



American Arbitration Association

Dispute Resolution Services Worldwide

President's
LETTER
and Financial
STATEMENTS

2002

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.



American Arbitration Association

Dispute Resolution Services Worldwide

2002 President's Letter and Financial Statements

For the American Arbitration Association (AAA), 2002 was a year marked by continued – albeit modest – growth in caseload, coupled with significant strides in a two-pronged program aimed at further strengthening our leadership position in the field of dispute resolution and putting in place the elements of a solid foundation for future growth.

The past year will be remembered for a stalled global economy and rising international tensions. It is a point of pride that, despite this difficult economic environment, we remained focused on the principal objectives that support our mission and vision. We have continued refining the rules and processes that make dispute resolution a highly attractive alternative means of conflict management for a growing number of domestic and international companies, developed new product offerings, expanded educational resources, and continued organizational fine tuning that leads to service enhancement.

Notable accomplishments during the year included:

- > steady growth in the number of parties attracted to our online services – the result of the innovative marriage of technology and dispute resolution methods,
- > the launch of AAA Independent Fact-Finding ServicesSM (IFFS) and its panel – a new service that provides business and not-for-profit organizations, the judiciary, and regulatory agencies with an impartial, objective alternative to existing investigative tools in situations where an organization's reputation could be at risk,
- > the publication of revised rules governing consumer and employer/employee disputes that provide additional fairness safeguards for consumers and employees involved in arbitrations,
- > the opening in June of the AAA's Northeast Case Management Center in East Providence, RI, the fourth and final step in a reorganization of our case management structure that began in 1996,
- > a continuing build-up of our international presence out of our Dublin office through an energetic educational campaign across all of western Europe,
- > the restructuring of the service desk of the International Centre for Dispute ResolutionSM (ICDR), which administers all our international cases,
- > a fresh look at our client product and service offerings along with our overall marketing, product, and service delivery strategy, and
- > important changes in our organizational structure, and the creation of an expanded publications subscription program.

Lastly – and perhaps most importantly in this brief recapitulation of the year's significant events – we successfully undertook a spirited education campaign in California against a number of regulatory initiatives introduced into that state's legislature during the past year. If enacted as drafted, these bills would have seriously weakened the role of arbitration and eroded the right of employees and consumers to take advantage of the rapid, inexpensive, and easily accessed alternative to justice that arbitration provides in juxtaposition to the costly and over-burdened court system.

BOTH DOMESTIC AND INTERNATIONAL CASELOADS GREW DESPITE WEAKENED ECONOMY

Turning for a moment to the financial side of our operations, we did well on a relative basis despite the bleakness of the global economic landscape. The number of cases administered by the American Arbitration Association grew about 5.6% to 230,258, and our No-Fault caseload, which continues to be an important element of our case administration services, grew 7.3% during the year to 178,234 cases.

Our operating revenues – at \$83.9 million – grew modestly on a year-to-year basis. As a result of a careful organization-wide expense management program, we were able to achieve a breakeven result from operations while opening the Northeast Case Management Center and mounting a significant arbitration education initiative in the State of California. This result excludes contributions made by the AAA to the Global Center for Dispute Resolution ResearchSM.

In the international arena, caseload growth approximated 3.5% with 672 cases administered for parties in more than 70 countries – the most handled by any alternative conflict management provider in the world. More than \$3.4 billion in claims and counterclaims were filed internationally with nearly half of the cases involving claims of over \$500,000. The average time from initiation to award was 10 months. Also, about 8% of the international cases we administered involved mediation.

Mediation continues to grow in importance in the resolution of cross-border business disputes. It is less formal, offers a degree of flexibility to opt in or out, and it can be an important strategic tool in working to preserve long-term relationships. It is the ICDR's practice to offer mediation to international parties that come before it under a contract clause calling for arbitration.

Last summer, the United Nations Commission for International Trade Law (UNCITRAL) passed a model conciliation (its term for mediation) law, and the AAA was invited to participate in the UNCITRAL deliberations. This is a great compliment to our organization, which was one of the few non-government organizations to be invited to have a seat at that table, participate in the debate, and play a role in consensus decisions.

Growth in caseload and the UNCITRAL invitation are indicative of the growing prestige of this organization in the field of international conflict resolution. We have long been the model and authoritative information source for emerging nations establishing arbitral institutions. In doing so, they enhance their attractiveness as potential trading partners in our increasingly global economy. Two years ago, we redefined the ICDR as a separate division of the AAA dedicated to handling international cases, giving it a distinct positioning in keeping with its international mission. Under our revised international rules, either the ICDR or the AAA may be named as the arbitral institution of choice in international contracts.

For many years the AAA has maintained an international arbitral panel, presently numbering 450, that has attracted men and women who are among the most highly respected in the global legal, judicial, and business communities. Each year, there is a comprehensive review of this panel to ensure that the roster is culturally diverse and balanced with respect to language skills and required areas of expertise. In addition, we offer specialized ICDR training programs for panel members in a number of globally dispersed locations.

In the past year, we restructured the ICDR case management group's operations in order to serve parties to international cases in the most effective manner possible. ICDR case management is now organized into three regionally specialized teams – the European Desk, the Americas Desk, and the Asian Desk. An experienced team leader, who is not assigned a specific caseload, oversees each team. That leader is responsible for quality control, conducting all conference calls and participating in preliminary hearings. Team leaders and international case managers are fluent in 12 languages – French, German, Greek, Hebrew, Italian, Japanese, Korean, Mandarin,

Polish, Portuguese, Spanish, and Russian – and have the skills and experience to cut across cultural barriers and ensure that all parties are fully informed and that the process runs smoothly.

AN ENERGETIC EUROPEAN EDUCATIONAL PROGRAM

Today, as a result of the efforts of the ICDR's Dublin office that opened in June, 2001, the understanding and appreciation of what we offer is growing exponentially in the European market. During 2002, that office led a very energetic and focused educational campaign aimed at "getting the message out." It involved multiple short education seminars offered in law offices, bar associations, and corporate counsels' offices literally across all of western Europe – Brussels, Paris, Amsterdam, Malta, London, Glasgow, Madrid, Rome, Milan, Munich, Berlin, and Lisbon.

Most importantly, where the message is heard, it is being well received. There is clear enthusiasm among participants in the European market for a well-managed alternative to the courts that produces – at a reasonable cost – a fair and enforceable result. The consistency of the process, the trained staff available for guidance, the quality of the international arbitral panel, the time-tested and widely accepted rules and procedures, and the speed of the process – ten months from initiation to award on average – are being received as very persuasive arguments for taking a fresh look at the benefits of utilizing dispute resolution alternatives to the court system.

The sponsorship of conferences and symposia continues to be an important method of both making a contribution to the field and maintaining a thought-leader role in the conflict management arena. At the end of May, the ICDR in Dublin held its first major conference, a highly successful one-day educational program that examined topics in three areas: corporate perspectives on international dispute resolution, the role of conflict management in a rapidly expanding global economy, and current trends and issues in international arbitration. The conference was oversubscribed, and, in all, 160 delegates from 22 countries participated. Co-sponsors included the Corporate and Public Solicitors Association, the Global Corporate Counsel Association, the International Bar Association, the Law Society of Ireland, and the Bar Council of Ireland.

