

CPFO Compensation & Benefits Practice Exam (Sample)

Study Guide



Everything you need from our exam experts!

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SAMPLE

Questions

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- 1. How is the term "hybrid" used in the context of retirement plans?**
 - A. It combines elements of both defined benefit and defined contribution plans**
 - B. It refers solely to employee stock ownership plans**
 - C. It indicates a plan exclusively for part-time employees**
 - D. It signifies a government-only retirement program**
- 2. What is the aim of target-risk funds in investment strategy?**
 - A. To achieve the highest possible returns regardless of risk**
 - B. To create a desired risk profile through mixed asset allocations**
 - C. To maintain a constant risk level over time**
 - D. To focus exclusively on real estate investments**
- 3. How often does GFOA recommend that an actuarial experience study be conducted?**
 - A. Annually**
 - B. Every five years**
 - C. Every two years**
 - D. Every ten years**
- 4. How frequently should investment portfolio performance be reviewed according to best practices?**
 - A. Monthly**
 - B. At least annually, preferably quarterly**
 - C. Every two years**
 - D. Only at the end of the investment term**
- 5. What is asset allocation in investment management?**
 - A. The practice of concentrating investments in a single asset type**
 - B. The practice of dividing an investment portfolio among major asset categories**
 - C. The method of investing in bonds only**
 - D. The strategy of investing exclusively in stocks**

- 6. Why is it advised not to issue OPEB bonds?**
- A. They can create significant future liabilities**
 - B. They have higher interest rates**
 - C. They reduce current cash flow**
 - D. They lead to excessive taxes**
- 7. Which of the following is a characteristic of a defined benefit plan?**
- A. Employee-directed asset management**
 - B. Variable benefits based on market performance**
 - C. Benefits determined by a specific formula**
 - D. Employer contributions based on employee initiative**
- 8. How can organizations utilize market data in compensation planning?**
- A. To define company culture**
 - B. To determine holiday schedules**
 - C. To benchmark compensation practices**
 - D. To assess employee satisfaction**
- 9. What are stock options?**
- A. Options for purchasing company bonds**
 - B. Contracts for future cash bonuses**
 - C. Contracts to purchase shares at a set price**
 - D. Shares granted as part of a salary package**
- 10. What does "fully-insured health plan" imply?**
- A. The employer pays all medical expenses out of pocket**
 - B. The employer pays premiums to an insurer who takes on claim risks**
 - C. Employees must pay the entire cost of their healthcare**
 - D. Health plans that cover only preventive services**

Answers

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- 1. A**
- 2. B**
- 3. B**
- 4. B**
- 5. B**
- 6. A**
- 7. C**
- 8. C**
- 9. C**
- 10. B**

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Explanations

1. How is the term "hybrid" used in the context of retirement plans?

A. It combines elements of both defined benefit and defined contribution plans

B. It refers solely to employee stock ownership plans

C. It indicates a plan exclusively for part-time employees

D. It signifies a government-only retirement program

In the context of retirement plans, the term "hybrid" specifically refers to a plan that combines elements of both defined benefit and defined contribution plans. This hybrid structure typically seeks to balance the predictable, defined benefits characteristic of traditional pension plans with some of the features of defined contribution plans, such as individual accounts and contribution flexibility. For example, a hybrid plan might guarantee a minimum benefit at retirement while also allowing for additional contributions based on employee earnings or job tenure that can be invested similar to a 401(k). This structure helps to manage risks for both employers and employees, as it provides some level of retirement security while also encouraging individual savings and investment. The other options do not capture the full scope of the hybrid plan concept. Employee stock ownership plans focus specifically on company stock and do not relate to the hybrid model's balance of benefits. A plan exclusively for part-time employees does not define a hybrid arrangement, nor does a government-only retirement program accurately describe a hybrid setup. The essence of hybrid plans is their dual nature in incorporating features from both defined benefit and contribution frameworks.

