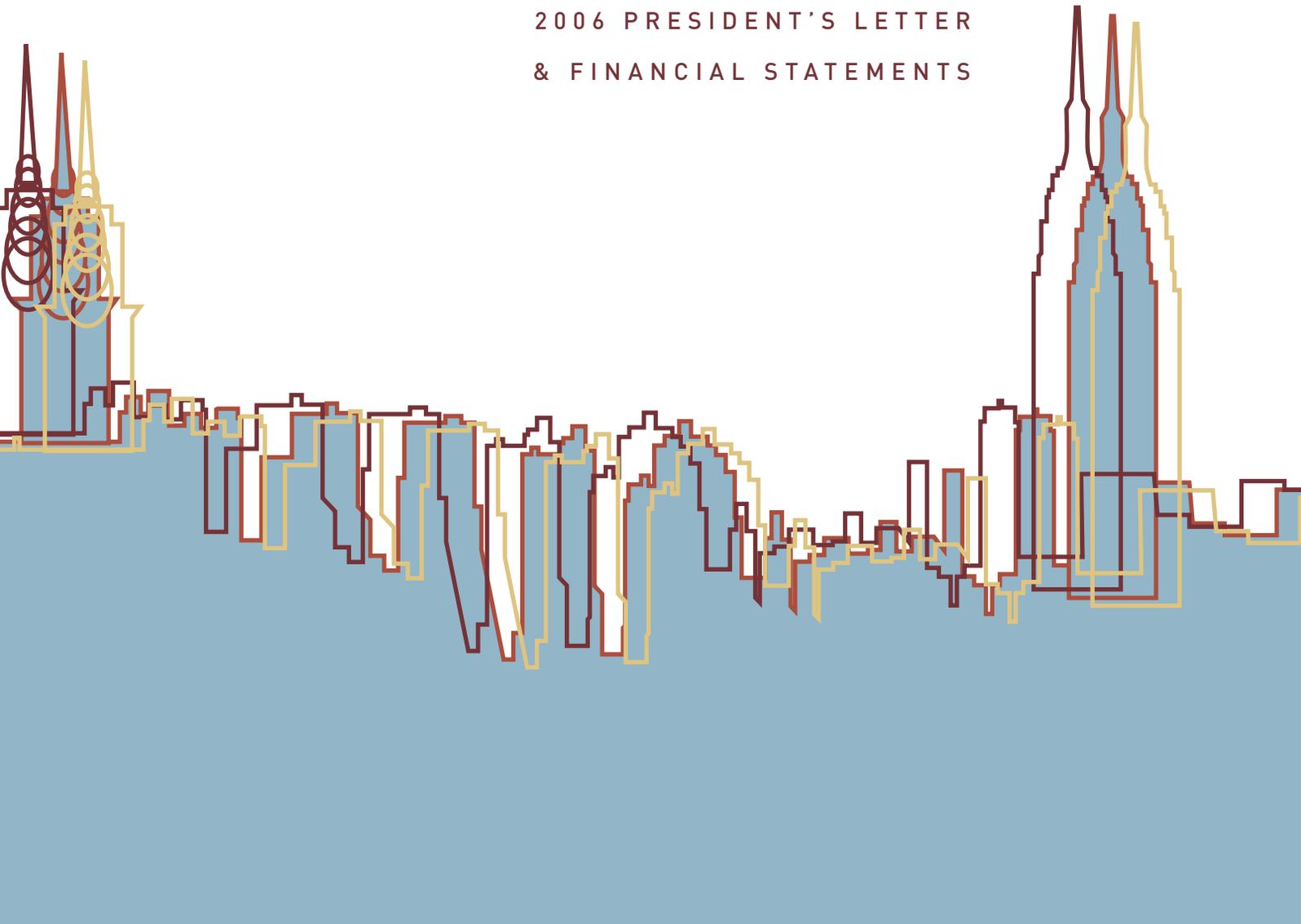




American Arbitration Association

Dispute Resolution Services Worldwide

2006 PRESIDENT'S LETTER
& FINANCIAL STATEMENTS





American Arbitration Association

Dispute Resolution Services Worldwide

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, a diverse Board, and commit to respect and increase diversity in all our endeavors.

“FOR THE AAA, 2006 WAS A TIME OF RECOMMITMENT TO THE PROMISE OF ADR AND TO RESPONDING TO THE CHANGING NEEDS OF OUR CUSTOMERS, ALL THE WHILE REMAINING FAITHFUL TO OUR MISSION AND OUR ETHICAL COMPASS.” – William K. Slate II

2006 PRESIDENT’S LETTER

In today’s economic climate, even the most altruistic, not-for-profit service organizations—the American Arbitration Association® (AAA) among them—are not immune to market challenges. It has become crucial for these organizations to consider changes in their constituency of users as well as their own competitive positions relative to similar organizations in their field.

