.**
- B Take advantage of a rising market.
- C Increase return and decrease market risk.
- D Outperform the lump-sum strategy.

### RATIONALE

- A CORRECT:** Dollar cost averaging encourages consistent saving and helps to eliminate emotional investing and market timing.
- B INCORRECT:** In a rising market, a lump-sum strategy would outperform the dollar cost averaging strategy.
- C INCORRECT:** Dollar cost averaging does not necessarily increase in all market conditions.
- D INCORRECT:** Dollar cost averaging does not guarantee better performance than lump-sum strategies.

## CFP® CERTIFICATION PRACTICE EXAM: SOLUTION 5

A client is considering investing \$50,000 in bonds for an addition to her portfolio. She is concerned about the timing of the cash flows from the portfolio and wants to maximize annual cash flows. Which of the following bonds would accomplish her goal?

- A A zero coupon bond priced at a yield to maturity of 6% over 20 years.
- B A 5% coupon bond priced at a yield to maturity of 4% over 20 years.
- C A 5% coupon bond priced at a yield to maturity of 6% over 20 years.**
- D A 4% coupon bond priced at a yield to maturity of 5% over 20 years.

## RATIONALE

- A INCORRECT:** This option provides no current income.
- B INCORRECT:** This is a 5% coupon but offers lower yield to maturity.
- C CORRECT:** This is a 5% coupon with the highest yield to maturity.
- D INCORRECT:** This offers a lower coupon and yield to maturity.

## CFP® CERTIFICATION PRACTICE EXAM: SOLUTION 6

A client borrowed \$15,000 at 10% interest. She immediately used \$8,000 to purchase shares in a stock mutual fund and put the remainder in her savings account, which bears no interest. Later that year she used funds in her checking account to pay off credit card debt to avoid an 18% finance charge. Without taking into account the investment interest limitation rules, which of the following is the maximum interest expense deduction that she can claim?

- A** None of the interest paid is deductible.
- B Interest on the \$8,000 paid for the mutual funds.**
- C** Interest on the \$8,000 paid for the mutual funds and the 18% credit card interest.
- D** Interest on the \$15,000 loan.

## RATIONALE

- A INCORRECT:** Investment interest expense is deductible.
- B CORRECT:** Investment interest expense incurred to purchase the mutual fund is deductible.
- C INCORRECT:** Credit card interest is not deductible; it is personal interest.
- D INCORRECT:** Of the \$15,000, only interest on the \$8,000 is deductible.

## CFP® CERTIFICATION PRACTICE EXAM: SOLUTION 7

A 68-year-old client who plans to continue working for several years has substantial assets in a traditional IRA and his employer's 401(k) plan. If the primary objective is to minimize the amount of required minimum distribution (RMD), which of the following should the client do?

- A** Convert the 401(k) assets to a Roth IRA.
- B Convert the traditional IRA assets to a Roth IRA.**
- C** Convert the 401(k) assets to a Roth 401(k).
- D** Purchase a qualified annuity with the IRA assets.

## RATIONALE

- A INCORRECT:** The 401(k) plan doesn't require taking minimum distributions until the employee retires; therefore conversion will not minimize RMD.
- B CORRECT:** Converting IRA assets to a Roth IRA will minimize RMDs since there is no RMD required for Roth IRAs.
- C INCORRECT:** The 401(k) plan doesn't require taking minimum distributions until the employee retires; therefore conversion will not minimize RMD.
- D INCORRECT:** The purchase of an annuity has no effect on RMDs.

## CFP® CERTIFICATION PRACTICE EXAM: SOLUTION 8

Frank is self-employed and has decided to save for his retirement in 3 years. Frank has a consistent Schedule C net income of \$220,000, and he contributes \$30,000 into a money purchase plan on the last day of each year. How much will his retirement account be worth at his retirement if he achieves 8% growth on his investments?

- A \$97,216
- B \$97,392**
- C \$105,183
- D \$142,841

### RATIONALE

- A INCORRECT:** This is close to the correct answer, but not calculable.
- B CORRECT:**  $PV = \$0$ . Payment = \$30,000 (end of year).  $N = 3$  years.  $i = 8$ .  $FV = \$97,392$ .
- C INCORRECT:** This is a calculation result using \$30,000 contributions as payment at the beginning of the year.
- D INCORRECT:** This is a calculation result using a contribution level equal to 20% of Schedule C net income.

## CFP® CERTIFICATION PRACTICE EXAM: SOLUTION 9

A high income, self-employed CFP® professional owns a considerable amount of tax-exempt securities and dividend-paying securities. Which of the following debts should the CFP® professional pay off first?

- A Qualified residence.
- B Trade or business.
- C Investment.
- D Consumer.**

### RATIONALE

- A INCORRECT:** This is an itemized deduction.
- B INCORRECT:** This is a deduction against business income and self-employment tax income.
- C INCORRECT:** This is a deduction against investment income (e.g., dividend-paying stocks)
- D CORRECT:** Consumer debt interest is nondeductible so the CFP® professional should pay this debt off first.



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