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2 On June 15, 1989, Articles of Incorporation (Exhibit P5) were filed which created  
3 The Palms II Homeowners Association (Palms II). That Association consisted of the  
4 condominium units which originally comprised Gardens III. Pursuant to the Articles of  
5 Incorporation for Palms II, the Association adopted the Declaration which had governed  
6 the membership, obligations and liabilities of Gardens III.

7 Sometime after the Incorporation of Palms II, by-laws were adopted by Palms II  
8 which supplanted the original by-laws governing Gardens III (Exhibits P2 and P3). Both  
9 parties agreed that the applicable by-laws governing Palms II were only those by-laws  
10 later adopted by Palms II to replace the Gardens III By-Laws.

11 The remaining facts relevant to the Petition are incorporated into the following  
12 Conclusions of Law addressing each of the allegations in the Petition.

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14 **Conclusions of Law:**

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16 **Allegation 1: Falsifying Annual Financial Reports to Members**

17 Two Profit & Loss Statements for Palms II were issued for each of the fiscal  
18 years 2004 and 2005. For fiscal year January through December, 2004, the Profit &  
19 Loss Statements reflected a net income discrepancy of approximately \$700 between  
20 the first statement and the second statement (Exhibits P-9B1 and P-9B2). For fiscal  
21 year January through December, 2005, both Profit & Loss Statements reflected the  
22 same net income amount, but there were some minor discrepancies between certain  
23 items listed in the Statements (Exhibits P-9B1 and P-9B2)

24 The Statements were prepared by one of the homeowners in Palms II who  
25 volunteered her time as an accountant for the Association. The undisputed evidence at  
26 the hearing established that the discrepancies were due to simple accounting errors  
27 between the first and the second statements.

28 There was no violation proven with respect to Allegation 1.  
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3       Allegation 2: No Annual Report

4       The Declaration requires that “An annual report shall be prepared by the  
5 management corporation, if any, or by such other party as the Board of Directors shall  
6 order.” Declaration, Article VI, Section 7. Palms II does not have a “management  
7 corporation.” The Board of Directors has contracted with one of the members of the  
8 Association to act as the Association’s manager for which she is paid \$1,000.00 per  
9 month.

10       A member of the Board testified that the Board considered the annual Profit and  
11 Loss Statements and the annual Balance Sheet (Exhibits P-9B1 and P-9B2) to  
12 comprise the Association’s “annual report.” There was no evidence presented to  
13 establish that either community documents governing the Association or state statutes  
14 required more.

15       There was no violation proven with respect to Allegation 2.

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17       Allegation 3: No Annual Audit:

18       Annual audits are not prepared for the Association because they are considered  
19 by the Board of Directors to be an unnecessary expense for such a relatively small  
20 organization.

21       The By-Laws which governed Gardens III required the Treasurer to “cause an  
22 annual audit of the Association books to be made by a public accountant at the  
23 completion of each fiscal year.” Gardens III By-Laws, Article VIII, Section 8(c).  
24 However, the parties agreed that the controlling by-laws were those subsequently  
25 adopted by Palms II. The Palms II By-Laws provide for the office of a  
26 “secretary/treasurer” and delineate the duties of that office. There is no specific  
27 requirement of an annual audit in the Palms II By-Laws. Palms II By-Laws Article IV,  
28 Section 4(c).

29       The By-Laws, however, are not controlling as to this issue. The Declaration,  
30 which was adopted prior to the enactment of the Palms II By-Laws, provides that “The

1 amount [of assessments] shall be established annually by the Board of Directors. The  
2 amount shall be established after the Board of Directors has examined the annual  
3 report *and the annual audit prepared by a certified public accountant.*” Declaration,  
4 Article VI, Section 6. Emphasis added.

5 The Declaration also provides in Article XVII, Section 7:

6 The covenants and restrictions of this Declaration may be amended during  
7 the first twenty (20) year period by an instrument signed by not less than  
8 ninety percent (90%) of the Owners, and thereafter by an instrument  
9 signed by not less than seventy-five percent (75%) of the owners.

