

ACMAT CORPORATION AND SUBSIDIARIES
SEPTEMBER 30, 2009

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ACMAT CORPORATION AND SUBSIDIARIES
Consolidated Balance Sheets

<u>Assets</u>	September 30, <u>2009</u> (Unaudited)	December 31, <u>2008</u>
Investments:		
Fixed maturities-available for sale at fair value (Cost of \$72,850,665 in 2009 and \$60,797,261 in 2008)	\$73,676,480	59,701,247
Equity securities, at fair value (Cost of \$2,258,579 in 2009 and \$1,913,359 in 2008)	2,108,478	995,722
Short-term investments, at cost which approximates fair value	<u>8,443,254</u>	<u>15,963,120</u>
Total investments	84,228,212	76,660,089
Cash and cash equivalents	5,875,158	12,554,590
Accrued interest receivable	711,391	338,486
Receivables, net of allowance for doubtful accounts of \$71,231	900,977	1,323,415
Reinsurance recoverable:		
Unpaid losses	3,650,772	3,530,878
Paid losses	--	98,652
Prepaid expenses	280,790	192,317
Income tax receivable	561,118	1,004,764
Property & equipment, net	10,389,570	10,644,847
Deferred policy acquisition costs	615,163	940,700
Other assets	672,571	1,054,957
Intangibles	<u>1,920,360</u>	<u>1,920,360</u>
	<u>\$109,806,082</u>	<u>110,264,055</u>
 <u>Liabilities & Stockholders' Equity</u>		
Accounts payable	\$1,081,861	1,923,689
Reserves for losses and loss adjustment expenses	23,343,427	23,064,539
Unearned premiums	1,725,811	2,911,613
Collateral held	33,984,007	28,541,360
Deferred income taxes	347,660	234,887
Accrued liabilities	898,248	3,088,431
Long-term debt	<u>5,444,444</u>	<u>6,037,427</u>
Total liabilities	66,825,458	65,801,946
 Stockholders' Equity:		
Common Stock (No par value; 3,500,000 shares authorized; 468,546 and 471,606 shares issued and outstanding)	468,546	471,606
Class A Stock (No par value; 10,000,000 shares authorized; 898,655 and 1,089,193 shares issued and outstanding)	898,655	1,089,193
Retained earnings	41,259,551	45,001,854
Accumulated other comprehensive income (loss)	<u>353,872</u>	<u>(2,100,544)</u>
Total stockholders' equity	<u>42,980,624</u>	<u>44,462,109</u>
	<u>\$109,806,082</u>	<u>110,264,055</u>

See Notes to Unaudited Consolidated Financial Statements.

ACMAT CORPORATION AND SUBSIDIARIES
Consolidated Statements of Earnings (Unaudited)

	Three months ended September 30		Nine months ended September 30	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
Contract revenues	\$ 195,273	1,420,256	1,260,740	3,483,091
Earned premiums	1,315,629	2,004,632	4,115,543	6,088,731
Investment income, net	826,183	907,289	2,433,846	3,043,034
Net realized capital gains (losses)	572,062	(1,717,232)	863,606	(1,839,644)
Other income	201,711	153,437	568,567	533,761
	<u>3,110,858</u>	<u>2,768,382</u>	<u>9,242,302</u>	<u>11,308,973</u>
Cost of contract revenues	307,677	1,395,940	1,772,926	3,604,966
Losses and loss adjustment expenses	293,126	(782,436)	913,109	82,830
Amortization of policy acquisition costs	429,506	597,724	1,380,920	1,708,915
General and administrative expenses	1,061,822	994,096	3,451,058	3,379,095
Interest expense	65,655	101,893	203,052	353,230
	<u>2,157,786</u>	<u>2,307,217</u>	<u>7,721,065</u>	<u>9,129,036</u>
Earnings before income taxes	953,072	461,165	1,521,237	2,179,937
Income taxes	<u>303,855</u>	<u>410,415</u>	<u>481,103</u>	<u>1,028,040</u>
Net earnings	<u>\$649,217</u>	<u>50,750</u>	<u>1,040,134</u>	<u>1,151,897</u>
Basic earnings per share	\$.47	.03	.76	.69
Diluted earnings per share	\$.44	.03	.70	.64

See Notes to Unaudited Consolidated Financial Statements.