There were three other conferences of note, all of which touched on international themes. In February, the Global Center for Dispute Resolution Research held a unique two-day symposium on international commercial arbitration. The Global Center, sponsored by the AAA, is dedicated to fact-based research that explores the use and effectiveness of dispute resolution methods in global commerce.

The February meeting, held in Barcelona, was attended by 32 invitees, all leaders in fields such as international law, academia, and international arbitration. Organizations represented included the United Nations, the World Trade Organization, the Mexican Chamber of Commerce, the International Chamber of Commerce, the Center for Transnational Law, the Permanent Court of Arbitration at The Hague, and the China Economic and Trade Arbitration Commission. The symposium, conceived as a "think tank" exercise, sought to determine on which topics the next generation of research in international dispute resolution should focus.

In June, the AAA's Corporate Counsel Committee held a meeting in New York to share information about the latest trends in dispute resolution, and in November, the AAA, in conjunction with the International Court of Arbitration of the International Chamber of Commerce and the International Centre for Settlement of Investment Disputes of the World Bank, hosted the 19th Joint Colloquium on International Arbitration. Among the topics discussed at the daylong meeting were parallel or overlapping proceedings in international arbitration, assessing damages in international arbitration, and how California's new disclosure requirements will affect cross-border arbitration.

TWO IMPORTANT NEW INTERNATIONAL COOPERATIVE AGREEMENTS

Two agreements were signed by the AAA in 2002 with important strategic international partners. In March, we entered into an agreement with the Permanent Court of Arbitration at The Hague (PCA) that calls for cooperation between the two organizations in promoting international arbitration and conciliation, the sponsoring of conferences and seminars on conflict management processes, the provision of mutual arbitration facilities and administrative services upon request, and the exchange of information in a variety of forms. The PCA is a first-rate European partner, and this accord, which is only the PCA's second cooperative agreement, promises to be an excellent step toward fostering continued growth in the use of ADR processes to help facilitate international trade.

During the summer, we signed the second cooperative agreement, this one with the Malta Arbitration Centre, bringing the total number of such accords to 57 involving parties from 41 countries. Like the agreement with the PCA, its purpose is to further promote the use of arbitration and other dispute resolution procedures through seminars, conferences, and educational programs. The two organizations will work jointly in the selection and appointment of panel members and exchange information on new developments aimed at improving dispute resolution processes. The Malta Centre – because of its location and its relationships with European, Mediterranean, and North African arbitral institutions – will be an important strategic partner in the region.

In addition, early in 2003, the AAA began to offer independent arbitration services in the context of the newly instituted “Safe Harbor” framework for U.S. companies seeking to avoid violations of European Union privacy laws in the cross-border transfer of sensitive personal data between Europe and the United States. Under the Safe Harbor umbrella guidelines jointly developed by the U.S. Department of Commerce and the European Commission, it is required that there be “readily available and affordable independent recourse mechanisms” capable of investigating and resolving the complaints of individuals – services that the AAA is well equipped to provide.

SIGNIFICANT RULES CHANGES FOR CONSUMERS, EMPLOYEES, AND HEALTH CARE PATIENTS

As we have noted in past reports, the responsibilities associated with being the leading U.S. provider of dispute resolution services guide much of our activity in any given year. Perhaps the greatest of those responsibilities is the establishment and periodic revision – in concert with a wide range of stakeholders in the field – of the rules and procedures that govern conflict resolution processes. In 2002, we were involved in rules and process refinements on a number of fronts, and driving the majority of those changes was this organization's dedication to maintaining the highest standards of fairness in the dispute resolution process.

For example, two significant and parallel steps were taken toward safeguarding the rights of access to justice for consumers and employees involved in arbitrations. In February, we announced that, as the result of developments in case law, we were changing the Association's fee structure for consumer disputes to make the process more financially accessible, particularly for consumers with smaller claims. A similar change was announced in late October for employees involved in disputes with their employers under employer-promulgated plans. In both instances, filing fees for claims of less than \$10,000 are capped at \$125 with all other administrative fees being paid by the employer or the company involved in the consumer dispute.

We also made it known in June that the Association will no longer administer cases in a health care dispute involving an individual patient unless both sides have voluntarily agreed to the arbitration process after the dispute arises. This change – once again fairness-oriented – is in

keeping with the AAA's Health Care Due Process Protocol that calls for the protection of an individual's ability to seek relief in court before going to the mandatory arbitration remedy called for in most medical insurance plan contracts.

THE LAUNCH OF AAA INDEPENDENT FACT-FINDING SERVICES

In June, we announced the creation of AAA Independent Fact-Finding Services, developed to fulfill a critical need in crisis situations in which organizations frequently find themselves under intense public scrutiny. IFFS provides independent, third-party fact-finders – drawn on a case-by-case basis from a panel of nationally recognized individuals – to corporations, partnerships, not-for-profit organizations, the judiciary, and regulatory agencies. The fact-finding team is available to investigate potential or developing problems that could adversely impact public confidence in an organization, damage its reputation, or erode shareholder value.

Operating under the AAA's imprimatur of integrity and impartiality, the findings of IFFS investigators carry a unique degree of credibility. The mission is not one of advocacy, but of independent investigation conducted according to the highest ethical standards. Because of their arms-length independence, their reports can be a major factor in preserving a hard-won reputation. To date, the response to this initiative from corporate general counsels – especially in light of the Sarbanes-Oxley Act – has been quite positive, and we have established a blue-ribbon group of 17 nationally prominent individuals to serve on the initial IFFS panel.

IMPRESSIVE INVOLVEMENT ACROSS A WIDE SPECTRUM OF INTERESTS

Each year we participate in a diverse range of activities that have substantial impact across a wide spectrum of interests. A partial list of these involvements for 2002 includes the following:

- > We worked with a task force of the National Construction Dispute Resolution Committee, whose mission is to encourage the effective use of dispute avoidance and resolution in the construction industry, in conducting a broad review of its structure and activities. The result was a more focused and streamlined committee – one better prepared to fulfill its mission and meet the needs of the construction industry.
- > We redesigned our education programs aimed at our various labor constituencies, part of a longer-term program reshaping the way we serve the labor/management community. The newly introduced Labor Arbitration Advocacy courses emphasize principles of collective bargaining, grievance negotiation, and fact-finding, and elements of case preparation and presentation.
- > In two highly visible assignments, we administered and certified elections for the Screen Actors Guild (SAG) and the United Federation of Teachers of New York (UFT). The SAG assignment involved re-running the bitterly contested election of three of the union's national officers. The election results were determined through the use of the Fast and Accurate Questionnaire Scanning System (FAQSS) that captures data automatically with a 99.98% accuracy level from all voting papers – even those that have been torn or otherwise damaged. FAQSS is the most advanced system available for accurately processing ballots with multiple candidates, one that helps avoid problems similar to those that occurred in Florida during the last presidential election.
- > The UFT election was initially a strike authorization vote following 19 months of negotiations with the City of New York. At the eleventh hour, as strike ballots were being tabulated, a tentative contract proposal was approved by the UFT's delegate body, and we then switched gears quickly to run an election involving ten different ballots for the individual approval of ten separate contracts, one for each type of teaching or administrative position.