2. What is the aim of target-risk funds in investment strategy?

A. To achieve the highest possible returns regardless of risk

B. To create a desired risk profile through mixed asset allocations

C. To maintain a constant risk level over time

D. To focus exclusively on real estate investments

The aim of target-risk funds is to create a desired risk profile through mixed asset allocations. This approach is designed to align with the investor's risk tolerance by diversifying investments across various asset classes, such as equities, bonds, and cash equivalents. By adjusting the proportions of these assets, target-risk funds allocate investments in a way that reflects a specific risk level, catering to investors who may be more conservative or aggressive in their investment strategies. These funds typically categorize themselves into different risk levels, often labeled as conservative, moderate, or aggressive, allowing investors to select a fund that corresponds to their individual risk tolerance. Over time, as market conditions change, the asset allocation may be managed to maintain this targeted risk profile, making it a strategic choice for those seeking a structured investment solution. Other approaches, such as aiming for the highest possible returns without regard to risk or focusing exclusively on a single type of investment, do not align with the fundamental purpose of target-risk funds, which is about achieving a balanced approach to risk and return based on the investor's comfort level.

3. How often does GFOA recommend that an actuarial experience study be conducted?

- A. Annually
- B. Every five years**
- C. Every two years
- D. Every ten years

The Government Finance Officers Association (GFOA) recommends conducting an actuarial experience study every five years. This recommendation is grounded in the need for pension funds to ensure that the assumptions used in their actuarial valuations remain valid over time. As demographics, economic conditions, investment performance, and other relevant factors can change, regular experience studies help to align actuarial assumptions with current realities, enhancing the accuracy and reliability of pension funding and management strategies. Conducting the study every five years strikes a balance between being frequent enough to monitor changes effectively, while also allowing sufficient time to evaluate trends. This timeframe helps pension plans make informed decisions regarding contributions, benefits, and funding policies, ultimately supporting the long-term sustainability and health of the pension fund.

4. How frequently should investment portfolio performance be reviewed according to best practices?

- A. Monthly
- B. At least annually, preferably quarterly**
- C. Every two years
- D. Only at the end of the investment term

Investment portfolio performance should be reviewed at least annually, with a preference for quarterly reviews, according to best practices. This frequency allows for timely assessment of how well the portfolio is meeting its goals in light of market conditions, changes in investment strategy, and shifts in individual circumstances like risk tolerance or expenses. Quarterly reviews strike a balance between being frequent enough to catch significant market shifts and not so frequent that they encourage reactionary decisions based on short-term volatility. This regular monitoring helps investors to adjust their investment strategy as necessary and can lead to more informed decision-making regarding asset allocation, risk management, and any rebalancing that might be necessary to maintain the desired investment strategy over time. Review at this recommended frequency ensures that the investment strategy remains aligned with the investor's long-term objectives and market realities.

5. What is asset allocation in investment management?

- A. The practice of concentrating investments in a single asset type
- B. The practice of dividing an investment portfolio among major asset categories**
- C. The method of investing in bonds only
- D. The strategy of investing exclusively in stocks

Asset allocation in investment management refers to the strategic process of dividing an investment portfolio among various asset categories, such as stocks, bonds, cash, and real estate. This approach is aimed at optimizing the balance between risk and reward based on an investor's goals, risk tolerance, and investment horizon. By diversifying across different asset classes, investors can reduce the impact of a poor-performing asset on their overall portfolio. For example, if equities are performing poorly, the bonds in the portfolio may still provide steady income, helping to cushion losses. This diversification is essential for managing risk and seeking more stable returns over time. Proper asset allocation can help investors achieve their long-term financial objectives while aligning their investment strategies with market conditions and personal circumstances.

6. Why is it advised not to issue OPEB bonds?

- A. They can create significant future liabilities**
- B. They have higher interest rates
- C. They reduce current cash flow
- D. They lead to excessive taxes

Issuing Other Post-Employment Benefits (OPEB) bonds is advised against primarily because they can create significant future liabilities. When an organization issues bonds to cover OPEB costs, it is essentially taking on debt that must be repaid with interest. This obligation can strain the organization's financial resources in the long run as it adds to the existing liabilities on the balance sheet. The nature of OPEB itself is inherently unpredictable; costs related to retiree benefits can fluctuate based on various factors such as healthcare costs and longevity. Thus, financing these expenses through bonds can lead to a situation where future cash flows are at risk, and the organization may find itself burdened with repayment obligations that outweigh the initial benefits of issuing the bonds. Other factors, while relevant to financial decision-making, do not capture the essence of the central issue that comes with OPEB bonds: the long-term fiscal liability. Understanding this aspect is crucial for managing public entity finances effectively and ensuring fiscal sustainability.

