



American Arbitration Association
Dispute Resolution Services Worldwide

2008

PRESIDENT'S LETTER &
FINANCIAL STATEMENTS



OUR SHARED MISSION

The American Arbitration Association is dedicated to the development and widespread use of prompt, effective and economical methods of dispute resolution. As a not-for-profit organization, our mission is one of service and education.

We are committed to providing exceptional neutrals, proficient case management, dedicated personnel, advanced education and training and innovative process knowledge to meet the conflict management and dispute resolution needs of the public now and in the future.

OUR SHARED VISION

The American Arbitration Association will be the global leader in conflict management – built on integrity, committed to innovation and embracing the highest standards of client service achievable in every undertaking.

OUR SHARED COMMITMENT TO DIVERSITY

The American Arbitration Association is the global leader in conflict management with core values of integrity and service. Our integrity demands impartial and fair treatment of all people with whom we come in contact, regardless of gender, race, ethnicity, age, religion, sexual orientation or other characterization. Our conflict management services put into practice our goal for the resolution of disputes between parties with different perspectives, experiences and backgrounds.

Because of the breadth of the Association's work and the global reach of its services, we recognize the importance and contribution of a diverse work force, a diverse Roster of Neutrals and diverse Board and we commit to respect and increase diversity in all our endeavors.

PRESIDENT'S LETTER

ROOTS OF TRANSFORMATION

In 2008, the world was captivated and ultimately affected by several momentous events in history. The events themselves varied in their historical significance, but one thing is unassailable: consequential change came to individuals and organizations worldwide.

Partly in response to external events and also to its own internal assessments, the American Arbitration Association® (AAA) underwent a thoughtful and significant transformation in 2008. Internal factors that included a keen desire to respond to its customers' expectations regarding alternative dispute resolution (ADR) services, as well as external considerations, such as the impact of the 2008 economy on the AAA's users, contributed to the AAA's felt need for change.

While the imperative to apply fresh approaches to AAA's activities was present, it was the AAA's will to transform itself in 2008 that laid the groundwork for its continued leadership in the field of ADR well into the future. The will to transform, however, is only one component of the process of change. There are in fact three elements of transformation: motivation, action and perseverance. In 2008, the AAA successfully engaged in all three and began to see the fruit of these efforts as the year progressed.

From Motivation to Manifestation

While the AAA's case volume remained strong in 2008, mid-year changes in the economic climate made it clear that some of the AAA's clients would be deeply affected by the changing world economic condition. To better serve users, the AAA took action on an initiative that had been germinating since late 2007.

Internal assessments of its business coupled with Voice of the Customer research conducted over the last several years showed that some rethinking of the AAA's operations was in order. Specifically, the AAA determined that customer needs varied according to the types of cases being filed and even the industries from which cases arose. Additionally, clients who frequently filed cases likely had different requirements regarding service as compared to less frequent filers.

Case types and client filing activity notwithstanding, the determination to increase the AAA's relevance to and services for its constituents—customers and “complimentors,” such as neutrals and trade associations—sprouted and grew in 2008.

To respond to the needs communicated by its clients and the opportunities that were becoming apparent, the Association's operations were reorganized, creating five divisions in order to meet the diverse needs of customers, complimentors and other constituents: Commercial, Construction, State Insurance, International and Labor, Employment and Elections Divisions.

FIELDS OF OPPORTUNITY

The AAA's reorganization of its operations into distinct divisions aided in the identification of new opportunities to serve users in 2008 and enabled the AAA to take greater advantage of those possibilities. The increased ability to concentrate business efforts on targeted customers and caseloads had all divisions making strides toward developing and delivering new services and solutions, both online and offline.

Commercial Division

The AAA's Commercial Division provides alternative dispute resolution (ADR) services that help parties to resolve business-to-business and business-to-consumer conflicts. The Commercial Division provides ADR services for disputes arising in the U.S. from industries and about subject areas that include technology, energy, insurance, healthcare, partnerships, intellectual property, franchises—to name a few. The Commercial Division's services, therefore, exclude resolution services for employment and labor-related matters, cross-border disputes, construction and real estate industry conflicts and state-mandated dispute resolution programs involving automobile insurance claims.

With this very clear focus in mind, the Division developed several innovative programs that included online and offline conflict resolution offerings, some in partnership with Cybersettle, a provider of an online patented double-blind bidding process. These services enabled clients with large and small commercial claims alike to resolve their disputes quicker and more effectively.

One program, developed in partnership with the organization Joint Resolution Services, will help deliver expedited resolution for disputes arising out of the reinsurance industry. Parties first attempt settlement through the Cybersettle online negotiation process. If they are unsuccessful, resolution attempts continue through AAA arbitration or mediation, under expedited procedures developed for reinsurance clients.

Another program piloted as of late 2008 provides an online payments processing firm with appeals procedures for parties returning luxury goods to sellers based on claims regarding the authenticity of the products. This unique program offers users the ability to file cases online through the AAA WebFile® system and includes automated arbitrator selection and “desk arbitration” processes. A special panel of arbitrators and modified Rules based on the AAA's Commercial Rules were put in place.

In addition to several original online resolution programs, the Commercial Division piloted an expedited non-binding arbitration program as a means of assisting organizations with no pre-dispute clauses in their customer contracts in order to resolve payment-related disputes after the disputes arose.