Users of AAA alternative dispute resolution (ADR) services have increasingly demanded to be treated like the paying consumers that they are, with options for ADR service delivery. In 2006, we took a page from the business books, borrowing selected strategic approaches to respond to these market challenges—but only in a way that did not and will not compromise our integrity or our services.

In 2006, we marked our 80th year, recognizing and responding to the inherent issues faced by many successful organizations in the mature stages of their business life-cycles, when any company (not-for-profit or otherwise) must reassess and reconfirm that it continues to meet the needs of its customers, keeping step with advancements and other changes in the marketplace and identifying new opportunities for service expansion.

The AAA is the leading provider of ADR services in the world. As is the experience of other “first-to-market” businesses, this has provided newer organizations with the opportunity to observe, and reap the benefit of, our groundbreaking efforts. Our position as the leader in an increasingly competitive field makes it even more important to close any gap between what our users—our customers—need and what we offer.

And so, in 2006, in the midst of growing our case load and creating new service models, we took stock of the business we have built, assuring our position to further ADR’s principles of fairness, speed and economy and to preserve the customers’ right to an alternative to traditional litigation. Our goal remains providing ADR users not only with a consistent method to pursue justice but also with recourse and support should they experience any problems in their dispute resolution processes. Recognizing that our customers have a choice among providers, our charge is to be their preferred option.

In 2006, we listened to our customers, responded quickly and responded well.

Many of the same economic forces that pervade businesses worldwide propel the plans of the AAA as well—in particular, the ongoing shift in power to the customer. 2006 was, for the AAA, a year of outreach to users, of turning feedback from in-depth user surveys into customer-focused initiatives and of extending the use of ADR into new areas.

Technology has changed the way companies do business, and the AAA is no exception. The Internet is no longer simply an information highway; it is a destination as well. With a complete redesign of our website, we have incorporated technological advances and enhanced information exchange in order to provide better service to inquirers and users.

In 2006, in the face of added pressure from courtroom-style approaches to conflict management, which challenged our core benefits, we reaffirmed our conviction that ADR is still the fastest, most cost-effective process for dispute resolution and reinvigorated our own operational efficiency efforts. Revenues and case filings grew in 2006, and initiatives undertaken in the following areas are beginning to already bear fruit in 2007.

CUSTOMER-FOCUSED ARBITRATION AND MEDIATION SERVICES

In 2006, we took our service-enhancement initiative to the next level, building on the strong foundation laid in previous years to identify and to create the services that our customers need and want.

Over the last five years, we have committed to improving our arbitration and mediation services—through the completion of the case management service center model—and introducing new services and products in response to customer needs. Implementation of the Business Action Plan a few short years ago led to the recognition of more opportunities to keep pace with the needs of our customers.

Listening to the Voice of the Customer. In 2006, the AAA completed “Voice of the Customer” (VOC) research, probing AAA case filers in an intensive study of customer attitudes toward services they received. Feedback revealed that recent AAA service improvements resonated with users, although it also identified a new urgency that ADR remains an efficient and cost-effective alternative to litigation. The AAA responded by devising pricing and service modifications to give the customer more flexibility. An alternative pricing structure to the regular commercial filing fee schedule will be tested in 2007, followed by a test program offering customers the opportunity to select and pay for the level of AAA administration they want for an individual case.

Refining Mediation Services. In 2006, the AAA’s mediation business increased 14% over 2005, primarily in the construction, commercial and employment areas, reflecting the AAA’s participation in the growing trend to use mediation to resolve certain disputes. Over the past year, we continued to refine our mediation services through initiatives that focused on the quality of the AAA’s Panel of Mediators and the needs of the mediation end-user, our customer. Our response included providing the option of staff mediators with immediate availability at a reduced fee as well as a highly trained conciliation staff that in 2006 reached an increasingly high percentage of settlement.

A full-scale review of the Panel of Mediators was completed in early June, paring the panel by approximately 300 mediators to a leaner, all-stellar array. Plans for an enhanced online mediator database searchable by specific criteria—such as number of years as a mediator, number of cases mediated and hourly mediation rate—will be realized shortly.

Utilizing advances in technology. Advanced technology enabled operational efficiencies: customer communications, including billing and case-related correspondence were streamlined, enabling AAA employees to respond more quickly to customers. Online services were expanded to provide a 24/7 approach to ADR for both our customers and our neutrals. Additional enhancements in case-management services continued, and their positive impact will be apparent.

Enhancing neutrals training. Recognizing the potential of the neutral on an individual case to foster great savings in time and cost to the parties, the AAA imposes stringent training and continuing education requirements on panel members. In 2006, the core arbitrator training workshops were refined to offer new arbitrators even more intense preparation in the wide range of issues frequently encountered by arbitrators serving on AAA cases. The result, *Arbitration Fundamentals & Best Practices for New AAA Arbitrators*, is a three-part program required for all new arbitrators on domestic commercial, construction and employment panels.