ACMAT CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (Unaudited)
September 30, 2009 and 2008

	Common Stock Par <u>Value</u>	Class A Stock Par <u>Value</u>	Retained <u>Earnings</u>	Accumulated Other Comprehensive <u>Income(Loss)</u>	Total Stockholders' <u>Equity</u>
Balance as of December 31, 2007	\$478,692	1,315,960	49,188,831	(2,017,899)	48,965,584
Comprehensive income:					
Net unrealized losses on debt and equity securities, net of reclassification	--	--	--	(1,513,198)	(1,513,198)
Net unrealized gains on derivatives qualifying as cash flow hedges	--	--	--	(9,275)	(9,275)
Net earnings	--	--	1,151,897	--	<u>1,151,897</u>
Total comprehensive income					(370,576)
Stock based compensation	--	--	55,994	--	55,994
Acquisition and retirement of 6,280 shares of Common Stock	(6,280)	--	(162,650)	--	(168,930)
Acquisition and retirement of 225,600 shares of Class A Stock	<u>--</u>	<u>(225,600)</u>	<u>(5,793,233)</u>	<u>--</u>	<u>(6,018,833)</u>
Balance as of September 30, 2008	<u>\$472,412</u>	<u>1,090,360</u>	<u>44,440,839</u>	<u>(3,540,372)</u>	<u>42,463,239</u>
Balance as of December 31, 2008	\$471,606	1,089,193	45,001,854	(2,100,544)	44,462,109
Comprehensive income:					
Net unrealized gains on debt and equity securities, net of reclassification	--	--	--	2,385,425	2,385,425
Net unrealized gains on derivatives qualifying as cash flow hedges	--	--	--	68,991	68,991
Net earnings	--	--	1,040,134	--	<u>1,040,134</u>
Total comprehensive income					3,494,550
Stock based compensation	--	--	30,745	--	30,745
Acquisition and retirement of 3,060 shares of Common Stock	(3,060)	--	(66,180)	--	(69,240)
Acquisition and retirement of 197,538 shares of Class A Stock	--	(197,538)	(4,837,203)	--	(5,034,741)
Issuance of 7,000 shares of Class A Stock pursuant to Stock Options	<u>--</u>	<u>7,000</u>	<u>90,201</u>	<u>--</u>	<u>97,201</u>
Balance as of September 30, 2009	<u>\$468,546</u>	<u>898,655</u>	<u>41,259,551</u>	<u>353,872</u>	<u>42,980,624</u>

See Notes to Unaudited Consolidated Financial Statements.

ACMAT CORPORATION AND SUBSIDIARIES
Consolidated Statements of Cash Flows (Unaudited)
Nine Months Ended September 30, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Cash flows from operating activities:		
Net earnings	\$1,040,134	1,151,897
Adjustments to reconcile net earnings to net cash used for operating activities:		
Stock based compensation	30,745	55,994
Depreciation and amortization	508,825	276,429
Net realized capital losses (gains)	(863,606)	1,839,644
Changes in:		
Accrued interest receivable	(372,905)	(71,729)
Reinsurance recoverable	(21,242)	(75,926)
Receivables, net	422,438	257,775
Deferred policy acquisition costs	325,537	292,710
Prepaid expenses and other assets	293,913	(1,031,610)
Accounts payable and other accrued liabilities	(2,963,020)	(1,430,434)
Reserves for losses and loss adjustment expenses	278,888	(29,524)
Collateral held	5,442,647	(1,499,695)
Income taxes	351,803	(8,080)
Unearned premiums	<u>(1,185,802)</u>	<u>(1,207,537)</u>
Net cash (used by) provided by operating activities	<u>3,288,355</u>	<u>(1,480,086)</u>
Cash flows from investing activities:		
Proceeds from investments sold or matured:		
Fixed maturities-sold	29,703,162	25,563,908
Fixed maturities-matured	1,210,000	--
Equity securities	1,196,172	--
Purchases of:		
Fixed maturities	(42,738,517)	(26,013,110)
Equity securities	(1,119,838)	(250,000)
Short-term investments, net	7,519,866	13,965,681
Capital expenditures	<u>(138,869)</u>	<u>(534,235)</u>
Net cash (used for) provided by investing activities	<u>(4,368,024)</u>	<u>12,732,244</u>
Cash flows from financing activities:		
Repayments on long-term debt	(592,983)	(2,029,323)
Issuance of Class A Stock	63,000	--
Tax benefit of exercising options	34,201	--
Payments for acquisition & retirement of stock	<u>(5,103,981)</u>	<u>(6,187,763)</u>
Net cash used for financing activities	<u>(5,599,763)</u>	<u>(8,217,086)</u>
Net change in cash	(6,679,432)	3,035,072
Cash at beginning of period	<u>12,554,590</u>	<u>6,239,190</u>
Cash at end of period	<u>\$ 5,875,158</u>	<u>9,274,262</u>