And while this program was being piloted, another suite of services was being fashioned to give organizations more pre-dispute, non-binding ADR options for customer and partner agreements. Program planning began in late 2008 and the new suite of non-binding services is expected to be launched to Commercial Division clients in early 2009.

The Commercial Division's new services will provide organizations with increased choices for managing and expediting business conflict resolution. Some businesses have disputes that arise with users who are consumers. With use of the AAA's Due Process Protocol, the AAA has maintained that fair and unbiased resolution in arbitration cases involving consumers and resulting from mandatory pre-dispute agreements is the norm. With regard to the AAA's consumer arbitration services, Northwestern Law School's Searle Civil Justice Institute conducted an in-depth study of the AAA's administration of consumer arbitration, commencing in 2008. That study, published in early 2009, found numerous positive aspects of AAA-administered consumer arbitrations, including the fact that costs of consumer arbitrations are low, proceedings are expeditious and the "repeat player" effect is not statistically significant. In addition, the AAA's review of arbitration clauses for compliance with the Consumer and Employment Protocols was found to be highly effective.

Construction

The Construction Division of the AAA serves a large and important group of users. Construction Division customers, complimentors and constituents range from architects, developers, builders and contractors to attorneys, real estate agents and judges. Changes in 2007 to standard-form contracts used by groups such as the American Institute of Architects (AIA) presented the AAA with opportunities to build new programs and enhance services to meet this varied group's needs around dispute resolution.

Initial Decision Maker (IDM) Procedures were developed in 2008 to support the new "stepped" dispute resolution requirements of the 2007 AIA Contract Documents. The Documents allow for the selection of an IDM other than the project architect when disputes arise. The Construction Division maintains a roster of professionals to provide IDM services as desired, and as a precursor to mediation and arbitration, per the AIA's new standard-form contract.

In 2008, the Construction Division increased promotion of ADR services designed for the unexpected events that sometimes arise with construction projects. The Construction Division's suite of dispute avoidance and resolution services include on-site and off-site options such as partnering, dispute resolution boards, informal mediation, mediation and arbitration. Thus far, some of the AAA's dispute avoidance and early resolution services have been used in connection with sports stadiums and commercial building projects.

Beyond development of new services to respond to industry needs and to take advantage of opportunities created by the industry, the Construction Division presented its regularly well-attended industry conference. The 2008 program, *ADR Works! Choosing the Right Resolution Options*, was offered in the spring and fall and was well received in both instances. In fact, one component of that program that covered On-Site Resolution services was adapted and was delivered via the Internet in early 2009. This model may prove highly effective in reaching customers in an industry deeply affected by the economic conditions of 2008.

International

In 2008, the International Centre for Dispute Resolution® (ICDR) achieved a milestone in its history—international cases filed exceeded 700 for the first time. While some of the AAA's Divisions were newly formed in 2008 as part of the reorganization of operations, the ICDR has provided arbitration and ADR services to organizations involved in cross-border disputes for over 13 years. And, through its international case management center in New York City, the ICDR delivers services in many different languages. In 2008, the ICDR took the next step and translated its arbitration Rules into Spanish, French, Italian, German, Chinese and Portuguese. An Arabic version of the Rules is expected in 2009.

Arabic Rules will serve the ICDR well in its new agreement to establish a centre of public and private arbitration and mediation in the Kingdom of Bahrain, in conjunction with the Ministry of Justice of the Kingdom of Bahrain. The newly formed Bahrain Chamber for Dispute Resolution will assist parties to resolve domestic and international disputes originating in Bahrain using alternative dispute resolution methods. The presence of some of the world's leading law firms and several regional and international financial institutions in Bahrain provides a distinct opportunity for the ICDR in the region and for increased use of ADR in general.

Other opportunities for heightened use of ADR outside of the United States presented themselves in 2008. Working with other entities, the ICDR developed the Online Dispute Resolution Program for Manufacturer/Supplier Disputes, which assists with the resolution of small claims between manufacturers and their suppliers—quickly, inexpensively and fairly. The Program takes no more than 60 days for resolution and involves negotiation, followed by arbitration if the matter is not settled in the negotiation phase. The program is available in English and Italian.

Energy was a significant issue for many in the world in 2008. The ICDR and the Association of International Petroleum Negotiators (AIPN) held a joint conference on the use of ADR in the oil and gas industry. The program was held in Brazil, an important oil-producing country. To serve the industry, the ICDR also maintains a panel of energy industry arbitrators available to hear disputes worldwide.

Labor, Employment, Elections

The Labor, Employment and Elections Division serves the dispute resolution and polling needs of employers and employees and consists of labor and employment ADR as well as elections services.

In 2008, the Labor, Employment and Elections Division held its annual Labor Advocacy training programs around the country. In total, the program consisted of 14 skills-building training sessions, ranging from introductory one-day to advanced-level two-day courses about representing clients—management and unions—in labor disputes. Also in the area of labor training, the Division developed a program in conjunction with the Scheinman Institute of Conflict Resolution at the Cornell University ILR School to train neutrals in the area of labor dispute resolution.

In the sphere of employee-employer dispute resolution, the Division has expanded services to include the AAA's redacted employment awards, which are now available through LexisNexis. In 2008, over 3,000 redacted full-text employment as well as over 7,000 labor awards from the AAA were accessible through LexisNexis.