Constantly attending to the rules. Because of the AAA's leadership position, any changes to the rules governing dispute resolution procedures have a significant impact on the ADR world. The AAA takes this responsibility seriously, refining its rules in accordance with legal developments to keep the ADR process as current and customer-friendly as possible.

Significant changes in 2006 were made to the *Employment Arbitration Rules and Mediation Procedures*, *International Dispute Resolution Procedures* and *Resolution of Patent Dispute Supplementary Procedures*. For example, in our employment and international rules, provisions for the availability of interim measures of relief were included in response to expressed needs of our customers. The patent procedures established a framework for preliminary hearings and scheduling orders while encouraging expedited time frames for the resolution of patent disputes.

INTENSIFIED CUSTOMER COMMUNICATION AND EDUCATION

In 2006, we spoke directly to our customers with a new emphasis on a venerable message—unequivocally stating our belief that ADR remains the best choice for effective conflict resolution and underscoring the importance of information exchange and education, here and abroad.

We understand that the best way to encourage more usage of ADR by our current customers is to provide an increasingly better user experience. Furthermore, we appreciate that to procure new users of ADR, it is imperative to educate the public in the benefits of using alternative methods of conflict management to litigation. To those ends, based on information culled from customer research, many improvements and considerable expansion of service were undertaken in 2006, as well as new education programs and publications and an increased Internet presence.

Revamping the AAA website. The complete redesign of www.adr.org not only put a more accessible face on the AAA, it created a much more dynamic multiple-use tool for, among others, case filing, research, education and publications purchase. More substantive content and easier navigability have enhanced the way that customers interact with the AAA.

Expanding education and training programs. Nationwide AAA educational programs are geared to educating the public about the advantages of using ADR to resolve disputes in general and the benefits of working with the AAA in particular. In 2006, a series of new labor-advocacy education programs were introduced in four markets with seven programs planned in 2007.

The AAA coordinated a construction roundtable to discuss leading practices in construction ADR, the substance of which will be featured in an upcoming *Dispute Resolution Journal*. In addition, efforts in 2006 resulted in a successful March 2007 program, *The Construction Mediation Conference: What You Can't Not Know*, in Miami. These national programs, along with countless programs presented at law firms, corporate legal departments, bar associations and other organizations enabled us to connect with our current and potential customers around the country.

In a major contribution to the literature of ADR education, in 2006 the AAA launched a six-book hard-cover series of handbooks on specific areas of ADR practice. The series, jointly published with JurisNet, LLC, began with the *Handbook on International Arbitration & ADR*, the *Handbook on Commercial Arbitration* and the *Handbook on Mediation*. Already in 2007, the *Handbook on Employment Arbitration & ADR* and the *Handbook on Labor Arbitration* have been published, soon to be joined by the *Handbook on Construction Arbitration & ADR*.

Participating in international conferences and organizations. Education and training in the United States is complemented by participation in and presentation of international conferences that attract users from every continent. For years, the AAA has joined the Mediation and Arbitration Commission of the Mexico City National Chamber of Commerce (CANACO) at conferences discussing arbitration and mediation in Latin America. A new cooperative agreement with CANACO resulted in the 2006 opening of the third International Centre for Dispute Resolution® (ICDR) office located in Mexico City. In addition, the ICDR and the Court of Arbitration at the Polish Chamber of Commerce in Warsaw signed an historic cooperative agreement to advance the use of ADR as a means of resolving disputes arising out of international commercial transactions. Both new agreements encourage future education opportunities.

We continued our work of the past six years as a nongovernmental organization (NGO) invitee of the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Working Group. This entity continuously examines ADR issues in the context of international law. As an authority on and a leader in the development of cross-border ADR practices, the AAA is now contributing to the discussion on changes to the *Procedures for Cases under the UNCITRAL Arbitration Rules*.

EXPANSION OF ADR USE AND IDENTIFICATION OF NEW MARKETS

To ensure that we as an organization continue to grow, we took steps in 2006 to expand the usage of ADR among current users as well as to seek and create new markets for the use of ADR.

Market leaders, especially those that are mature companies, are charged with encouraging customers to increase the use of their services as well as discovering and promoting new uses for them. Dedicated to the development and widespread use of prompt, effective and economical methods of dispute resolution, the AAA has taken on this charge, amplifying its work in the mediation of insurance claims, elections and online dispute resolution.