- > We were selected by the Internal Revenue Service to provide a list of qualified neutrals to serve in Section 351 contingent liability tax cases that go to binding arbitration.
- > We introduced new supplementary rules designed to guide arbitration procedures in reinsurance disputes and to streamline the selection process for umpires in these disputes.
- > We held the first neutrals conference in almost two years in January 2003 in Scottsdale, AZ. The two-day meeting was attended by more than 200 neutrals from our national roster. The conference provided the opportunity for participants to continue their required training, network and exchange ideas with colleagues, and interact with AAA executives and staff.
- > The AAA sent six arbitrators from its national panel to arbitrate disputes at the 2002 Olympic Games. Serving pro bono, the arbitrators were on hand to decide cases filed under the constitution and bylaws of the U.S. Olympic Committee (USOC) as well as those claims filed with the Court of Arbitration for Sport once the games had started. The AAA also serves the U.S. Anti-Doping Agency, which was created by the USOC and is charged with investigating drug use by American athletes. The most noteworthy cases in which we participated involved the dispute between bobsledders Jean Racine and Jennifer Davidson as well as an arbitration about the status of banned U.S. bobsledder Pavle Jovanovic.

THE USE OF ONLINE DISPUTE RESOLUTION GATHERS MOMENTUM

Technology continues to be a major driving force for change in the way we deliver our services, and, as we have stated in the past, our objective is to become the global leader in the application of technology to dispute resolution. It is clear to us that as the volume of online transactions rapidly builds, it becomes increasingly inefficient to go off-line to resolve disputes in traditional ways – this is the principal reason why we have invested more than \$2.5 million in the development of Online Dispute Resolution (ODR) capabilities using AAA WebFileSM.

AAA WebFile's ODR technology framework offers parties participating in either traditional or eCommerce transactions a fast and cost-effective way to handle all or part of the dispute resolution process online. This software encourages parties to a dispute to file, pay filing fees, respond to filings, select mediators or arbitrators, and transfer documents – all in a secure, case-specific online environment.

In the past year, the acceptance and use of this new technology has been gaining momentum. Since the launch of the product two years ago, over 2,000 cases have been filed, and by the close of 2002 a total of 748 mediations and arbitrations had been filed and completed. While the majority of claims filed fell in the \$10,000 to \$75,000 range, in 63 cases claim amounts exceeded \$500,000.

In addition to upgrades of WebFile's functionality, the AAA's technology group has introduced a series of enhancements to our Web site at www.adr.org. An online center for neutrals was also launched this year in a pilot test mode. It provides a Web-based means for neutrals and case managers to communicate, transfer documents, and make arbitrators' personal calendars available for scheduling purposes.

In July, we began making our Library and Information Center's Online Public Access Catalog (OPAC) available through our Web site. OPAC provides researchers online access to reference information on more than 22,000 books, pamphlets, articles, and periodicals dealing with ADR topics.

In January, we formed a strategic association with Visagent Corporation, a company that develops online market exchanges, primarily in the grocery, health, and beauty marketplaces. As part

of the agreement, the AAA will provide a range of dispute resolution services. These will include electronic, documents-only, telephonic, and in-person arbitrations to Visagent exchange members involved in trade disputes.

In March, the AAA entered into a first-of-its-kind agreement with NeuStar Inc. in which we resolve disputes that arise over trademarks and domain names for the Internet domain .us – known as “America’s Internet address.” The majority of disputes are expected to involve trademark owners seeking to protect their intellectual property rights against those who register or use a .us domain name in bad faith.

AN EVOLVING ORGANIZATIONAL STRUCTURE

As noted earlier, the final step of our case management-restructuring program, begun in 1996, was taken this year with the opening of the Northeast Case Management Center in East Providence, RI. Previously, case management centers had been opened in Dallas, Atlanta, and Fresno – all with the objective of improving client service and enhancing the case management process by capitalizing on advanced case-handling technology and concentrating the caseload in the hands of a highly trained group of case administrators.

Changes of sweeping importance were made regarding membership in late 2002. At that time, the AAA Board of Directors voted to change the AAA’s bylaws, discontinuing the traditional formal membership. A comprehensive subscription program offering access to the full range of AAA’s award-winning publications and information services is now offered at discounted rates to former members, and all interested parties. The Board took the step of removing member participation in the governance of our organization in order to avoid any potential liabilities to which members might have been exposed.

We also did some organizational fine-tuning by realigning certain senior management responsibilities in the interest of improved service delivery, and – as a matter of good organizational management practice – we began a thorough re-examination of our strategic positioning in the marketplace. This effort involves focused market research that will help us analyze our core value propositions, better understand the profile of our target audiences, and evaluate the effectiveness of our delivery systems and marketing strategy.

THE CALIFORNIA INITIATIVES

Six bills proposing the regulation of consumer arbitration in California were introduced into the California legislature during 2002, and four were signed into law by Governor Gray Davis by the beginning of October. One bill, which might have forced private companies to stop administering consumer cases in the state, was vetoed. That particular piece of legislation would have compelled arbitration providers to disclose possible conflicts of interest that went far beyond accepted legal definitions, and it also provided mechanisms for disqualifying arbitration providers.

The bills signed into law by Gov. Davis require arbitration providers to meet new disclosure requirements that call for compiling and publishing data about the outcomes of cases they handle, the names of non-consumer parties they represent, and the names of and fees charged by their arbitrators. One bill eliminates the “loser pays” clauses in arbitration agreements, and another bars providers from administering cases where they have a financial interest in one of the parties or their attorneys.

When the bulk of this legislation was first introduced, it was in a far harsher form, one that would certainly, if enacted as drafted, have had a chilling effect on the future of consumer and employee arbitration in California. The AAA felt strongly that this attack on arbitration under the guise of “consumer advocacy” had to be met head-on, and we committed both money and resources to an education effort conducted in concert with other individuals – including some of our board members – and organizations that shared our concerns.

Our basic position is that to curtail access to arbitration is to limit the access of many individuals to a fair and just resolution of their claims. The right to a jury trial is increasingly available only to the rich or those with headline-grabbing claims. The plain fact is that surveys by the American Bar Association and the National Center for State Courts suggest that 100 million Americans feel shut out of the legal system because of the high cost of courtroom justice. Arbitration, by comparison, is typically far quicker and far less expensive.