And, as in the Commercial Division, a suite of non-binding dispute resolution services was created. Employers seeking pre-dispute, non-binding resolution alternatives for employer-employee conflicts will have access to non-binding ADR services in 2009.

AAA Elections Services, also part of the Division due to synergies between Labor and Elections services, found new opportunities to promote its offerings. Because 2008 was an election year, Elections had several meaningful occasions, in periodicals and elsewhere, to discuss the benefits of its services. One such opportunity was *Voting in America: The Road Ahead*, a national conference held in Washington, D.C. and sponsored by the Pew Charitable Trusts. The program revisited the 2008 national election after its conclusion and involved a discussion on elections administration and modernizing the nation's voting system. AAA Elections was the only private elections service organization that participated in this important forum.

In addition to providing online and offline elections, AAA Elections Services also is able to administer survey polls. In 2008, Elections processed over 100,000 teacher surveys for the United Federation of Teachers (UFT) in New York City.

State Insurance

The AAA has successfully handled no-fault automobile claim disputes in the states of Minnesota and New York for many years. In 2008, the AAA's Minnesota center handling no-fault claims completed a competitive bid and was reappointed by the Minnesota Supreme Court as the administrative organization for the state's No-Fault arbitration program. The AAA's Minneapolis office has administered this caseload since its inception in 1975.

In New York, the New York No-Fault/SUM center implemented several service and operational enhancements to benefit users. The online State Uninsured Motorist (SUM) awards have been redacted and coded to allow users to conduct searches by topic in a far easier fashion than previously. Additional online enhancements included giving users the ability to provide feedback on services through a new online tool. Implementation of the tool allows the center to quickly determine clients' needs and allows staff to take action on customer issues in a very timely fashion.

THE AAA MISSION AND CONTINUED PUBLIC SERVICE

Education

Like its division-based efforts, the AAA's mission of education had fertile ground in which to grow in 2008. The reorganization of its operations allowed the AAA's new divisions to focus education efforts on their respective constituents in a targeted way. That focus enabled the AAA to develop more tailored programs, whether delivered at the offices of organizations it serves, at other off-site venues or, now, via the Internet.

In 2008, the AAA launched a new website, www.aaauonline.org and formalized the work of its training department, American Arbitration Association University (AAAU), to support the AAA's overall training and education efforts. The AAAU website enables users to, among other things, learn about and sign up for courses offered by or in conjunction with the AAA. Through the aaauonline.org website, the AAAU offered several live, online courses that were accessible from around the country and around the world. Courses were presented via the Internet by experts in the field of ADR from different industries and practice areas.

With the likelihood of the economic situation that began to unfold in 2007-2008 having long-term effects, clients probably will seek less costly online training. So, the importance of the AAA's online training through aaauonline.org to organizations will potentially increase. The AAA is ready for this opportunity.

Legislation

Legislative initiatives concerning alternative dispute resolution gained steam in 2008. Although not new, the Arbitration Fairness Act, which was introduced in Congress and would impact the enforceability of pre-dispute consumer, franchise and employment arbitration agreements, continued to garner substantial attention in 2008. In 2008, the AAA provided testimony in two Congressional hearings as well as, at the invitation of legislative staff and other organizations, education, training and observations about and on the impact of the proposed legislation. The AAA also provided possible alternatives to address the concerns of those proposing the legislation. The AAA continues to monitor developments connected with—and continues to be a resource for those considering—the legislation as it makes its way through Congress. It should be noted that great use has been made of the Due Process Protocol over the years since the introduction of the Arbitration Fairness Act.

Diversity

The AAA serves a varied group of constituents with manifold needs related to alternative dispute resolution. Service enhancements and altogether new service offerings and delivery methods are only part of what has helped the AAA remain on the forefront of the field. The AAA's efforts to increase diversity in ADR are an important part of serving the ADR community. Among other diversity-related initiatives, in 2008, the Association established a media bureau, which prominently involves neutrals from diverse backgrounds. This media bureau provides the press and others with access to knowledgeable ADR experts from diverse backgrounds who can offer a variety of points of view on topics in the industry.

Other initiatives included the creation of the AAA A. Leon Higgenbotham, Jr. Fellowship Program, which will annually provide 15-20 diverse professionals in the field of ADR with comprehensive ADR training and opportunities to network to enhance their expertise and to help position them to be future leaders in the field. The AAA also continued to develop alliances with minority bar associations in the U.S.

SUMMARY

The challenges and changes that faced organizations as well as much of the world in 2008 presented significant opportunities for the AAA. Reorganizing its operations to serve the needs of clients in distinct businesses, industries or with specialized individual needs, has positioned the AAA to better hear and respond to the Voice of the Customer and to identify, develop and bring to fruition faster, new services for those who seek the AAA's expertise in conflict management.

2008 saw the piloting and implementation of several important service offerings at the AAA, whether they were online, offline, served the international community, expedited resolution time frames or enabled the AAA to fulfill its mission of education and service in the ADR field.

The AAA clearly engaged in a meaningful transformation in 2008. This latest and important evolution in the AAA's operational structure will undoubtedly serve the organization, its customers, constituents and the dispute resolution community in general well, now and far into the future.

The referenced achievements are the result of tremendous efforts on the part of the Board and staff, and heartfelt thanks go out to all.

A handwritten signature in black ink that reads "William K. State II". The signature is written in a cursive style with a large, stylized "W" and "S". The "II" is written as two vertical lines to the right of the name. The signature ends with a long, horizontal stroke that tapers to a point on the right.