7. Which of the following is a characteristic of a defined benefit plan?

- A. Employee-directed asset management**
- B. Variable benefits based on market performance**
- C. Benefits determined by a specific formula**
- D. Employer contributions based on employee initiative**

A defined benefit plan is characterized by the way it determines retirement benefits for employees. Rather than relying on the individual management of retirement accounts or market fluctuations, a defined benefit plan provides a guaranteed retirement benefit calculated using a predetermined formula. This typically takes into account factors such as the employee's salary, years of service, and a defined benefit multiplier. This formulaic approach ensures that the employee receives a specific amount of money upon retirement, regardless of the performance of the investments held by the plan. This certainty is a key feature that distinguishes defined benefit plans from defined contribution plans, where benefits are directly influenced by contributions and investment performance. The focus on a specific formula for benefits gives employees a clearer understanding of their expected retirement income. In contrast, characteristics such as employee-directed asset management, variable benefits based on market performance, or employer contributions based on employee initiative align more closely with defined contribution plans, where individuals typically have more control over their investment choices, and retirement outcomes hinge on market conditions and personal contributions.

8. How can organizations utilize market data in compensation planning?

- A. To define company culture**
- B. To determine holiday schedules**
- C. To benchmark compensation practices**
- D. To assess employee satisfaction**

Utilizing market data in compensation planning primarily serves the purpose of benchmarking compensation practices. Organizations need to remain competitive in attracting and retaining talent, and market data provides insights into what similar positions in the industry are paying. By analyzing this data, organizations can set salary ranges that are aligned with or competitive against the prevailing market rates, ensuring that they are not overpaying or underpaying their employees. This practice helps create equitable pay structures and can be essential in maintaining compliance with equal pay legislation as well. Benchmarking also enables organizations to adjust their compensation strategies based on market trends, demand for specific skill sets, and overall economic conditions. By making data-driven decisions regarding compensation, organizations can attract high-quality candidates and improve employee satisfaction and retention in the long run. This practical approach ties directly to workforce planning and organizational competitiveness.

9. What are stock options?

- A. Options for purchasing company bonds
- B. Contracts for future cash bonuses
- C. Contracts to purchase shares at a set price**
- D. Shares granted as part of a salary package

Stock options are contracts that grant an individual the right, but not the obligation, to purchase shares of a company at a predetermined price, known as the exercise price or strike price. This means that the holder of the option can buy shares at this fixed price even if the market price of the shares increases over time. This mechanism is particularly attractive because it can provide significant financial benefits if the company's stock performs well, making the ability to purchase at the set price valuable. Stock options are often utilized as a form of incentive compensation, allowing employees to benefit directly from the company's growth and align their interests with those of shareholders. In contrast, the other options do not accurately reflect the nature of stock options. The first option pertains to purchasing company bonds, which are debt instruments, not equity. The second option refers to contracts for future cash bonuses, which are unrelated to stock ownership. The fourth option suggests that shares are granted as part of a salary package, which describes restricted stock units or direct stock grants, not stock options. Thus, the correct definition of stock options is succinctly captured in the response that identifies them as contracts to purchase shares at a set price.

10. What does "fully-insured health plan" imply?

- A. The employer pays all medical expenses out of pocket
- B. The employer pays premiums to an insurer who takes on claim risks**
- C. Employees must pay the entire cost of their healthcare
- D. Health plans that cover only preventive services

A fully-insured health plan refers to an arrangement where an employer pays premiums to an insurance company. In this model, the insurer assumes the financial risks associated with the health and medical claims of the employees. This means that the employer does not bear the burden of paying for each individual medical expense out of pocket; instead, they transfer this risk to the insurer by making regular premium payments. Consequently, when employees utilize healthcare services, the insurer is responsible for processing and paying the claims according to the terms of the policy. This arrangement allows employers to predict and manage their healthcare costs more effectively, as they can plan for the fixed premiums rather than incurring unpredictable out-of-pocket expenses associated with individual medical claims. It also provides employees with access to a network of healthcare providers and benefits as determined by the insurance policy, enhancing their overall health coverage.