Fortunately, by working with California legislators and the governor's staff, we and other interested parties were able to convince them to soften or remove entirely some of the most restrictive and potentially damaging provisions of these bills. Nonetheless, the legislation that was eventually signed into law will require arbitral organizations administering consumer, non-union employment, and health care arbitration cases to devote significant resources to complying with broad new disclosure requirements. The AAA was in compliance with these new regulations as of January 1, 2003 and posted the required first quarter data on its Web site at the beginning of April, 2003.

LIVING THE VALUES AWARD AND THE HOELLERING FELLOWSHIP

In February 2002, I had the genuine pleasure of announcing via an organization-wide teleconference that the second winner of the President's Award for Living the Values was seven-year staff member John Germani, a Commercial Supervisor in the Southeast Case Management Center in Atlanta. Inaugurated in 2001 as part of the AAA's 75th anniversary celebration, this award is given to the individual who best exemplifies the core values that will help the Association build and achieve its vision for the future. In all, a total of six awards were given out, one for \$10,000 to Mr. Germani and five \$3,000 awards to staff members in New York, Dallas, and Somerset, NJ.

In August, Oliver Connolly, an international lawyer and arbitrator, was named as the 2002-2003 recipient of the Hoellering International Fellowship. The fellowship is awarded annually in honor of Michael F. Hoellering, the former General Counsel of the AAA, to an outstanding member of the profession. It is intended to provide opportunities for exceptional scholars, judges, and legal practitioners from other nations to engage in research on dispute management and resolution. Mr. Connolly is a graduate of Dublin University, Trinity College, who practices law in Ireland, the United States, and the United Kingdom.

The Hoellering Fellow for 2001 was Chen Jian, a vice division chief with the secretariat of the China International Economic and Trade Arbitration Commission in Beijing. Mr. Jian worked in the AAA's New York office for ten months on a comparative study of the arbitration regulations of the United States and the People's Republic of China.

As I noted at the outset, 2002 was not an easy year for any of us, and the AAA was, indeed, fortunate to fare as well as it did from a strictly business and financial perspective in what, for most of the nation, was a sorely troubled economic climate. That aside, 2002 was in most other respects a highly productive period during which this organization once again demonstrated its willingness to change and innovate, and underscored its commitment to long and hard work in its quest to achieve core objectives. Across the organization we were clearly faithful to our mission's objectives: integrity in relationships, innovation (abundantly so), and pursuit of the highest standards of client service achievable in every undertaking. To our Board, staff, and senior management team, I offer heartfelt personal thanks for your committed efforts and remarkable support over the past 12 months.



William K. Slate II
President and Chief Executive Officer

Board of Directors

- José María Abascal, Esq.
- ⁺¹⁺⁺ Howard J. Aibel, Esq.
C. Mark Baker, Esq.
Fulbright & Jaworski L.L.P.
- William B. Baker
*Vice President, Emeritus
University of California*
- George F. Becker
*Former President
United Steelworkers of
America, AFL-CIO, CLC*
- ^{*1**} John Beechey, Esq.
Clifford Chance LLP
- John D. Bond III
- Frank J. Branchini
*President and
Chief Executive Officer
Group Health Incorporated*
- John E. Bulman, Esq.
*Little, Bulman,
Medeiros & Whitney, P.C.*
- Christine W. S. Byrd, Esq.
Irell & Manella LLP
- Joe F. Canterbury, Jr., Esq.
*Canterbury, Stuber, Elder,
Gooch & Surratt, P.C.*
- ^{*1**} James H. Carter, Esq.
Sullivan & Cromwell
- Hon. Gilbert F. Casellas
*President
Casellas & Associates, LLC*
- Louis L. C. Chang, Esq.
*Mediator and Arbitrator
Lou Chang, ALC*
- Zela G. Claiborne, Esq.
Mediator and Arbitrator
- Peter D. Collisson, Esq.
Professional Corporation
- ⁺⁺ Robert Coulson
*Retired, Past President
American Arbitration Association*
- Scott A. Crozier
*Senior Vice President,
General Counsel and Secretary
PETSMART, Inc.*
- Jose M. de Lasa
*Senior Vice President,
Secretary and General Counsel
Abbott Laboratories*
- Edward S. G. Dennis, Jr.
- Roger L. Desjardon
*Chairman, President and
Chief Executive Officer
Prudential Property and
Casualty Insurance Company*
- Mary S. Elcano
*General Counsel and
Corporate Secretary
American Red Cross*
- ⁺¹⁺⁺ John D. Feerick
*Leonard F. Manning
Professorship of Law
Fordham University Law School*
- ^{*1**} Israel J. Floyd
*Secretary and General Counsel
Hercules Incorporated*
- ^{*} Linda K. Foley
*President
The Newspaper Guild-CWA*
- George S. Frazza, Esq.
*Patterson, Belknap,
Webb & Tyler LLP*
- Samuel P. Fried
*Senior Vice President, General
Counsel, and Secretary
Limited Brands, Inc.*
- Paul D. Friedland, Esq.
White & Case LLP
- Robert A. Georgine
*Chairman, President and
Chief Executive Officer
ULLICO Inc.*
- Gilberto Giusti, Esq.
Pinheiro Neto-Advogados
- David R. Haigh, Q.C.
*Burnet, Duckworth &
Palmer LLP*
- C. C. Harness, III
*President
Accord Services*
- Sally A. Harpole, Esq.
Sally Harpole & Co.
- David M. Heilbron, Esq.
Bingham McCutchen, LLP
- Jonathan P. Hiatt
*General Counsel
American Federation of
Labor and Congress of
Industrial Organizations*
- ⁺¹⁺⁺ Norman M. Hinerfeld
*Chairman and
Chief Executive Officer
The Delta Group*
- Kay H. Hodge, Esq.
*Stoneman, Chandler &
Miller LLP*
- Professor James R. Holbrook
*S.J. Quinney College of Law
University of Utah*
- ^{*} Bud Geo. Holman, Esq.
Kelley Drye & Warren LLP
- ⁺¹⁺⁺ Hon. Howard M. Holtzmann
- Judith Richards Hope, Esq.
*Paul, Hastings,
Janofsky & Walker, LLP*
- William K. Hoskins
*Managing Partner
Resolution Counsel, LLP*
- Jane Howard-Martin
*Assistant General Counsel,
Labor & Employment
Transportation & Power Systems
Honeywell*
- ^{*1**} Jerry M. Hunter, Esq.
Bryan Cave LLP
- Lisa G. Iglesias
*General Counsel,
Vice President and Secretary
Spherion Corporation*
- ^{**} James R. Jenkins
*Senior Vice President
and General Counsel
Deere & Company*
- ^{*1**} Richard K. Jeydel
*Senior Vice President,
Secretary and General Counsel
Kanematsu USA Inc.*