President and Chief Executive Officer

May 7, 2009

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American Arbitration Association
Dispute Resolution Services Worldwide

AMERICAN ARBITRATION ASSOCIATION, INC. AND SUBSIDIARIES

REPORT ON CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2008 AND 2007

AMERICAN ARBITRATION ASSOCIATION, INC. AND SUBSIDIARIES

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS
TO THE BOARD OF DIRECTORS
AMERICAN ARBITRATION ASSOCIATION, INC.

We have audited the accompanying consolidated balance sheets of American Arbitration Association, Inc. and Subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of American Arbitration Association, Inc. and Subsidiaries as of December 31, 2008 and 2007, and the changes in their net assets and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1, American Arbitration Association, Inc. and Subsidiaries changed its method of accounting for employee benefit plans upon adoption of Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans."

Handwritten signature of J.H. Cohen LLP in black ink.

New York, New York

April 22, 2009

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
ASSETS		
Cash and cash equivalents	\$ 8,996,000	\$ 8,323,000
Investments, at fair value (Note 2)	71,668,000	88,694,000
Administration fees receivable, net of allowances for cancellations and uncollectable accounts of \$1,073,000 in 2008 and \$941,000 in 2007	17,654,000	22,947,000
Other receivables	511,000	208,000
Prepaid expenses	3,129,000	2,872,000
Construction and internal use software development in progress (Note 4)	44,000	37,000
Furnishings, equipment and leasehold improvements, net (Note 4)	<u>7,653,000</u>	<u>8,810,000</u>
Total Assets	<u>\$109,655,000</u>	<u>\$131,891,000</u>
 LIABILITIES AND NET ASSETS		
Liabilities		
Accounts payable and accrued expenses (Notes 3 and 5)	\$ 59,884,000	\$ 63,073,000
Accrued postretirement medical costs (Note 3)	6,081,000	8,400,000
Accrued pension liability (Note 3)	11,330,000	4,986,000
Deferred rent	3,606,000	3,955,000
Deferred revenue	<u>2,687,000</u>	<u>2,451,000</u>
Total Liabilities	83,588,000	82,865,000
Commitments and contingencies (Note 5)	-	-
Unrestricted net assets	<u>26,067,000</u>	<u>49,026,000</u>
Total Liabilities and Net Assets	<u>\$109,655,000</u>	<u>\$131,891,000</u>

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF OPERATIONS AND
CHANGES IN NET ASSETS
YEARS ENDED DECEMBER 31, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
OPERATING REVENUES		
Administration fees earned:		
Commercial	\$46,551,000	\$45,559,000
State insurance	13,840,000	15,753,000
Labor	5,232,000	4,937,000
Elections	3,693,000	5,281,000
Totals	<u>69,316,000</u>	<u>71,530,000</u>
Publications and education	<u>1,349,000</u>	<u>1,118,000</u>
Totals	<u>70,665,000</u>	<u>72,648,000</u>
OPERATING EXPENSES		
Administration of tribunals	61,112,000	59,801,000
Elections	3,762,000	5,042,000
Publications and education	1,987,000	1,855,000
General and administration	3,313,000	3,091,000
Totals	<u>70,174,000</u>	<u>69,789,000</u>
Net Operating Income	491,000	2,859,000
NON OPERATING INCOME AND EXPENSES		
Interest and dividends on investments, net of fees (Note 2)	1,998,000	3,341,000
Net realized and unrealized (losses)/gains on investments	(19,328,000)	2,574,000
Loss on disposal of assets (Note 4)	(62,000)	-
CHANGE IN UNRESTRICTED NET ASSETS BEFORE CHANGES IN NET ASSETS	(16,901,000)	8,774,000
Effect of adoption of recognition provision of SFAS 158 (Note 3)	-	1,866,000
Minimum pension liability adjustment (Note 3)	(8,691,000)	1,262,000
Postretirement medical obligation adjustment (Note 3)	<u>2,633,000</u>	<u>-</u>
CHANGE IN UNRESTRICTED NET ASSETS	(22,959,000)	11,902,000
UNRESTRICTED NET ASSETS, BEGINNING OF YEAR	<u>49,026,000</u>	<u>37,124,000</u>
UNRESTRICTED NET ASSETS, END OF YEAR	<u>\$26,067,000</u>	<u>\$49,026,000</u>

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	(\$22,959,000)	\$11,902,000
Adjustments to reconcile the change in net assets to net cash provided by operating activities:		
Depreciation and amortization	2,241,000	2,340,000
Bad debt and change in provision for uncollectible accounts	631,000	437,000
Net realized and unrealized losses/(gains) on investments	19,328,000	(2,574,000)
Loss on disposal of assets	62,000	-
Changes in operating assets and liabilities:		
Decrease/(Increase) in administration fees receivable	4,662,000	(2,778,000)
Increase in other receivables	(303,000)	(19,000)
Increase in prepaid expenses	(257,000)	(441,000)
Decrease in accounts payable and accrued expenses	(3,189,000)	(2,581,000)
Decrease in accrued postretirement medical costs	(2,319,000)	(1,570,000)
Increase/(Decrease) in accrued pension liability	6,344,000	(3,205,000)
(Decrease)/Increase in deferred rent	(349,000)	312,000
Increase in deferred revenue	<u>236,000</u>	<u>111,000</u>
Net cash provided by operating activities	<u>4,128,000</u>	<u>1,934,000</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of furnishings, equipment and leasehold improvements	(1,109,000)	(658,000)
Proceeds from sales of investments	58,909,000	30,850,000
Purchase of investments	(61,211,000)	(36,588,000)
Construction and internal use software development in progress	<u>(44,000)</u>	<u>(37,000)</u>
Net cash used in investing activities	<u>(3,455,000)</u>	<u>(6,433,000)</u>
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	673,000	(4,499,000)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>8,323,000</u>	<u>12,822,000</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u><u>\$ 8,996,000</u></u>	<u><u>\$ 8,323,000</u></u>