Increasing usage of mediation services. In 2006, the administration of insurance claims showed significant growth. Our administration of mediations resulting from homeowner-policy disputes related to the disastrous Hurricanes Katrina and Rita in 2005—where we were pleased to be able to provide much-needed relief with mediation services free to policyholders and at deeply reduced rates to insurance carriers—was a springboard to more cases in the area of disaster relief. In 2006, U.S. District Court Judge

L.T. Senter, Jr. ordered 21 cases to be mediated through the Mississippi Hurricane Katrina Mediation Program within the federal courthouse. Also, the State of North Carolina selected the AAA to administer a state-mandated mediation program for claims resulting from Tropical Storm Ernesto and disaster-related residential property insurance claims in the future.

On a personal note, I was pleased to recognize the University of Southern Mississippi, Calcasieu Parish in Louisiana and the law firm of Baldwin Haspel, LLC in New Orleans with *AAA Distinguished Public Service Awards* for their contributions to the success of the hurricane mediation programs.

Expanding the administration of elections. The largest private election-provider in the country, the AAA administered more than 350 elections in 2006 through online, telephonic and traditional balloting processes. New election services and balloting options have paved the way to what is anticipated to be the AAA's largest election year to date in 2007, with over two million ballots expected to be sent to postal workers, teachers, firefighters, actors and other voters in union and other organization elections throughout the year.

It is a tribute to our work in elections and propensity to public service that the newly created Feerick Center for Social Justice and Dispute Resolution at Fordham Law School invited us to contribute the benefit of our experience and best practices in determining fresh ways that ADR can be utilized earlier in the labor-representation process.

Evolving with new technology. The arbitration pioneer, the AAA began by administering 128 domestic cases in its first year, grew to administering a spectrum of cases internationally and now includes cyberspace as a delivery option. Recognizing that most new markets rely heavily on technology and require some form of online dispute resolution, the AAA has developed and enhanced its delivery of online services.

The area of No-Fault insurance claims has shown significant growth in utilizing online technology; the State of Minnesota showed a 10% increase over 2005 in the number of filers managing some aspect of their cases online. To better serve the State of New York and its constituents seeking No-Fault arbitration and conciliation services, electronic filing has been made available. The AAA also implemented a significant innovation in facilitating research on New York No-Fault insurance awards: all AAA NYS No-Fault awards issued since the fall of 2005—more than 30,000 at the close of 2006—were made available in a searchable online library on the AAA's New York No-Fault website.

In addition to managing claims more efficiently with increased opportunities for online filing, through AAA WebFile®, the AAA expanded its online services with a new partner. In 2006, the AAA formed a strategic alliance with Cybersettle, Inc., the world's leading online-settlement company, with its patented double-blind bid algorithmic model. AAA clients using the AAA's online case management tools in selected case loads may attempt settlement with Cybersettle before AAA neutrals are selected. Similarly, Cybersettle clients who have not reached settlement through online negotiation may switch to the AAA's dispute resolution processes, including mediation and arbitration. The AAA and Cybersettle will promote the other's services when appropriate and will make joint proposals and business presentations.

We have found that online customers also seek traditional dispute resolution processes. For example, the Electronic Retailing Association (ERA) named the AAA to use fact-finding to handle its online counterfeiting cases.

FIDELITY TO OUR PUBLIC SERVICE MISSION

While responding to the demands of the marketplace, the not-for-profit AAA vigorously embraced its position as the world leader in ADR education, in the advancement of the field and in the furtherance of diversity and inclusiveness.

Working to establish the AAA Foundation and Research Center. In 2006, the AAA continued work on the creation of an AAA Foundation and Research Center to mine the repository of 80 years of AAA data on domestic and international commercial arbitration, mediation and conciliation as well as to serve the important function of attention to research and development for the AAA proper. Among the opportunities contemplated is the creation of the first-ever Global Knowledge Bank to capture data on current international arbitration and mediation cases of critical decision-making interest to businesses, advocates, governments and, of course, the AAA.

The AAA continued discussions with individuals and institutional leaders here and abroad exploring the practical, intellectual and public policy benefits of the Foundation and was met with universal enthusiastic support. Such a global initiative will require significant financial resources; to begin to meet this challenge, the AAA offered several “naming” opportunities to ensure a solid financial support base.

Furthering diversity. Because of the breadth and global reach of our services, we recognize the importance and contribution of diversity and inclusiveness and, in 2006, established the new national AAA Advisory Committee on Diversity, dedicated to promoting inclusion of those individuals who historically have not participated in ADR. The committee identified areas that are as yet unaddressed in ADR and devised initiatives to be executed in 2007 specifically to (1) counteract the underlying misperception that diverse professionals may be less experienced, (2) promote the selection of diverse neutrals and arbitrators by parties and (3) identify and mentor future women and minority neutrals and ADR practitioners.

In 2006, we were pleased to note that AAA diversity benchmarks show an increase in diversity in staff, management and neutrals. These increases are the result of years of attention and focus to diversity and inclusiveness. For three years, the AAA has sponsored the Minority Professionals in Alternative Dispute Resolution Conference at the Capital University Law School in Ohio. In addition, we are proud that the Connecticut Labor and Employment Women (CLEW) presented their Outstanding Woman of the Year Award to Karen Jalkut, AAA district vice president, for her years of work on behalf of women neutrals in the New England region.