10 The Palms II By-Laws specifically refer to and incorporate the Declaration. The  
11 absence of an audit requirement in the Palms II By-Laws, which “may be amended at  
12 any meeting of the Board of Directors by a majority vote of the members of the Board”  
13 (Palms II By-Laws, Art. VI), cannot supplant specific language of the Declaration  
14 requiring such an audit. The language in the Declaration, which explicitly requires an  
15 annual audit prepared by a certified public accountant, can be deleted from the  
16 Declaration only by an amendment signed by at least seventy-five percent of the  
17 owners.

18 Consequently, under the Declaration governing the Association, assessments  
19 can be set only after the Board has considered an annual audit which must be prepared  
20 by a certified public accountant.

21 As to Allegation 3, there was a violation of the Declaration.

22 Allegation 4: No Annual Budget:

23 Annual budgets are not prepared for the Association. The by-laws which  
24 governed Gardens III required the Treasurer to “prepare an annual budget and  
25 statement of income and expenditures to be presented to the membership at its regular  
26 Annual Meeting, and deliver a copy to the members.” Gardens III By-laws, Article VIII,  
27 Section 8(c). However, the Palms II By-laws do not contain such a budget requirement.

28 Rather, those By-Laws provide that the Secretary/Treasurer “shall prepare  
29 complete financial statements for the fiscal year and shall present them at the annual  
30 meeting of the homeowners after the end of each year.” Palm II By-Laws, Article IV,

1 Section 4 (c). Furthermore, there is no specific reference to a "budget" in the  
2 Declaration.

3 Consequently, as to Allegation 4, there is no violation.

4 Allegation 5: Improper Assessment Increase:

5 In 2006, the Board of Directors raised the annual assessment from \$139.00 per  
6 month to \$153.00 per month. The Declaration, Article VI, Section 9 provides that "the  
7 maximum annual assessment may be increased by an amount up to ten percent (10%)  
8 per annum...any greater annual increase in the maximum annual assessment shall  
9 require a two-thirds (2/3) vote of each class of Members."

10 The maximum amount the Board could raise the annual assessment for 2006,  
11 without a vote of the membership, was \$13.90 per month. The assessment was  
12 actually raised by \$14.00 per month. That assessment was a violation of the  
13 Declaration by an amount of \$0.10 per month per member.

14 Allegation 6: No Accounting for Money Spent:

15 Article IV, Section 4 (c) of the Palms II By-laws provides:

16 The Secretary/Treasurer shall have custody of all the corporate funds and  
17 securities and shall keep full and accurate accounts of receipts and  
18 disbursements in books belonging to the corporation and shall deposit all  
19 moneys and other valuable effects in the name of and to the credit of the  
20 corporation in such depositories as may be designated by the Board of  
21 Directors. He/she shall disburse the funds of the corporation as may be  
22 ordered by the Board, taking proper vouchers for such disbursements, and  
23 shall render to the President and to the directors at the meetings of the  
24 Board, or whenever they may require it, an account of all his transactions  
25 and of the financial condition of the corporation. He/she shall prepare  
26 complete financial statements for the fiscal year and shall present them at  
27 the annual meeting of the homeowners after the end of each year.

28 The only reference to accounting records in the Declaration is found in Article VI,  
29 Section 6, which addresses the records the Board must consider in setting the amount  
30 of the annual assessment. Those records are the annual report and the annual audit  
prepared by a certified public accountant.

1 The Annual Profit & Loss statements and Annual Balance Sheet clearly  
2 represent an accounting for the money received and spent by the Association. The  
3 evidence was sufficient to establish that, even though the requirement of an annual  
4 audit was not met by the Association, the financial records that were annually prepared  
5 and maintained by the Association were sufficient to account for how the money was  
6 spent by the Board. As to Allegation 6, no violation was established.

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8 Allegation 7: No Annual/Untimely Meeting:

9 The Palms II By-Laws, Article III, Section 3 requires that the annual meeting of  
10 the Association be held on the third Wednesday of February. The annual meetings of  
11 the Association frequently occurred several months after that date. The delay in  
12 complying with the By-Laws was due, however, to a lack of a sufficient number of  
13 Association members in attendance at the February annual meeting to constitute a  
14 quorum, as required by Palms II By-Laws, Article III, Section 4. The annual meeting  
15 was eventually held every year once a quorum was achieved.