See Notes to Unaudited Consolidated Financial Statements.

ACMAT CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS:

(1) Financial Statements

The consolidated financial statements include the accounts of ACMAT Corporation ("ACMAT" or the "Company") and its subsidiaries. The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and are unaudited.

The interim financial information contained in this report has been prepared from the books and records of the Company and its subsidiaries and reflects, in the opinion of the management of the Company, all adjustments (consisting of normal and recurring accruals) necessary to fairly present results of operations for the periods indicated. All significant intercompany accounts and transactions have been eliminated in consolidation.

These statements should be read in conjunction with the financial statements and notes thereto included in the Company's annual report for the year ended December 31, 2008.

(2) Adoption of New Accounting Standards

Fair Value Measurements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosure about fair value measurement. It applies to other pronouncements that require or permit fair value but does not require any new fair value measurements. The statement defines fair value as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."

FAS 157 establishes a fair value hierarchy to increase consistency and comparability in fair value measurements and disclosures. The hierarchy is based on the input used in valuation and gives the highest priority to quoted prices in active markets. The highest possible level should be used to measure fair value. FAS 157 was effective for fiscal years beginning after November 15, 2007.

In February 2008, FASB issued FASB Staff Position (FSP) FAS 157-2, *Effective Date of FASB Statement No. 157* (FSP FAS 157-2), which permits a one-year deferral of the application of FASB Statement No. 157, for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually).

The Company adopted FAS 157 and FSP FAS 157-2 effective January 1, 2008. Accordingly, the provisions of FAS 157 were not applied to intangible assets held by the Company and will be measured annually for impairment testing purposes only. The adoption of FAS 157 and FSP FAS 157 on January 1, 2009 for non-financial assets and non-financial liabilities did not have a material effect on the Company's results of operations, financial position or liquidity.

Fair Value Option for Financial Assets and Financial Liabilities

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (FAS 159). FAS 159 permits an entity to irrevocably elect fair value on a contract-by-contract basis as the initial and subsequent measurement attributed for many financial assets and liabilities and certain other items including property and casualty insurance contracts. Entities electing the fair value option would be required to recognize changes in fair value in earnings and to expense upfront costs and fees associated with the item for which the fair value option is elected. Entities electing the fair value option are required to distinguish on the face of the statement of financial position, the fair value of assets and liabilities for which the fair value option has been elected and similar assets and liabilities measured using another measurement attribute. An entity can accomplish this by either reporting the fair value and non-fair value carrying amounts as separate line items or aggregate those amounts and disclose parenthetically the amount of fair value included in the aggregate amount.