Awarding the AAA Library and Information Center. The Pepperdine University School of Law, home of The Straus Institute for Dispute Resolution, was awarded the world's largest collection of materials on conflict resolution by the AAA. Concluding a detailed review process of interest from U.S. law schools and business schools, the AAA selected Pepperdine to take over its prestigious Library and Information Center, consisting of more than 24,000 titles on arbitration, mediation, negotiation, fact-finding and other international and domestic dispute resolution procedures. Pepperdine will showcase the AAA Library in a new and expanded facility and strengthen its organizational ties with the Association.

Filing *Amicus* Brief. In 2006, the AAA filed an *amicus curiae* brief in the case *GulfPetro Trading Company v. Nigerian National Petroleum Corporation* that is currently proceeding before the United States Court of Appeals for the Fifth Circuit. The importance of the *GulfPetro* case lies in the standard of review to be applied by the court when presented with a motion to vacate an international arbitration award where the New York Convention applies. Also of significance, and a first in the AAA's 80-year history, the *amicus* brief was filed jointly with another international arbitration institution, the Swiss Arbitration Association.

Honoring staff. The President's Award for Living the Values is presented each year to that individual who, in the judgment of a committee of peers, epitomizes the AAA's core values—integrity, conflict management and service, standards intrinsic to the AAA as it sets forth to accomplish its vision for the future. The 2006 recipient was Catherine Stewart, case management supervisor in the AAA Western Case Management Center in Fresno, California.

IN CONCLUSION

In 2006, we reaffirmed our conviction that ADR is the fastest, most cost-efficient choice for dispute resolution. In so doing, we embraced our responsibility to ensure that we continue to provide the most streamlined, cost-effective and customer-centered alternatives to costly and lengthy litigation proceedings. Recognizing that steps must be taken to sustain our growth as a mature organization, a reinvigorated AAA responded with a meld of new products and services, educational and customer outreach and development of new service opportunities for ADR.

We at the AAA are poised to proceed on this trajectory in 2007, maintaining the close contact we have established this year with those who seek our services while reaching out to potential customers with the goal of encouraging *more usage, new users* and *new uses* of ADR.

Once again, my personal and heartfelt thanks go out to our Board, our staff and our senior management for their dedication, hard work and support.



William K. Slate II

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Dispute Resolution Services Worldwide

AMERICAN ARBITRATION ASSOCIATION, INC. AND SUBSIDIARIES

REPORT ON CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2006 AND 2005

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, 2006 and 2005, 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, 2006 and 2005, 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.

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

New York, New York
April 24, 2007

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2006 AND 2005

ASSETS	2006	2005
Cash and cash equivalents	\$ 12,822,000	\$ 598,000
Investments, at fair value (Note 2)	80,382,000	73,351,000
Administration fees receivable, net of allowances for cancellations and uncollectable accounts of \$923,000 in 2006 and \$1,005,000 in 2005	18,833,000	18,320,000
Other receivables	189,000	363,000
Prepaid expenses	2,431,000	2,577,000
Construction in progress (Note 4)	2,451,000	31,000
Deferred pension costs (Note 3)	-	520,000
Furnishings, equipment and leasehold improvements, net (Note 4)	8,041,000	11,072,000
Total Assets	\$125,149,000	\$106,832,000
LIABILITIES AND NET ASSETS		
Liabilities		
Accounts payable and accrued expenses (Notes 3 and 5)	\$ 63,881,000	\$ 57,054,000
Accrued postretirement medical costs (Note 3)	9,970,000	9,668,000
Accrued pension liability (Note 3)	8,191,000	9,944,000
Deferred rent	3,643,000	4,153,000
Deferred revenue	2,340,000	2,110,000
Total Liabilities	88,025,000	82,929,000
Commitments and contingencies (Note 5)	-	-
Unrestricted net assets	37,124,000	23,903,000
Total Liabilities and Net Assets	\$ 125,149,000	\$106,832,000

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
YEARS ENDED DECEMBER 31, 2006 AND 2005