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business and principles of consolidation

The accompanying consolidated financial statements include the financial position and operating activities of the American Arbitration Association, Inc. and the Subsidiaries it controls, ADRWorld.com and The International Centre for Dispute Resolution, LLC. All intercompany accounts and transactions have been eliminated in consolidation. As used herein, the “Association” includes the American Arbitration Association, Inc. and Subsidiaries.

The American Arbitration Association, Inc. (“AAA”) is a not-for-profit organization that provides administrative, educational and development services for the widespread use of dispute resolution procedures.

ADRWorld.com (“ADRW”), a Delaware limited liability company, delivers via the Internet alternative dispute resolution news, research and industry information.

The International Centre for Dispute Resolution, LLC (“ICDR, LLC”), an Irish subsidiary of the Association, promotes, facilitates and provides dispute management services.

Accounting change

In 2007, the Association adopted the provisions of Statement of Financial Accounting Standards No. 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)” (“SFAS 158”), which became effective for fiscal years ending after June 15, 2007. SFAS 158 requires an employer that sponsors a defined benefit pension or postretirement plan to report the funded status of each plan in its statement of financial position and to include enhanced disclosures about each plan in its notes to the financial statements. In addition, SFAS 158 requires the measurement of plan assets and benefit obligations as of the date of the employer’s fiscal year-end statement of financial position. The effect of adopting SFAS 158 was a change in net assets in 2007 reflecting the recognition of a prior service credit and net actuarial gain totaling \$1,866,000.

Administration fees

The initial filing fee for commercial cases, which is subject to a minimum fee, is billed at the commencement of the dispute resolution process. Over the next 60 days, which is the time period for refund eligibility, a portion of the refundable initial filing is recognized as revenue as services are performed. Under certain circumstances, the 60-day time period for refund eligibility is extended indefinitely for arbitration cases that utilize the AAA’s mediation services. Based on analysis of current trends, the Association recorded a provision for deferred revenue in 2008 and 2007 of \$255,000 and \$250,000, respectively, which is included in the accompanying consolidated balance sheets and represents the estimated amount of future refunds.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Administration fees (concluded)

A case service fee is payable in advance prior to the first scheduled hearing. The case service fee is refundable at the conclusion of the case if no hearings have occurred. Case service fee revenue is recognized, net of estimated refunds, as case administration services are provided.

Deferred case service fee revenue of \$2,431,000 and \$2,157,000 as of December 31, 2008 and 2007, respectively, are included in deferred revenue in the accompanying consolidated balance sheets.

Cash and cash equivalents

The Association considers all highly liquid investments with maturities of three months or less on the date of purchase to be cash equivalents.

Concentrations of credit risk

Financial instruments, which potentially subject the Association to concentrations of credit risk, include cash and cash equivalents and administration fees receivable. The Association maintains cash and cash equivalents in bank deposit and other accounts, the balances of which exceeded federally insured limits by \$16,253,000 and \$15,658,000 as of December 31, 2008 and 2007, respectively. The Association places its cash and cash equivalents with creditworthy, high-quality financial institutions. Credit risk with respect to fees receivable is also limited because the Association deals with a large number of customers in a wide geographic area. The Association closely monitors the extension of credit to its customers while maintaining allowances for potential credit losses. On a periodic basis, the Association evaluates its fees receivable and establishes an allowance for doubtful accounts, based on a history of past write-offs and collections and current credit considerations.

Investments

Investments are reported at fair value. Cash equivalents included in investments are held for investment purposes. Changes in unrealized investment gains or losses are reported in the statements of operations and changes in net assets.

Furnishings, equipment and leasehold improvements

Furnishings, equipment and leasehold improvements are stated at cost. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the individual asset or the lease term, if shorter than the useful life. The cost of maintenance and repairs is charged to expense as incurred.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Capitalization of software

The Association capitalizes costs incurred for the development of software for internal use in accordance with Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." The costs associated with the development of case management and financial applications currently in use were amortized over five years. In 2008, the Association began a new project to design and develop new case management applications. The cost of this development will also be amortized over five years once the new software is placed in service, which is expected to occur in 2010. The balance of software development in progress at December 31, 2008 was \$41,000.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Tax status

The AAA is exempt from federal income tax under the provisions of Section 501(c)(3) of the Internal Revenue Code; therefore, no provision for income taxes is included in the Association's consolidated financial statements.

ICDR, LLC is a taxable entity in Ireland. There are no provisions for income taxes for 2008 and 2007 due to losses incurred. As of December 31, 2008 and 2007, ICDR, LLC has offset the deferred tax asset related to its loss carryforwards of approximately \$3,200,000 and \$2,436,000, respectively, by a valuation allowance of an equivalent amount as such deferred tax asset is not expected to be realized. Accordingly, there are no credits for income taxes reflected in the accompanying consolidated statements of operations and changes in net assets to offset ICDR, LLC's pretax losses.

