

Where 401(k) Plans Go Wrong



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Where 401(k) Plans Go Wrong—Even When Everyone Means Well

Most 401(k) compliance failures don't stem from bad intentions. They come from capable, well-meaning teams who assume their processes—or their partners—have everything covered. That's what auditors that specialize in retirement plans see year after year.

Their findings highlight a consistent pattern: plan sponsors often believe they've mitigated risk when, in reality, critical gaps remain.

Mistake #1: Assuming Fiduciary Responsibility Has Been Transferred

One of the most common—and most dangerous—misconceptions is that fiduciary responsibility can be fully handed off. Hiring a 3(16) fiduciary, engaging a strong TPA, or even joining a PEP or PEO may shift administrative duties, but it does not eliminate accountability.

From a regulatory standpoint, the plan sponsor remains responsible. Even if another party is signing Form 5500 filings or managing day-to-day operations, the Department of Labor (DOL) and IRS still look to the Plan Sponsor when something goes wrong.

The implication is clear: the role of the Plan Sponsor isn't to execute every task, but to maintain enough understanding to ask informed questions, identify inconsistencies, and take action when needed.

Mistake #2: Incorrectly defining Compensation

Compensation errors are widespread—and often underestimated. Statistically, roughly 75% of audits uncover issues tied to how compensation is defined and applied.

The problem typically arises when payroll practices and plan documents fall out of alignment. Certain pay types—such as bonuses, manual checks, or special payments—may be excluded when they should be included, or vice versa. These discrepancies don't stay isolated; they cascade into incorrect deferrals, employer match calculations, compliance testing, and ultimately, costly corrections.

True-up calculations add another layer of risk, especially when they're based on incorrect pay periods or include compensation earned before an employee becomes eligible.

At its core, “compensation” in a retirement plan context is not a generic HR concept—it's a precise, technical definition that must be consistently applied across plan documents, payroll systems, and recordkeeping platforms.

Mistake #3: Overreliance on Technology

Modern retirement plans rely heavily on integrated systems—payroll platforms, recordkeepers, and increasingly, AI-driven tools. While automation improves efficiency, it can also create a false sense of security.

A system allowing a transaction doesn't guarantee that it's compliant.

Recent regulatory changes under SECURE 2.0 illustrate this risk. For example, Roth catch-up contribution rules for Highly Compensated Employees are often misunderstood or misapplied within payroll systems. Some platforms permit employees to designate catch-up contributions prematurely, even though contributions only qualify as “catch-up” after the standard deferral limit or another testing limit is reached.



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When systems process these contributions incorrectly, the consequences can include misreported data, potential double taxation, and the need for expensive corrections.

Technology is a powerful tool—but it cannot replace informed oversight or alignment with the governing plan document.

The Bigger Picture

These three issues—misplaced reliance on vendors, inconsistent compensation definitions, and over trust in automation—share a common thread: they develop quietly. Plans can operate for years with these underlying errors, only for them to surface during an audit.

By that point, corrections are often more complex and costly.

The takeaway for plan sponsors isn't to do more, but to stay engaged. Understanding how the pieces fit together—vendors, systems, and plan provisions—remains essential. Compliance isn't something you can fully outsource; it's something you continuously oversee.

In the world of retirement plans, even small misunderstandings can compound into significant risks over time. This is why it is so important for you to stay in contact with your Account Executive. If you are thinking about making changes to your plan or providers (payroll or recordkeeping) keep your Account Executive informed. RMS is here to help you navigate the complexities of retirement plan compliance and administration.



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