Board of Directors

- ^{***} Joia M. Johnson
*Executive Vice President
and General Counsel
RARE Hospitality
International, Inc.*
- John J. Kerr, Jr., Esq.
Simpson Thacher & Bartlett
- Jeffrey B. Kindler
*Senior Vice President
and General Counsel
Pfizer Inc.*
- Olivia F. Kirtley, CPA
*Chair of the Board –
AICPA Board of Examiners
American Institute of
Certified Public Accountants*
- ^{**} Edward V. Lahey, Jr.
*General Counsel
Essex Boat Works, Inc.*
- ^{**} Carolyn B. Lamm, Esq.
White & Case LLP
- L. Gene Lemon, Esq.
- Frankie F. L. Leung, Esq.
Professor of Law
- ^{**} L. G. Lewis, Jr.
*Chairman
H2L Consulting Engineers*
- Sanford M. Litvack Esq.
*Quinn Emanuel Urquhart
Oliver & Hedges, LLP*
- ⁺⁺⁺ Richard S. Lombard, Esq.
- Carlos E. Loumiet, Esq.
Hunton & Williams LLP
- ⁺⁺ Vincent J. Love, CPA
Kramer Love & Cutler, LLP
- ⁺⁺⁺ E. Nobles Lowe, Esq.
- William B. Lytton
*Executive Vice President
and General Counsel
Tyco International Ltd.*
- ^{**} Lewis Maltby
*President
National Workrights Institute*
- Siri S. Marshall
*Senior Vice President,
Corporate Affairs,
General Counsel and Secretary
General Mills*
- LaBrena Jones Martin
*Managing Director and
General Counsel
RBC Capital Markets*
- Kenneth R. Masterson
*Executive Vice President,
General Counsel and Secretary
FedEx Corporation*
- Maud Mater
*Executive Vice President,
General Counsel & Secretary
Freddie Mac*
- Dr. Robert H. McGuckin, III
*Director of Economic Research
The Conference Board*
- Hon. Vincent L. McKusick
Pierce Atwood
- Anne H. McNamara
*Senior Vice President and
General Counsel (Retired)
American Airlines, Inc. and
AMR Corp.*
- Paul S. Miller, Esq.
Kaye Scholer LLP
- ^{*} Charles R. Morgan
*Executive Vice President
and General Counsel
BellSouth Corporation*
- ^{*} Sara E. Moss, Esq.
- Richard E. Mulroy, Esq.
- Angel Muñoz-Noya, Esq.
Lespier, Muñoz-Noya & Rivera
- Betty Southard Murphy, Esq.
Baker & Hostetler
- James J. Myers, Esq.
Gadsby Hannah LLP
- Lawrence O'Donnell, III
*Executive Vice President –
Operations Support and
Chief Administrative Officer
Waste Management, Inc.*
- Martin J. Oppenheimer, Esq.
Proskauer Rose LLP
- Carlos G. Ortiz
*General Counsel
Goya Foods, Inc.*
- ^{***} Richard W. Page, Esq.
The Page Firm
- ^{*} Dr. Joan Parker
*Employment and Labor
Arbitrator and Mediator*
- Deval L. Patrick
*Executive Vice President,
General Counsel & Secretary
The Coca-Cola Company*
- Bennett G. Picker, Esq.
*Stradley Ronon
Stevens & Young, LLP*
- Dr. Alejandro Ponieman
*Presidente
Asociacion Interamericana
de Mediacion*
- Roberta Cooper Ramo, Esq.
*Modrall, Sperling, Roehl,
Harris & Sisk, P.A.*
- Lucy Reed, Esq.
*Freshfields Bruckhaus
Deringer LLP*
- ^{**} Hon. Janet Reno
- Dennis Rivera
*President
1199 SEIU New York's
Health & Human Service Union,
AFL-CIO*
- Carlos M. Rivera-Vicente, Esq.
Cancio, Nadal, Rivera & Diaz
- David W. Rivkin, Esq.
Debevoise & Plimpton
- C. Kenneth Roberts, Esq.
- Norman L. Roberts
*Managing Director
HRD Management Company L.L.C.*
- Barbara Paul Robinson, Esq.
Debevoise & Plimpton

Board of Directors

- Juan Rodriguez, Esq.
Sullivan & Cromwell LLP
- *^{***} Mark A. Roesler, Esq.
*Chairman and
Chief Executive Officer
CMG Worldwide, Inc.*
- E. Mabry Rogers, Esq.
Bradley Arant Rose & White LLP
- Hon. Thomasina V. Rogers
*Commissioner
U.S. Occupational Safety and
Health Review Commission*
- Landon H. Rowland
*Chairman
Janus Capital Group, Inc.*
- Stevan A. Sandberg
*President
Staubach Advisory Services*
- *^{***} Diane Kosmach Schumacher
*Senior Vice President,
General Counsel and
Chief Compliance Officer
Cooper Industries, Inc.*
- ** Dr. Siegfried Schwung
*Vice President,
General Counsel Product
DaimlerChrysler AG*
- John Scriven
*Senior Vice President,
General Counsel and
Secretary to the Board
ABB Ltd.*
- Jerome J. Shestack, Esq.
*Wolf, Block, Schorr and
Solis-Cohen LLP*
- Charlie Silvestri, Esq.
- Marsha E. Simms, Esq.
Weil, Gotshal & Manges LLP
- *^{***} William K. Slate II
*President and
Chief Executive Officer
American Arbitration Association*
- Janet Maleson Spencer, Esq.
*Labor and Employment
Arbitrator and Mediator*
- Delbert L. Spurlock, Jr.
*Executive Vice President
and Associate Publisher
New York Daily News*
- Theodore J. St. Antoine
*James E. and Sarah A. Degan
Professor Emeritus of Law
University of Michigan Law School*
- ** Donald B. Straus
*Retired, Past President
American Arbitration Association*
- Michael P. Sullivan
*Chairman of the Board (Retired)
International Dairy Queen, Inc.*
- Timothy J. Sullivan
*President
The College of William
and Mary in Virginia*
- Peter D. Sutherland
*Chairman
Goldman Sachs International*
- *^{***} Hon. John Charles Thomas
Hunton & Williams
- *^{***} John M. Townsend, Esq.
Hughes Hubbard & Reed LLP
- Richard L. Trumka
*Secretary-Treasurer
American Federation of
Labor and Congress of
Industrial Organizations*
- M. Caroline Turner
*Senior Vice President,
General Counsel (Retired)
Coors Brewing Company*
- Howard D. Venzie, Jr., Esq.
Venzie, Phillips & Warshawer, P.C.
- Richard S. Ward, Esq.
- ** Hon. William H. Webster
*Milbank, Tweed,
Hadley & McCloy LLP*
- * Judith C. Whittaker
*Executive Vice-President
and General Counsel
Hallmark Cards, Incorporated*
- Donald E. Wightman
*National President
Utility Workers Union of America,
AFL-CIO*
- Michael S. Wilder, Esq.
- *^{***} J. Warren Wood, III
*Vice President,
General Counsel and Secretary
The Robert Wood
Johnson Foundation*
- * Max Zimny, Esq.
Arbitrator and Mediator

* Member of the 2001–2002
Executive Committee

** Proposed Member
of the 2002–2003
Executive Committee

+ Past Chairman of the Board

** Honorary Member of the
Executive Committee

Board Nominees

David R. Andrews
*Senior Vice President for Government
Affairs, General Counsel and Secretary
PepsiCo, Inc.*

Hon. Louis C. Bechtle
Conrad O'Brien Gellman & Rohn, P.C.