As a single member LLC, any taxable income or loss of ADRW is passed on to the member and taxable in accordance with the member's tax status.

Fair value of financial instruments

The carrying amounts of cash and cash equivalents, administration fees receivable, accounts payable and accrued expenses approximate fair value because of the short-term nature of the items.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONCLUDED)

Fair value of financial instruments (concluded)

In September 2006, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 157, “Fair Value Measurements” (“SFAS 157”), which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. In early 2008, the FASB issued Staff Position (“FSP”) FAS-157-2, “Effective Date of FASB Statement No. 157,” which delays by one year the effective date of SFAS 157 for certain nonfinancial assets and nonfinancial liabilities. The Association has adopted the portion of SFAS 157 that has not been delayed as of the beginning of its 2008 fiscal year and plans to adopt the balance of its provisions as of the beginning of its 2009 fiscal year.

New accounting pronouncements

In June 2006, Financial Accounting Standards Board (“FASB”) Interpretation No. 48 (“FIN 48”), “Accounting for Uncertainty in Income Taxes – An Interpretation of SFAS No. 109,” was issued. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 109, “Accounting for Income Taxes.” FIN 48 also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. In addition, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FASB Staff Position (“FSP”) FIN 48-3 deferred adoption for most nonpublic enterprises to annual periods beginning after December 15, 2008. Many not-for-profit entities have not previously applied the provisions of SFAS No. 109 and during the deferral period the FASB plans to issue guidance on how to apply the provisions of FIN 48 to these entities. The Association, pursuant to the FSP, has elected to defer its application until its required effective date of January 1, 2009. Management does not expect the adoption of FIN 48 to have a material effect on the financial condition or the results of operations of the Association.

Reclassifications

Certain prior year balances have been reclassified to conform with the current year financial statement presentation.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 - INVESTMENTS

Investments at December 31, 2008 and 2007 consist of the following:

	2008		2007	
	Cost	Fair Value	Cost	Fair Value
Fixed income/Money market funds	\$65,084,000	\$61,840,000	\$37,350,000	\$37,326,000
Domestic equity mutual funds	15,325,000	9,828,000	21,316,000	23,829,000
International equity mutual funds	-	-	22,000,000	23,209,000
Real estate mutual funds	-	-	4,230,000	4,330,000
Totals	<u>\$80,409,000</u>	<u>\$71,668,000</u>	<u>\$84,896,000</u>	<u>\$88,694,000</u>

Interest and dividends on investments are reported net of investment management fees and bank charges of \$551,000 and \$668,000 in 2008 and 2007, respectively.

As stated in Note 1, on January 1, 2008, the Association adopted the methods of fair value as described in SFAS 157 to value its financial assets and liabilities. As defined in SFAS 157, fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In order to increase consistency and comparability in fair value measurements, SFAS 157 establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

- Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for identical assets or liabilities. The fair value hierarchy gives the highest priority level to Level 1 inputs.
- Level 2: Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in inactive markets; or model-derived valuations in which all significant inputs are observable or can be derived principally from or corroborated with observable market data.
- Level 3: Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

In determining fair value, the Association utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 – INVESTMENTS (CONCLUDED)

Financial assets carried at fair value at December 31, 2008 are classified in the table below in one of the three categories described above:

	Level 1	Level 2	Level 3	Total
Fixed income/Money market funds	\$53,106,000	–	\$8,734,000	\$61,840,000
Domestic equity mutual funds	9,828,000	–	–	9,828,000
Totals	<u>\$62,934,000</u>	<u>–</u>	<u>\$8,734,000</u>	<u>\$71,668,000</u>

Investments in mutual funds, which account for \$53,106,000 of the Association's fixed income and money market fund holdings and \$9,828,000 of the domestic equity mutual fund holdings at December 31, 2008, are valued using market prices on active markets (Level 1). Level 1 instrument valuations are obtained from real-time quotes for transactions in active exchange markets.

Investments in a collective trust, which account for \$8,734,000 of the Association's fixed income holdings at December 31, 2008, are valued based on identification of value by the collective trust investment manager. Although the collective trust investment manager has classified the underlying securities held by the trust primarily as Level 1 and Level 2 assets, the Association has classified its investment in the trust as a Level 3 asset since independent market quotes are not available for the overall trust.

Changes in assets measured at fair value using Level 3 inputs for the year ended December 31, 2008 are as follows:

	Balance January 1, 2008	Net Realized and Unrealized Losses	Reinvested Dividends (net of fees)	Purchases, Sales and Settlements	Balance December 31, 2008	Change in Unrealized Gains/(Losses) for Investments Still Held at December 31, 2008
Collective trust, at fair market value	<u>\$22,476,000</u>	<u>\$(2,225,000)</u>	<u>\$ 483,000</u>	<u>\$(12,000,000)</u>	<u>\$ 8,734,000</u>	<u>\$(1,382,000)</u>

As of December 2008, the Association had issued a liquidation order for the collective trust holdings. The Association received approximately \$6,919,000 in proceeds in February 2009 and expects to receive the proceeds from the remaining holdings during the second quarter of 2009 as the collective trust is liquidated in a measured and prudent manner.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3 - PENSION AND OTHER POSTRETIREMENT BENEFITS PLANS

The Association maintains a noncontributory, qualified defined benefit pension plan covering all eligible employees. Effective December 31, 2006, the defined benefit pension plan was frozen and no additional benefits will be accrued by employees for future years of service. Accordingly, at December 31, 2008 and 2007, the projected benefit obligation and accumulated benefit obligation are equal.