FAS 159 is effective for fiscal years beginning after November 15, 2007. Upon adoption, an entity is permitted to elect the fair value option irrevocably for any existing asset or liability within the scope of the standard. The adjustment to reflect

the difference between the fair value and the carrying amount would be accounted for as a cumulative-effect adjustment to retained earnings as of the date of initial adoption. Retrospective application would not be permitted. The Company did not elect the fair value option for assets and liabilities currently held upon its adoption of FAS 159 effective January 1, 2008. Therefore FAS 159 did not have an impact on the Company's results of operations, financial condition or liquidity.

Determination of the Useful Life of Intangible Assets

In April 2008, the FASB issued FSP FAS 142-3, *Determination of the Useful Life of Intangible Assets*. The FSP amends the factors that an entity should consider in determining the useful life of a recognized intangible asset under FAS 142, Goodwill and Other Intangible Assets, to include the entity's historical experience in renewing or extending similar arrangements, whether or not the arrangements have explicit renewal or extension provisions. Previously, an entity was precluded from using its own assumptions about renewal or extension of an arrangement where there was likely to be substantial cost or modifications. Entities without their own historical experience should consider the assumptions market participants would use about renewal or extension. The amendment may result in the useful life of an entity's intangible asset differing from the period of expected cash flows that was used to measure the fair value of the underlying asset using the market participant's perceived value. The FSP also requires disclosure to provide information on an entity's intent and/or ability to renew or extend the arrangement.

FSP FAS 142-3 was effective for financial statements issued for fiscal years beginning after December 15, 2008, and for interim periods within those fiscal years. The adoption of FSP FAS 142-3 on January 1, 2009 did not have a material effect on the Company's results of operation, financial position or liquidity and did not require additional disclosures related to existing intangibles.

Collateral Assignment Split-Dollar Life Insurance Arrangements

In March 2007, the FASB issued Emerging Issues Task Force Issue No. 06-10, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements* (EITF 06-10). EITF 06-10 provides guidance on the recognition and measurement of assets related to collateral assignment split-dollar life insurance arrangements. The Company adopted provisions of EITF 06-10 effective January 1, 2008, EITF 06-10 did not have a material effect on its results of operations, financial condition or liquidity.

(3) Accounting Standards Not Yet Adopted

Disclosures about Fair Value of Financial Instruments

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* (FSP FAS 107-1). FSP FAS 107-1 amends FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, to require disclosures in the body or in the accompanying notes to financial statements for interim reporting periods and in financial statements for annual reporting periods for the fair value of all financial instruments for which it is practicable to estimate that value, whether recognized or not recognized in the balance sheet. This FSP also amends APB opinion No. 28, "Interim Financial Reporting", to require entities to disclose the methods and significant assumptions used to estimate the fair value of financial instruments and describe changes in methods and significant assumptions in both interim and annual financial statements. FSP FAS 107-1 is effective for interim reporting periods ending after June 15, 2009. The Company adopted this guidance for the quarter ended June 30, 2009 and there has been no material impact as a result of adoption.

Additional Fair Value Measurement Guidance

In April 2009, the FASB issued FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP FAS 157-4), FSP FAS 157-4 provides guidance for determining when a transaction is not orderly and for estimating fair value in accordance with FASB Statement No. 157, *Fair Value Measurements* (FAS 157), when there has been a significant decrease in the volume and level of activity for an asset or liability. FSP FAS 157-4 does not change the measurement objective of FAS 157 which is "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."

FSP FAS 157-4 requires the disclosure of the inputs and valuation techniques used, as well as any changes in valuation techniques and inputs used during the period, to measure fair value in interim and annual periods. In addition, FSP FAS 157-4 requires that the presentation of the fair value hierarchy be presented by major security type as described in FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (as amended by FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*).

The provisions of FSP FAS 157-4 are effective for interim periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The implementation of FSP FAS 157-4 did not have a material effect on its results of operations, financial position or liquidity.

Other-Than-Temporary Impairments

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (FSP FAS 115-2). FSP FAS 115-2 modifies the existing other-than-temporary impairment guidance to require the recognition of an other-than-temporary impairment when an entity has the intent to sell a debt security or when it is more likely than not an entity will be required to sell the debt security before its anticipated recovery.