OPERATING REVENUES	<u>2006</u>	<u>2005</u>
Administration fees earned:		
Commercial	\$ 44,533,000	\$ 42,744,000
State insurance	17,729,000	17,399,000
Labor	4,832,000	4,888,000
Elections	<u>3,468,000</u>	<u>2,731,000</u>
Total	70,562,000	67,762,000
Publications and education	<u>1,763,000</u>	<u>1,785,000</u>
Total	<u>72,325,000</u>	<u>69,547,000</u>
 OPERATING EXPENSES		
Administration of tribunals	61,918,000	67,345,000
Elections	3,135,000	2,554,000
Publications and education	2,256,000	3,453,000
General and administration	<u>2,847,000</u>	<u>3,380,000</u>
Total	<u>70,156,000</u>	<u>76,732,000</u>
 Net operating income (loss)	 2,169,000	 (7,185,000)
 NON OPERATING INCOME AND EXPENSES		
Interest and dividends on investments, net of fees (Note 2)	2,296,000	2,635,000
Net realized and unrealized gains on investments	7,297,000	2,249,000
Contribution expense (Note 6)	-	(623,000)
Loss on disposal of assets (Note 4)	<u>(1,048,000)</u>	<u>(649,000)</u>
Change in unrestricted net assets before minimum pension liability	10,714,000	(3,573,000)
Minimum pension liability adjustment (Note 3)	<u>2,507,000</u>	<u>346,000</u>
Change in unrestricted net assets	13,221,000	(3,227,000)
Unrestricted net assets, beginning of year	<u>23,903,000</u>	<u>27,130,000</u>
 Unrestricted net assets, end of year	 <u>\$ 37,124,000</u>	 <u>\$ 23,903,000</u>

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2006 AND 2005

CASH FLOWS FROM OPERATING ACTIVITIES	2006	2005
Change in net assets	\$ 13,221,000	\$ (3,227,000)
Adjustments to reconcile the change in net assets to net cash provided by operating activities:		
Depreciation and amortization	2,887,000	3,817,000
Net realized and unrealized gain on investments	(7,297,000)	(2,249,000)
Postretirement benefits other than pensions	302,000	441,000
Loss on disposal of assets	1,048,000	649,000
Changes in operating assets and liabilities:		
(Increase)/Decrease in administration fees receivable	(513,000)	6,777,000
Decrease/(Increase) in other receivables	174,000	(138,000)
Decrease in prepaid expenses	146,000	247,000
Increase/(Decrease) in accounts payable and accrued expenses	6,827,000	(1,626,000)
(Decrease)/Increase in accrued pension liability	(1,233,000)	936,000
Decrease in deferred rent	(510,000)	(609,000)
Increase/(Decrease) in deferred revenue	230,000	(92,000)
Net cash provided by operating activities	15,282,000	4,926,000
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of furnishings, equipment and leasehold improvements	(873,000)	(1,375,000)
Proceeds from sales of investments	40,126,000	66,821,000
Purchase of investments	(39,860,000)	(69,743,000)
Construction in progress	(2,451,000)	(31,000)
Net cash used in investing activities	(3,058,000)	(4,328,000)
Net increase in cash and cash equivalents	12,224,000	598,000
Cash and cash equivalents, beginning of year	598,000	—
Cash and cash equivalents, end of year	\$ 12,822,000	\$ 598,000

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.

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 2006 and 2005 of \$126,000 and \$39,000, respectively, which is included in the accompanying consolidated balance sheets and represents the estimated amount of future refunds.

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 \$2,151,000 and \$1,933,000 as of December 31, 2006 and 2005, respectively, are included in deferred revenue in the accompanying consolidated balance sheets.

CONTRIBUTIONS

In 2005, the Association contributed money to fund expenses incurred by the Global Center for Dispute Resolution Research ("GCDRR"). On an annual basis, the Association also contributes money to the ICDR, LLC.

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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 \$16,600,000 and \$8,200,000 as of December 31, 2006 and 2005, 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.

CAPITALIZATION OF SOFTWARE

The Association capitalized expenses 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 software are amortized over five years.

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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONCLUDED)

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 2006 and 2005 due to losses incurred. As of December 31, 2006 and 2005, ICDR, LLC has offset the deferred tax asset related to its loss carryforwards of \$2,000,000 and \$1,600,000, 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 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. The fair value of investments is determined by quoted market prices.

RECLASSIFICATIONS

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

NOTE 2 - INVESTMENTS

Investments at December 31, 2006 and 2005 consist of the following:

	2006		2005	
	Cost	Fair Value	Cost	Fair Value
Fixed income/Money market funds	\$ 35,672,000	\$ 35,371,000	\$ 34,117,000	\$ 33,947,000
Domestic equity mutual funds	16,738,000	19,568,000	20,852,000	23,494,000
International equity mutual funds	11,809,000	14,448,000	7,054,000	8,069,000
Real estate mutual funds	9,116,000	10,995,000	7,151,000	7,841,000
Totals	<u>\$ 73,335,000</u>	<u>\$ 80,382,000</u>	<u>\$ 69,174,000</u>	<u>\$ 73,351,000</u>

Interest and dividends on investments are reported net of fees of \$679,000 and \$560,000 in 2006 and 2005, respectively.

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. The curtailment of the plan has been accounted for in accordance with Statement of Financial Accounting Standards No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits." The Association recognized in operating expenses a curtailment loss of \$434,000 in 2006 and a reduction in benefit obligation of \$3,131,000 in 2006.