The Association makes contributions to the Plan based on actuarial calculations. Total employer contributions required for the fiscal year beginning January 1, 2009 are estimated to be \$1,357,000. Including this minimum required contribution, the Association expects to contribute approximately \$3,400,000 to the Plan during 2009.

The Association also provides certain health care benefits for substantially all of its retirees. The Association is required to accrue the estimated cost of these retiree benefit payments during the employees' active service period. The Association pays the cost of the postretirement benefits as incurred.

Employees hired on or after July 1, 2003 are not eligible for retiree healthcare coverage. Prior to a change in eligibility provisions in December 2008, active employees hired on or before June 30, 2003 were eligible for retiree healthcare coverage upon retirement with at least 10 years of service after age 45. Effective December 31, 2008, eligibility for retiree medical was changed to require 15 years of service after the age of 45. However, exceptions were made for employees who would be eligible for retiree healthcare coverage as of December 31, 2008 under the previous eligibility rules of having at least 10 years of service after age 45, for employees who have at least 15 years of service as of December 31, 2008 and who were within 2 years of eligibility under the previous rules, and for a small group of senior executives. Employees who qualify under those exceptions will maintain the previous eligibility provision. The change in this benefit also limits the Association's annual net subsidy for retiree healthcare coverage to twice the 2008 net subsidy provided for all participants. The effect of these changes was a reduction in accrued postretirement medical costs and a corresponding increase in net assets of \$2,633,000 at December 31, 2008.

The Association also maintains a nonqualified Supplemental Retirement Plan. For 2008 and 2007, the expense associated with this unfunded plan, which is included in general and administrative expenses, was \$3,000 and \$146,000, respectively. For 2008 and 2007, the accrued benefit obligation, which is actuarially determined and included in accounts payable and accrued expenses, was \$36,000 and \$565,000, respectively. The discount rate used to determine the benefit obligation was 6.25% and 6.50% in 2008 and 2007, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3 - PENSION AND OTHER POSTRETIREMENT BENEFITS PLANS (CONTINUED)

For the defined benefit plan and the healthcare benefit plan, the following tables set forth each plan's funded status and amounts recognized in the Association's financial statements at December 31, 2008 and 2007:

	Pension Benefits		Healthcare Benefits	
	2008	2007	2008	2007
Benefit obligation at December 31	\$33,411,000	\$33,118,000	\$6,081,000	\$8,400,000
Fair value of plan assets at December 31	22,081,000	28,132,000	-	-
Net unfunded status of the plan	(11,330,000)	(4,986,000)	(6,081,000)	(8,400,000)
Unrecognized net loss/(gain)				
included in net assets	13,839,000	5,149,000	(4,499,000)	(1,866,000)
Employer's contribution	2,500,000	2,500,000	360,000	324,000
Plan participants' contributions	-	-	42,000	42,000
Net periodic benefit costs	153,000	557,000	673,000	620,000
Subsidies received	-	-	28,000	-
Benefit payments	(2,299,000)	(2,705,000)	(431,000)	(366,000)
Amounts recognized in other changes in net assets in the statement of operations and changes in net assets consist of:				
Prior service credit	-	-	(3,728,000)	(888,000)
Net actuarial loss/(gain)	8,691,000	(1,262,000)	(770,000)	(978,000)
Weighted-average assumptions to determine the benefit obligation as of December 31:				
Discount rate	6.25%	6.50%	6.25%	6.50%
Weighted-average assumptions to determine the net benefit cost for the year ended December 31:				
Discount rate	6.50%	6.50%	6.50%	6.50%
Expected return on plan assets	7.50%	7.50%	N/A	N/A

The estimated net loss for the defined benefit pension plan that will be amortized from unrestricted net assets into net periodic benefit cost for the next fiscal year is \$865,000. The estimated prior service cost credit and net gain totaling \$730,000 and \$15,000, respectively, for the postretirement plan will be amortized from changes in unrestricted net assets into net periodic benefit cost over the next fiscal year.

For measurement purposes, a 9.50% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2009. The rate was assumed to decrease gradually to 5.00% until 2017 and remain at that level thereafter.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3 - PENSION AND OTHER POSTRETIREMENT BENEFITS PLANS (CONTINUED)

The pension plan provides a benefit equal to the sum of (a) for each year of benefit accrual service (or any fractional part thereof) credited on or before January 1, 1997, 1.75% of earnings in effect on January 1, 1997 and (b) for each year of benefit accrual service credited after January 1, 1997 and through December 31, 2006, 1.75% of earnings in effect on January 1 of such year.