Fred G. Bennett, Esq.
*Quinn Emanuel Urquhart
Oliver & Hedges, LLP*

Richard T. Bennett, Esq.
Bennett Lotterhos Sulser & Wilson, P.A.

Christian Bouckaert, Esq.
Norton Rose

Bill L. Bryant, Jr.
*Katz, Kutter,
Alderman & Bryant, P.A.*

Laura Campbell
*Associate General Counsel
International Union,
United Auto Workers*

Hon. Richard J. Goldstone
*Justice
Constitutional Court of South Africa*

Charles A. James
*Vice President and General Counsel
ChevronTexaco Corporation*

Charisse R. Lillie, Esq.
*Ballard Spahr
Andrews & Ingersoll, LLP*

Joseph M. Matthews, Esq.
*Law Firm of Colson Hicks Eidson
Joseph M. Matthews, P.A.*

Hon. Gabrielle Kirk McDonald

William H. Neukom, Esq.
Preston Gates & Ellis, LLP

Dr. Claus von Wobeser
Von Wobeser y Sierra, S.C.

Executive Committee Nominees

James R. Jenkins
*Senior Vice President
and General Counsel
Deere & Company*

Carolyn B. Lamm, Esq.
White & Case LLP

L. G. Lewis, Jr.
*Chairman
H2L Consulting Engineers*

Lewis Maltby
*President
National Workrights Institute*

Hon. Janet Reno

Dr. Siegfried Schwung
*Vice President,
General Counsel Product
DaimlerChrysler AG*

Hon. William H. Webster
*Milbank, Tweed,
Hadley & McCloy LLP*

Officers & Executive Staff

Edward V. Lahey, Jr.
General Counsel
Essex Boat Works, Inc.
Chairman of the
Board of Directors

James H. Carter, Esq.
Sullivan & Cromwell
Chairman of the Executive
Committee of the Board of Directors

William K. Slate II
President and
Chief Executive Officer

John C. Emmert, Jr.
Executive Vice President
and Chief Operating Officer

Jennifer J. Coffman
Corporate Secretary

Florence M. Peterson
General Counsel

Francesco Rossi
Senior Vice President,
Chief Financial Officer
and Treasurer

Mark E. Appel
Senior Vice President

Roy M. Arbeit
Senior Vice President

India Johnson
Senior Vice President

Robert E. Meade
Senior Vice President

Richard W. Naimark
Senior Vice President, AAA
and Executive Director
Global Center for
Dispute Resolution Research

Christine L. Newhall
Senior Vice President

Fern Schair
Senior Vice President

Diane Abegglen
Vice President –
Neutrals Relations

Steven Andersen
Vice President –
International Development

Neil Carmichael
Vice President –
Curriculum Development

Kenneth Egger
Vice President –
Elections

Christopher Heelan
Vice President –
Finance and Controller

Harry Kaminsky
Vice President –
Neutrals Services

Karin B. Kimtis
Vice President –
Marketing

Debi Miller-Moore
Vice President –
eCommerce Services

Kersten Norlin
Vice President –
Corporate Communications

Ted Pons
Vice President –
Publications

Morag Rollins
Vice President –
Human Resources

Gene Truncellito
Vice President –
Staff Education
and Development

Eric Tuchmann
Associate General Counsel

Joseph Williams
Vice President –
Information Services

Jeffrey Zaino
Vice President –
Elections

Frank T. Zotto
Vice President –
Case Management

Independent Auditors' Report

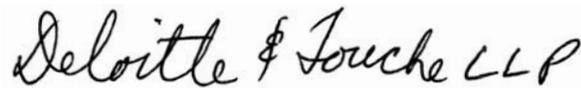
TO THE BOARD OF DIRECTORS
OF AMERICAN ARBITRATION ASSOCIATION, INC.

We have audited the accompanying balance sheets of American Arbitration Association, Inc. (the "Association") as of December 31, 2002 and 2001, and the related statements of operations and changes in net assets and of 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 financial statements referred to above present fairly, in all material respects, the financial position of the Association as of December 31, 2002 and 2001, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

14

A handwritten signature in black ink that reads "Deloitte & Touche LLP". The signature is written in a cursive, flowing style.

March 14, 2003

BALANCE SHEETS
DECEMBER 31, 2002 AND 2001

	2002	2001
ASSETS		
Cash and Cash Equivalents	\$ 1,098,000	\$ 3,806,000
Investments – At fair value (Note 2)	48,729,000	57,215,000
Administration Fees Receivable Less allowances for cancellations and uncollectible accounts of \$1,538,000 in 2002 and 2001	27,940,000	18,178,000
Other Receivables (Note 5)	988,000	575,000
Prepaid Expenses and Other Assets (Notes 5 & 6)	3,563,000	3,574,000
Deferred Pension Costs (Note 4)	1,081,000	1,264,000
Furnishings, Equipment and Leasehold Improvements – Net (Note 5)	17,613,000	17,166,000
Total Assets	<u>\$ 101,012,000</u>	<u>\$ 101,778,000</u>
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable and accrued expenses	\$ 58,032,000	\$ 51,334,000
Accrued postretirement medical costs (Note 4)	8,026,000	7,480,000
Accrued pension liability (Note 4)	11,659,000	6,347,000
Deferred revenue	3,069,000	2,836,000
Total Liabilities	80,786,000	67,997,000
COMMITMENTS AND CONTINGENCIES (NOTE 3)	–	–
UNRESTRICTED NET ASSETS	20,226,000	33,781,000
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 101,012,000</u>	<u>\$ 101,778,000</u>

See notes to financial statements.

STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
YEARS ENDED DECEMBER 31, 2002 AND 2001

	2002	2001
OPERATING REVENUES		
Administration fees earned:		
Commercial	\$ 45,657,000	\$ 47,309,000
Accident:		
Uninsured motorist	2,033,000	1,573,000
No-Fault	24,718,000	22,150,000
Labor	5,135,000	4,896,000
Elections	2,554,000	3,695,000
Total administrative fees earned	80,097,000	79,623,000
Publications and education	2,632,000	1,631,000
Membership dues	1,209,000	1,854,000
Total operating revenue	83,938,000	83,108,000
EXPENSES		
Administration of tribunals	72,525,000	76,285,000
Elections	2,337,000	3,350,000
Publications and education	4,440,000	3,781,000
Membership	468,000	543,000
Contribution expense (Note 7)	827,000	602,000
General and administration	4,197,000	4,153,000
Total operating expenses	84,794,000	88,714,000
OPERATING LOSS	(856,000)	(5,606,000)
NON OPERATING REVENUES AND EXPENSES		
Interest and dividends on investments –		
Net of Fees (Note 2)	1,223,000	1,393,000
Net (loss) gain on sales of investments	(9,603,000)	1,042,000
Unrealized investment gain (loss)	1,928,000	(1,275,000)
Loss on disposal of assets	(15,000)	(173,000)
CHANGE IN NET ASSETS	(7,323,000)	(4,619,000)
UNRESTRICTED NET ASSETS, BEGINNING OF YEAR	33,781,000	41,382,000
MINIMUM PENSION LIABILITY		
ADJUSTMENT (NOTE 4)	(6,232,000)	(2,982,000)
UNRESTRICTED NET ASSETS, END OF YEAR	\$ 20,226,000	\$ 33,781,000

STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2002 AND 2001

	2002	2001
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ (7,323,000)	\$ (4,619,000)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization – net	3,478,000	3,153,000
Net loss (gain) on sales of investments	9,603,000	(1,042,000)
Postretirement benefits other than pensions	546,000	531,000
Unrealized investment (gain) loss	(1,928,000)	1,275,000
Loss on the disposal of assets	15,000	173,000
Changes in operating assets and liabilities:		
(Increase) decrease in administration fees receivable	(9,762,000)	102,000
(Increase) decrease in other receivables	(413,000)	324,000
Decrease in prepaid expenses and other assets	374,000	6,020,000
Increase in accounts payable and accrued expenses	6,716,000	3,047,000
(Decrease) increase in minimum pension liability	(737,000)	948,000
Increase in deferred revenue	233,000	2,222,000
Net cash provided by operating activities	802,000	12,134,000
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of furnishings, equipment and leasehold improvements	(3,857,000)	(4,361,000)
Proceeds from sales of investments	142,217,000	105,275,000
Purchase of investments	(141,406,000)	(105,201,000)
In-progress construction	(446,000)	(5,981,000)
Net cash used in investing activities	(3,492,000)	(10,268,000)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal payments on capital lease	(18,000)	(79,000)
Net cash used in financing activities	(18,000)	(79,000)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(2,708,000)	1,787,000
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	3,806,000	2,019,000
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 1,098,000	\$ 3,806,000

See notes to financial statements.

Notes to Financial Statements

Years Ended December 31, 2002 and 2001

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

ADRWorld.com, a Delaware limited liability company (LLC), delivers via the internet, ADR news research and industry information. Operating results of ADRWorld.com are included in the financial statements.

The Global Center for Dispute Resolution Research (GCDRR), a research organization dedicated to exploring the effectiveness and enhancing the utility of business dispute resolution methods throughout the world, is affiliated with the American Arbitration Association. The GCDRR has its own Board of Directors and receives its funding from the Association.

Administration Fees The Association bills a nonrefundable initial filing fee at the commencement of the dispute resolution process, and then bills a case service fee 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.

Revenues are recognized as the nonrefundable initial and administrative filing fees are billed. Case service fee revenues are deferred until a hearing has occurred.

At December 31, 2002 and 2001 the amounts deferred were \$2,725,000 and \$2,228,000, respectively.

The Association collects amounts in advance for unearned arbitrators' compensation, which are included in accounts payable.

Membership Dues Membership dues are recognized upon receipt from the member. As of January 1, 2002, the membership dues structure was amended. In accordance with the new structure, all members including individual, corporate and firm members, paid a standard fee of \$250. On December 20, 2002, the Association's Board of Directors amended the by-laws to eliminate the reference to members in its governing documents. As such, the Association is no longer a membership organization.

Contributions The Association contributes money on a daily basis to fund expenses incurred by GCDRR. In 2002 and 2001, such contributions were \$827,000 and \$602,000, respectively.

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

Investments Investments are reported at fair value. Cash equivalents included in investments are held for investment purposes. Realized gains and losses are determined on a first-in, first-out basis. Changes in unrealized investment gains or losses are reported in the statement of operations and changes in net assets.

Goodwill Goodwill, included in prepaid expenses and other assets, is reported net of accumulated amortization. The amount amortized on a monthly basis is determined by the estimated useful life of the asset on a straight-line basis, in accordance with Accounting Principles Board Opinion No. 17, "Intangible Assets." Goodwill is presently being amortized over a period of five years.

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

Capitalization of Software The Association capitalizes expenses incurred for the development of software for internal use in accordance with Statement of Position No. 98-1 "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use."

Impairment of long-lived assets In accordance with Statement of Financial Accounting Standards (SFAS) No. 121 "Accounting for the Impairment of Long-Lived Assets," of the FASB, management reviews long-lived assets and certain identifiable intangible assets whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. In the event that an impairment occurs, the fair value of the related asset is estimated, and the Association records a charge to the change in net assets calculated by comparing goodwill's carrying value to the estimated fair value. FASB statement No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets," which defines an impairment as the condition that exists when the carrying amount of a long-lived asset is not recoverable and exceeds its fair value is effective for financial statements issued for fiscal years beginning after December 31, 2001. This statement is applicable to furnishings, equipment and leasehold improvements but not to goodwill which is accounted for in accordance with SFAS No. 121.

Use of Estimates The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts of assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Tax Status The Association 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 financial statements.

Reclassification The 2001 financial statements have been reclassified to conform to the 2002 presentation.

2. INVESTMENTS

In 2002, the structure of the investment portfolio changed. Previously, the Association utilized an active management philosophy for the portfolio. During 2002 the strategy was changed to passive management utilizing mutual funds.

Investments at December 31, 2002 and 2001 consist of the following:

	2002		2001	
	Cost	Fair Value	Cost	Fair Value
Domestic				
Equity Securities	\$ -	\$ -	\$ 33,166,000	\$ 32,129,000
Government and				
Agency Bonds	-	-	14,205,000	14,245,000
Corporate Bonds	-	-	6,119,000	6,289,000
Short-term Investments	-	-	4,552,000	4,552,000
Interm. Duration				
Bond Fund	35,722,000	36,849,000	-	-
Total Stock Market				
Index Fund	12,058,000	11,880,000	-	-
	\$ 47,780,000	\$ 48,729,000	\$ 58,042,000	\$ 57,215,000

20

Fair values for government and corporate bonds include accrued interest receivable at December 31, 2001 of \$154,000. There were no direct investments in government and corporate bonds at December 31, 2002.

At December 31, 2001, the Association recorded as Government and Agency bonds "TBA" contracts worth \$5,024,000. The Association's portfolio does not include TBA contracts at December 31, 2002.

Interest and dividends on investments are reported net of investment fees of \$610,000 and \$550,000 at December 31, 2002 and 2001 respectively.

3. COMMITMENTS AND CONTINGENCIES

The Association conducts all of its activities from leased office space and is currently a party to various leases that expire between 2003 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, 2002 and 2001 amounted to \$12,336,000 and \$12,315,000, respectively. In addition, the Association leases certain office furniture and computer equipment under various operating leases, all of which expire over the next one to three years.