16 As to Allegation 7, no violation was established.

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18 Allegation 8: Failure to Provide Books and Records:

19 Final Profit & Loss and Balance Statements for each year were provided to  
20 Petitioner. However, Petitioner maintained that she was not allowed to review the  
21 actual invoices, receipts, bids, etc. upon which those accounting summaries were  
22 based.

23 Under A.R.S. §33-1258A, "all financial and other records of the association shall  
24 be made reasonably available for examination by any member or any person  
25 designated by the member in writing as the member's representative." There are some  
26 listed exceptions to the disclosure requirement in the statute, but none of those  
27 exceptions apply to the requests made by Petitioner.

28 Respondent acknowledged that, under state law, members were entitled to  
29 review the documents supporting the accounting summaries, and advised that it would  
30 make those documents available to members requesting them in the future.

1 Failure to provide the records when requested by Petitioner was a violation of  
2 A.R.S. §33-1258A.

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5 Allegation 9: Only the Manager Is Authorized to Sign Association Checks

6 The Association manager is the only authorized signer on the checking account  
7 for the Association (Exhibit P-15B).

8 The Palms II By-laws Article V, Section 2 provides:

9 The moneys of the corporation shall be deposited in such bank or banks  
10 or trust company as the Board of Directors shall designate, and shall be  
11 drawn out only by check signed by such persons as may be designated  
12 from time to time by resolution of the Board of Directors.

13 Respondent acknowledged the potential problem that existed in having only one  
14 signer on the account in the event that signer became incapacitated. It indicated that it  
15 will address the issue of adding more signers to the account with the Board. However,  
16 given the broad discretion of the Board under language of the By-Laws, there was not a  
17 violation.

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19 Allegation 10: No Insurance Bond

20 There is a general policy of property and liability insurance in effect for the  
21 Association. One of the provisions of that policy insures losses incurred as a result of  
22 employee "dishonesty" up to a maximum of \$50,000.00 (Exhibit P-15B).

23 The current manager of Palms II is not an employee of the Association, but  
24 rather an independent contractor. Article XII, Section 7 of the Declaration requires the  
25 Board of Directors to "obtain a fidelity bond covering the treasurer of the Association  
26 and anyone who is responsible for funds held by or administered for the Association."  
27 In addition to specifying the amount of the bond, the Declaration provides that "in the  
28 event that a management agent is retained by the Association, the management agent  
29 must obtain a fidelity bond at its own expense covering its personnel."  
30

1 Respondent acknowledged that the Association's manager needs to be bonded.  
2 The manager testified that she had been looking into obtaining a fidelity bond as a result  
3 of the issues raised by this Petition.

4 A violation of the Declaration was established as to Allegation 10.

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6 Allegation 11: Improper Maintenance

7 Several photographs were introduced into evidence to demonstrate the condition  
8 of building exteriors and the common grounds (Exhibits R15 and P17). Respondent  
9 acknowledged that there were several items on the property that were in need of  
10 maintenance, but stressed that those items had to be addressed on a priority basis due  
11 to a lack of funds. It characterized the buildings and grounds as being in relatively good  
12 shape, given the age of the subdivision, and the photographs offered by Respondent  
13 generally support that claim (Exhibit R15).

14 Photographs offered into evidence by Petitioner (Exhibit P17), however, depicted  
15 a crumbling perimeter wall, and large patches of paint peeling under the eaves of one of  
16 the units. These items are in obvious need of repair and were acknowledged by the  
17 parties to have been in that condition for several years.

18 Respondent recognized the need to address the specific maintenance issues  
19 raised by Petitioner, and expressed its intention to bring these matters to the attention of  
20 the Board of Directors, perhaps through a request for a special assessment.

21 Article IX, Section 1 of the Declaration provides that the Association bears the  
22 responsibility for maintaining the exterior of the buildings and the grounds surrounding  
23 the units. It further provides that "The Board of Directors shall use a reasonably high  
24 standard of care in providing for the repair, management and maintenance of the  
25 Property, so that the Project will reflect a high pride of ownership."