The Association makes contributions to the plan based on actuarial calculations. Total employer contributions required for the fiscal year beginning January 1, 2007 are zero. The Association expects to make a discretionary contribution of up to \$1,000,000 to the plan during 2007.

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. Active employees hired on or before June 30, 2003 are eligible for retiree healthcare coverage upon retirement with at least 10 years of service after age 45.

The Association also maintains a nonqualified Supplemental Retirement Plan. For 2006 and 2005, the expense associated with this unfunded plan, which is included in general and administrative expenses, was \$10,000 and \$67,000, respectively. For 2006 and 2005, the accrued benefit obligation, which is actuarially determined and included in accounts payable and accrued expenses, was \$419,000 and \$409,000, respectively. The discount rate used to determine the benefit obligation was 6.00% and 5.75% in 2006 and 2005, respectively.

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, 2006 and 2005:

	Pension Benefits		Healthcare Benefits	
	2006	2005	2006	2005
Benefit obligation at December 31	\$ 35,052,000	\$ 39,235,000	\$ 7,921,000	\$ 8,193,000
Fair value of plan assets at December 31	26,861,000	25,713,000	-	-
Funded status	<u>\$ (8,191,000)</u>	<u>\$(13,522,000)</u>	<u>\$ (7,921,000)</u>	<u>\$(8,193,000)</u>
Accrued benefit costs recognized in the balance sheets	<u>\$ (8,191,000)</u>	<u>\$ (9,944,000)</u>	<u>\$ (9,970,000)</u>	<u>\$(9,668,000)</u>
Net periodic benefit costs	\$ 2,840,000	\$ 2,999,000	\$ 573,000	\$ 782,000
Curtailment loss	434,000	-	-	-
Employer's contribution	2,000,000	1,715,000	270,000	341,000
Plan participants' contributions	-	-	38,000	21,000
Benefits paid	3,202,000	2,327,000	309,000	362,000

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

	Pension Benefits		Healthcare Benefits	
	2006	2005	2006	2005
Weighted-average assumptions to determine the benefit obligation as of December 31:				
Discount rate	6.00%	5.75%	6.00%	5.75%
Expected return on plan assets	7.50%	7.50%	N/A	N/A
Rate of compensation increase	4.80%	4.80%	N/A	N/A
Weighted-average assumptions to determine the net benefit cost for the year ended December 31:				
Discount rate	6.00%	5.75%	6.00%	5.75%
Expected return on plan assets	7.50%	7.50%	N/A	N/A
Rate of compensation increase	4.80%	4.80%	N/A	N/A

The accumulated benefit obligation related to the defined benefit pension plan as of December 31, 2006 and 2005 was \$35,052,000 and \$35,658,000, respectively.

For measurement purposes, a 9.00% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2007. The rate was assumed to decrease gradually to 4.50% until 2013 and remain at that level thereafter.

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.

The provisions of SFAS No. 87, "Employers' Accounting for Pensions" ("SFAS 87"), require the Association to recognize a minimum pension liability relating to certain unfunded obligations, establish an intangible asset relating thereto, and adjust net assets. At year-end, this minimum pension liability is remeasured as required by SFAS 87. As a result, at December 31, 2006 and 2005, the Association's additional minimum liability was \$6,412,000 and \$9,439,000, respectively, and the related intangible asset was \$0 and \$520,000, respectively. Net assets increased by \$2,507,000 and \$346,000 in 2006 and 2005, 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 of \$8,191,000 in 2006, which is related to the accrued benefit cost of \$1,779,000 and an additional minimum liability of \$6,412,000. The Association recognized an accrued pension liability of \$9,944,000 in 2005, which is related to the accrued benefit cost of \$505,000 and an additional minimum liability of \$9,439,000.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Estimated future benefit payments attributable to estimated future employee service in each of the five years subsequent to December 31, 2006, and in the aggregate for the five years beginning in 2012 are as follows:

<u>January 1,</u>	<u>Pension Benefits</u>	<u>Healthcare Benefits</u>
2007	\$ 2,061,000	\$ 367,000
2008	2,102,000	396,000
2009	2,155,000	413,000
2010	2,158,000	451,000
2011	2,208,000	477,000
Thereafter	11,527,000	2,791,000

The target allocations of pension assets are outlined below:

	<u>Target Allocation</u>	<u>Percentage of Plan Assets at December 31,</u>	
		<u>2006</u>	<u>2005</u>
Plan assets:			
Equity securities	40 - 70%	56%	55%
Fixed income/Group annuity contract	30 - 60%	44	45
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 goals and objectives of the Association's Pension Investment Objectives and Policies Statement.

In September 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" ("SFAS 158"). SFAS 158 requires the employer to recognize the overfunded or underfunded status of a defined postretirement plan as an asset or liability in its statement of financial position and to recognize changes in the funded status in the year in which the changes occur through comprehensive income. The provisions of SFAS 158 are effective for fiscal years ending after June 15, 2007.