Net minimum noncancelable lease commitments for office facilities, equipment and software, exclusive of any future escalation charges, are summarized below:

YEARS, ENDING DECEMBER 31,	
2003	\$ 11,245,000
2004	10,433,000
2005	9,308,000
2006	8,777,000
2007	7,877,000
Thereafter	36,776,000
	<u>\$ 84,416,000</u>

Obligations under a capital lease totaled \$18,000 at December 31, 2001 and were included in accounts payable. There were no capital lease obligations at December 31, 2002.

The Association is a defendant in certain lawsuits arising in the ordinary course of operations. 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 financial position.

In 1997, the Association entered into a five year letter of credit agreement totaling \$1,065,000 in 2002 and \$1,420,000 in 2001 in accordance with the terms of the agreement. This agreement guarantees an operating lease rental obligation and is secured by the investment portfolio.

21

4. PENSION AND OTHER POSTRETIREMENT BENEFITS PLANS

The Association maintains a noncontributory, qualified defined benefit pension plan covering all eligible employees. The Association makes contributions to the plan based on actuarial calculations.

As of January 1, 2001, the Association amended the plan, eliminating the plan-participant required contribution. As a result, all eligible employees become members of the plan.

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.

As of February 2003, the Association decided to take action to minimize retiree health care benefit costs. Although a plan of action and implementation date have not been finalized, it is anticipated that benefit accrual formulae will be modified and that this will reduce future Association liabilities and costs related to the retiree plan.

The following tables set forth each plan's funded status and amounts recognized in the Association's financial statements at December 31, 2002 and 2001:

	PENSION BENEFITS		OTHER BENEFITS	
	2002	2001	2002	2001
Benefit obligation at December 31	\$ 31,177,000	\$ 27,339,000	\$ 8,326,000	\$ 7,430,000
Fair value of plan assets at December 31	17,105,000	18,851,000	–	–
Funded status	\$ (14,072,000)	(8,488,000)	(8,326,000)	(7,430,000)
Accrued benefit cost recognized in the balance sheets	\$ (11,659,000)	\$ (6,347,000)	\$ (8,026,000)	\$ (7,480,000)
Weighted-average assumption as of December 31				
Discount rate	6.50%	7.25%	6.50%	7.25%
Expected return on plan assets	7.50%	8.50%	n/a	n/a
Rate of compensation increase	5.80%	5.80%	n/a	n/a

For measurement purposes, a 9.75% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2002. The rate was assumed to decrease gradually to 4.5% for 2009 and remain at that level thereafter.

	PENSION BENEFITS		OTHER BENEFITS	
	2002	2001	2002	2001
Benefit cost	\$ 1,833,000	\$ 1,243,000	\$ 914,000	\$ 855,000
Employer's contribution	2,570,000	296,000	368,000	324,000
Plan participants' contributions	–	14,000	12,000	6,000
Benefits paid	2,415,000	2,192,000	380,000	330,000

The pension plan provides benefits 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 on January 1, 1997, and (b) for each year of benefit accrual service credited after January 1, 1997, 1.75% of earnings as in effect on January 1 of such year.

The provisions of Financial Accounting Standards Board Statement No. 87, "Employers' Accounting for Pensions," require the Association to recognize a minimum pension liability relating to certain unfunded obligations, establish an intangible asset relating thereto, and reduce net assets. At year-end, this minimum pension liability is remeasured as required by the Statement. As a result, at December 31, 2002 and 2001, the Association's additional minimum liability was \$10,559,000 and \$4,509,000, respectively. The related intangible asset was \$1,081,000 and \$1,264,000, respectively. Net assets were adjusted by \$6,232,000 and \$2,982,000 for 2002 and 2001, respectively, to reflect the net change in the additional minimum liability offset by the net change in the related intangible asset. The Association recognized an accrued pension liability in 2002 and 2001 of \$11,659,000 and \$6,347,000, respectively, which in 2002 is related to the accrued benefit cost of \$1,100,000 and an additional minimum liability of \$10,559,000.

5. FURNISHINGS, EQUIPMENT AND LEASEHOLD IMPROVEMENTS

Furnishings, equipment and leasehold improvements as of December 31, 2002 and 2001 were as follows:

	2002	2001
Furnishings and equipment	\$ 18,207,000	\$ 16,878,000
Leasehold improvements	12,362,000	10,079,000
	30,569,000	26,957,000
Less accumulated depreciation and amortization	12,956,000	9,791,000
	<u>\$ 17,613,000</u>	<u>\$ 17,166,000</u>

23

In 2002 and 2001, the cost of leasehold improvements has been reduced by \$670,000 and \$260,000, respectively, due from landlords for reimbursement of construction costs. The amounts due are included in other receivables.

In 2002 and 2001, the Association recognized a loss of approximately \$15,000 and \$173,000 relating to the disposal of certain assets with original costs totaling \$244,000 and \$971,000, respectively.

Also included in furnishings and equipment are costs associated with the development of software for internal use of \$4,907,000 for both years and \$1,483,000 and \$525,000 of accumulated amortization for 2002 and 2001, respectively.

Included in prepaid expense are in-progress construction costs for leased facilities of \$446,000 and \$1,076,000 for 2002 and 2001, respectively. When placed into service, these in-progress construction costs will be included in capital assets and amortized over their estimated useful lives.

6. ACQUISITION

On December 7, 2000, the Association purchased ADRWorld.com (ADRW), a Delaware Limited Liability Company. ADRW delivers via the internet ADR news, research and industry information to individuals, companies, and institutions around the world. The acquisition price included cash of \$153,000 and the issuance of notes payable totaling \$280,000 to an original investor which were payable over one year at 6%. The note was paid in 2001. The acquisition was recorded in accordance with the purchase method of accounting and, accordingly, the purchase price has been allocated to the assets acquired and liabilities assumed based on estimated fair values. Goodwill of \$428,000 is being amortized over five years on a straight-line basis. The purchase agreement includes additional consideration contingent on future earnings. Operating results of ADRW since the date of acquisition are included in the financial statements. Amortization expense was \$86,000 in 2002 and 2001. Accumulated amortization totaled \$177,000 and \$91,000 at December 31, 2002 and 2001 respectively.

7. GLOBAL CENTER FOR DISPUTE RESOLUTION RESEARCH

In the ordinary course of business, the Association has made contributions to the Global Center for Dispute Resolution Research (GCDRR). These contributions, which are used to fund expenses incurred by the GCDRR, reflect an economic interest by the Association. Since the Association maintains only a minority voting interest on the GCDRR's Board of Directors, the Association does not have direct control over how the GCDRR operates or derives contributions from other members. In accordance with Statement of Position 94-3, "Reporting of Related Entities by Not-for-Profit Organizations," the Association reports these contributions on the statement of operations and changes in net assets.

In 1998, the Association's Board of Directors approved the funding of up to \$6,250,000 over a period of five years. These contributions are not guaranteed by the Association, but are approved on an annual basis. For the years ended December 31, 2002 and 2001, amounts contributed to GCDRR totaled \$827,000 and \$602,000, respectively and have aggregated \$1,893,000 to December 31, 2002.



American Arbitration Association
Dispute Resolution Services Worldwide