26 The standard of care reflected in Exhibit P17, particularly with respect to the  
27 perimeter wall and exterior paint on some of the units, falls below the standard required  
28 under the Declaration. As such, a violation of Allegation 11 was established.  
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1                   Allegation 12: No Nominating Committee

2                   Evidence presented at the hearing established that a nominating committee was  
3 designated prior to each election as required under the Palms II By-laws, Article IV,  
4 Section 5. Although Petitioner argued that the “committee” has consisted of only one  
5 person in the past, there is no requirement as to the minimum number of committee  
6 members or their qualifications specified in the By-Laws or the Declaration.

7                   No violation was established as to Allegation 12.

8                   Allegation 13: No Notice of Candidates for Office:

9                   Petitioner alleged that there was insufficient notice provided to members of the  
10 Association regarding candidates for office. Respondent replied that the notice is  
11 provided by the election ballot and the annual meeting announcement that goes out to  
12 each member prior to the annual elections.

13                   Palms II By-laws Article III, Section 6, provides that “Notice of the annual or any  
14 special meeting shall be given by sending written notice to all Members not less than  
15 thirty (30) days, nor more that fifty (50) days in advance of the meeting.” Additionally,  
16 Article IV, Section 5 of the By-laws requires that the nominating committee report,  
17 presumably listing the nominees, shall be “filed with the Secretary in sufficient time to  
18 enable him/her to include this nominating report in the notice to the homeowners which  
19 notifies them of the time and place of the annual homeowners’ meeting as required by  
20 these By-laws.”

21                   There was no evidence presented to establish that election notice requirements  
22 were not being met by the Association. A violation of Allegation 13 was not  
23 established.  
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25                   Allegation 14: Officers Being Elected by Proxy:

26                   Proxies are no longer in use to elect officers of the Association. Elections now  
27 require votes to be cast in person or by absentee ballot which is consistent with the  
28 requirements of A.R.S. §33-1250C. This allegation is moot.  
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1 Those records shall include but are not limited to, records of all funds acquired and held  
2 by the Association and all receipts, invoices, bids, payment records, bills etc. which are  
3 received or regularly kept by the Association.

4 (4) Any person authorized to manage the Association by the Board of Directors,  
5 who is not an employee of the Association, must obtain a fidelity bond “in an amount not  
6 less than the maximum amount of funds that will be in the custody of the Association or  
7 its agent at any time while the bond is in force. The coverage must be for an amount  
8 equal to at least the total sum of three (3) months assessments on all Units in the  
9 Project plus the Association’s reserve funds.” Declaration, Article XII, Section 7.

10 (5) The Association shall take all reasonable measures to maintain the property  
11 with a standard of care that reflects a high pride of ownership as stated in Article IX,  
12 Section 1 of the Declaration. Specifically, the Association shall repair the crumbling  
13 perimeter wall and flaking paint under the eaves of the units, as depicted in Exhibit P17.  
14 Those repairs must be completed within a reasonable time, not to exceed six months.

15  
16 The Petitioner prevailed on five of the seventeen allegations. Her failure to  
17 prevail on the majority of the issues, which Respondent was required to defend, does  
18 not justify an order requiring Respondent to reimburse Petitioner’s filing fee under A.R.S.  
19 §41-2198.02 (A).

20 Although Respondent was noncompliant with some state statutes and certain  
21 provisions of the governing documents for the Association, such noncompliance did not  
22 evidence bad faith, reckless disregard of the applicable governing documents and  
23 statutes, or negligence sufficient to warrant the imposition of civil penalties under A.R.S.  
24 §41-2198.02(A).

25 This Order is the final administrative decision and is not subject to a request for  
26 rehearing. It is enforceable through contempt of court proceedings filed in Superior  
27 Court. A.R.S. §41-2198.02 (B). Such contempt proceedings may result in an award of  
28 attorney fees and costs to the prevailing party.  
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Done this day, June 11, 2007.

\_\_\_\_\_  
Michael K. Carroll  
Administrative Law Judge

Original transmitted by mail this  
\_\_\_\_ day of \_\_\_\_\_, 2007, to:

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By \_\_\_\_\_