Estimated future benefit payments in each of the five years subsequent to December 31, 2008 and in the aggregate for the five years beginning in 2014 are as follows:

<u>January 1,</u>	<u>Pension Benefits</u>	<u>Healthcare Benefits</u>
2009	\$2,478,000	\$412,000
2010	2,451,000	443,000
2011	2,421,000	480,000
2012	2,432,000	480,000
2013	2,433,000	501,000
Years 2014 to 2018	12,116,000	3,108,000

The target allocations of pension assets are outlined below:

	<u>Target Allocation</u>	<u>Percentage of Plan Assets at December 31,</u>	
		<u>2008</u>	<u>2007</u>
Plan assets:			
Equity securities	40 - 70%	<u>36%</u>	<u>57%</u>
Fixed income/Group annuity contract	30 - 60%	<u>64%</u>	<u>43</u>
Total		<u>100%</u>	<u>100%</u>

The overall objective of these allocations is to provide for long-term growth while maintaining an acceptable level of risk. The expected long-term rate of return on assets is 7.5%. The assumption is based on future rates of return for the investment portfolio, with consideration given to the distribution of investments by asset class and historical rates of return for each individual asset class. All investments are chosen with prudence and due diligence by investment managers to ensure that results over time meet the objectives of the Association's Pension Investment Objectives and Policies Statement.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3 - PENSION AND OTHER POSTRETIREMENT BENEFITS PLANS (CONCLUDED)

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 (“DIMA”) introduced a prescription drug benefit under Medicare, as well as a Federal subsidy to sponsors of retiree medical benefit plans that provide a benefit that is similar to Medicare. In accordance with Financial Accounting Standards Board Staff Position (“FSP”) No. 106-2, “Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003,” the Association elected to recognize the effects of DIMA on its retiree medical benefits expense in 2005. Due to the inclusion of DIMA, the plan’s benefit obligation was reduced by \$1,315,000 in 2008 and by \$1,568,000 in 2007.

NOTE 4 - FURNISHINGS, EQUIPMENT AND LEASEHOLD IMPROVEMENTS

Furnishings, equipment and leasehold improvements consist of the following:

	2008	2007
Furnishings and equipment	\$15,240,000	\$14,750,000
Leasehold improvements	13,351,000	13,393,000
	<u>28,591,000</u>	<u>28,143,000</u>
Less accumulated depreciation and amortization	(20,938,000)	(19,333,000)
Totals	<u>\$7,653,000</u>	<u>\$8,810,000</u>

In 2008 and 2007, the Association recognized a net loss of approximately \$62,000 and \$0 relating to the disposal of certain assets with original costs totaling \$697,000 and \$6,754,000, respectively.

Furnishings and equipment as of December 31, 2008 and 2007 includes costs associated with the development of software for internal use of \$4,907,000. Related accumulated amortization for both periods was \$4,907,000.

In-progress construction costs for leased facilities totaled \$3,000 in 2008 and \$37,000 in 2007. When placed into service, these in-progress construction costs will be included in capital assets and amortized over the lives of the underlying leases. In-progress construction amounting to \$37,000 and \$2,451,000 was completed and placed into service during 2008 and 2007, respectively.

In-progress internal-use software development costs totaled \$41,000 in 2008 and \$0 in 2007. When placed into service, these in-progress software development costs will be included in capital assets and amortized over a period of five years. No in-progress software development costs were placed into service during 2008 and 2007.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 - COMMITMENTS AND CONTINGENCIES

Lease commitments

The Association conducts all of its activities from leased office space and is currently a party to various leases that expire between 2009 and 2017. Most of the leases provide for future escalation charges relating to real estate taxes and other building operating expenses. Rental expenses charged to operations for the years ended December 31, 2008 and 2007 amounted to \$10,323,000 and \$10,343,000, respectively. In addition, the Association leases certain computer and office equipment under various operating leases, all of which expire over the next one to four years.

Due to the consolidation of certain offices during 2006, the Association recorded liabilities for future lease obligations of \$28,000 and \$142,000 for 2008 and 2007, respectively. These liabilities are included in accounts payable and accrued expenses in the accompanying consolidated balance sheets.

Minimum noncancelable lease commitments for office facilities, equipment and software, exclusive of any future escalation charges, due in each of the five years subsequent to December 31, 2008 and thereafter are as follows:

<u>Year Ending December 31,</u>	<u>Amount</u>
2009	\$10,898,000
2010	10,285,000
2011	9,704,000
2012	9,529,000
2013	4,745,000
Thereafter	<u>7,581,000</u>
Total	<u>\$52,742,000</u>

NOTE 5 - COMMITMENTS AND CONTINGENCIES (CONCLUDED)

Lease commitments (concluded)

The Association is the sublessor for leased office facilities under a sublease contract that expires in 2013. The minimum rentals to be received under noncancelable subleases in each of the five years subsequent to December 31, 2008 are as follows:

<u>Year Ending December 31,</u>	<u>Amount</u>
2009	\$2,110,000
2010	2,264,000
2011	2,264,000
2012	2,264,000
2013	189,000
Total	<u>\$9,091,000</u>

Contingencies

The Association is a defendant in certain lawsuits arising in the ordinary course of business. While the outcome of lawsuits or other proceedings against the Association cannot be predicted with certainty, the Association does not expect that those matters will have a material adverse effect on its consolidated financial position.

The Association bills and collects amounts in advance for unearned arbitrators' compensation. At December 31, 2008 and 2007, advance deposits collected totaled \$54,976,000 and \$57,158,000, respectively. These amounts are included in accounts payable and accrued expenses in the accompanying consolidated balance sheets.

The Association has a letter of credit agreement totaling \$355,000 at December 31, 2008. This agreement guarantees an operating lease rental obligation and is secured by the investment portfolio.



American Arbitration Association
Dispute Resolution Services Worldwide

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