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 decreased by \$1,924,000 in 2006 and by \$1,777,000 in 2005. The reduction in the net periodic postretirement benefit cost for 2006 was \$449,000 and for 2005 was \$218,000.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 - FURNISHINGS, EQUIPMENT AND LEASEHOLD IMPROVEMENTS

Furnishings, equipment and leasehold improvements consist of the following:

	<u>2006</u>	<u>2005</u>
Furnishings and equipment	\$ 17,749,000	\$ 17,961,000
Leasehold improvements	<u>12,871,000</u>	<u>14,314,000</u>
	30,620,000	32,275,000
Less accumulated depreciation and amortization	<u>(22,579,000)</u>	<u>(21,203,000)</u>
Total	<u>\$ 8,041,000</u>	<u>\$ 11,072,000</u>

In 2006 and 2005, the Association recognized a net loss of approximately \$1,048,000 and \$649,000 relating to the disposal of certain assets with original costs totaling \$2,559,000 and \$2,789,000, respectively. Included in these amounts and recorded as part of operations in 2006 and 2005 were \$755,000 and \$650,000, respectively, in losses related to the disposal of certain assets due to office consolidations that had original costs of \$2,146,000 and \$1,622,000, respectively.

Furnishings and equipment as of December 31, 2006 and 2005 includes costs associated with the development of software for internal use of \$4,907,000. Related accumulated amortization for 2006 and 2005 were \$4,907,000 and \$4,457,000, respectively.

In-progress construction costs for leased facilities totaled \$2,451,000 in 2006 and \$31,000 in 2005. 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 \$31,000 and \$524,000 was completed and placed into service during 2006 and 2005, respectively.

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 2007 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, 2006 and 2005 amounted to \$12,142,000 and \$12,499,000, respectively. In addition, the Association leases certain computer and office equipment under various operating leases, all of which expire over the next one to five years.

Due to the consolidation of certain offices during 2006 and 2005, the Association recorded expenses of approximately \$689,000 and \$652,000, respectively, which accounted for future lease payments and related costs, sublease brokerage commissions and early termination payouts for those leased offices. These expenses are included in the administration of tribunals in the accompanying consolidated statements of operations and changes in net assets. The related liability of \$227,000 and \$652,000 for 2006 and 2005, respectively, is included in accounts payable and accrued expenses in the accompanying consolidated balance sheets.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 - COMMITMENTS AND CONTINGENCIES (CONCLUDED)

LEASE COMMITMENTS (CONCLUDED)

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, 2006 and thereafter are as follows:

<u>Year Ending December 31,</u>	<u>Amount</u>
2007	\$ 10,626,000
2008	8,888,000
2009	8,387,000
2010	7,861,000
2011	7,435,000
Thereafter	<u>19,224,000</u>
Total	<u>\$ 62,421,000</u>

The Association is the sublessor for certain leased office facilities under sublease contracts that expire between 2007 and 2013. The minimum rentals to be received under noncancelable subleases in each of the five years subsequent to December 31, 2006 and thereafter are as follows:

<u>Year Ending December 31,</u>	<u>Amount</u>
2007	\$ 1,476,000
2008	2,110,000
2009	2,110,000
2010	2,264,000
2011	2,264,000
Thereafter	<u>2,452,000</u>
Total	<u>\$ 12,676,000</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, 2006 and 2005, advance deposits collected totaled \$56,224,000 and \$52,867,000, 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 \$1,065,000 at December 31, 2006. This agreement guarantees an operating lease rental obligation and is secured by the investment portfolio.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 - GLOBAL CENTER FOR DISPUTE RESOLUTION RESEARCH

In the ordinary course of business, the Association made contributions in 2005 to GCDRR, a research organization dedicated to exploring the effectiveness and enhancing the utility of business dispute resolution methods throughout the world. These contributions, which were used to fund expenses incurred by GCDRR, reflected an economic interest by the Association. Since the Association maintained only a minority voting interest on GCDRR's Board of Directors, the Association did not have direct control over how GCDRR operated or derived other contributions. In accordance with Statement of Position 94-3, "Reporting of Related Entities by Not-for-Profit Organizations," the Association did not consolidate the operating results of GCDRR and, accordingly, reported these contributions on the statements of operations and changes in net assets.

As of August 1, 2005, GCDRR's Board of Directors agreed to dissolve itself and to place control of GCDRR with the CEO and Chairmen of the Association. The Association, as the primary contributor to GCDRR, also ceased contributing to GCDRR as of August 1, 2005.

For the year ended December 31, 2005, amounts contributed to GCDRR totaled \$623,000. Contributions to GCDRR have aggregated \$3,787,000 through December 31, 2005.



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