Additionally, FSP FAS 115-2 changes the presentation and amount of other-than-temporary losses recognized in the income statement for instances when the Company determines that there is a credit loss on a debt security but it is more likely than not that the entity will not be required to sell the security prior to the anticipated recovery of its remaining cost basis. For these debt securities, the amount representing the credit loss will be reported as an impairment loss in the Consolidated Statement of Income and the amount related to all other factors will be reported in accumulated other comprehensive income. FSP FAS 115-2 also requires the presentation of other-than-temporary impairments separately from realized gains and losses on the face of the income statement.

In addition to the changes in measurement and presentation, FSP FAS 115-2 is intended to enhance the existing disclosure requirements for other-than-temporary impairments and requires all disclosures related to other-than-temporary impairments in both interim and annual periods.

The provisions of FSP FAS 115-2 are effective for interim periods ending after June 15, 2009. The Company adopted FSP FAS 115-2 during the quarter ended June 30, 2009 and this adoption did not have a material effect on any of the Other-Than-Temporary changes to date.

(4) Earnings Per Share

The following is a reconciliation of the numerators and denominators of the basic and diluted EPS computations for the three-month periods ended September 30, 2009 and 2008:

		Weighted Average Shares Outstanding	Per-Share Amount
<u>2009:</u>	<u>Earnings</u>		
Basic EPS:			
Earnings available to stockholders	\$649,217	1,367,375	\$.47
Effect of Dilutive Securities:			
Stock options	<u> --</u>	<u>119,739</u>	
Diluted EPS:			
Earnings available to stockholders	<u>\$649,217</u>	<u>1,487,114</u>	<u>\$.44</u>
<u>2008:</u>			
Basic EPS:			
Earnings available to stockholders	\$50,750	1,595,248	\$.03
Effect of Dilutive Securities:			
Stock options	<u> --</u>	<u>133,764</u>	
Diluted EPS:			
Earnings available to stockholders	<u>\$50,750</u>	<u>1,729,012</u>	<u>\$.03</u>

The following is a reconciliation of the numerators and denominators of the basic and diluted EPS computations for the nine-month periods ended September 30, 2009 and 2008:

	<u>Earnings</u>	<u>Weighted Average Shares Outstanding</u>	<u>Per-Share Amount</u>
<u>2009:</u>			
Basic EPS:			
Earnings available to stockholders	\$1,040,134	1,375,946	\$.76
Effect of Dilutive Securities:			
Stock options	<u> --</u>	<u>114,994</u>	
Diluted EPS:			
Earnings available to stockholders	<u>\$1,040,134</u>	<u>1,490,940</u>	<u>\$.70</u>
<u>2008:</u>			
Basic EPS:			
Earnings available to stockholders	\$1,151,897	1,670,476	\$.69
Effect of Dilutive Securities:			
Stock options	<u> --</u>	<u>137,693</u>	
Diluted EPS:			
Earnings available to stockholders	<u>\$1,151,897</u>	<u>1,808,169</u>	<u>\$.64</u>

(5) Supplemental Cash Flow Information

Income taxes paid during the nine months ended September 30, 2009 and 2008 was \$95,099 and \$1,036,120, respectively. Interest paid for the nine months ended September 30, 2009 and 2008 was \$203,052 and \$358,125, respectively.

(6) Comprehensive Income (Loss)

The following table summarizes reclassification adjustments for other comprehensive income (loss) and the related tax effects for the nine months ended September 30, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Unrealized losses on investments:		
Unrealized holding gains (losses) arising during period	\$2,949,405	(3,352,842)
Less reclassification adjustment for (losses) gains included in net income	569,980	(1,839,644)
Unrealized gain (loss) on derivatives qualifying as cash flow hedges	<u>68,991</u>	<u>(9,275)</u>
Other comprehensive income (loss)	<u>\$2,454,416</u>	<u>(1,522,473)</u>

(7) Stock-Based Compensation

The Company periodically grants non-qualified stock options giving such individuals the right to purchase restricted shares of the Company's Common Stock and Class A Stock. The majority of the options outstanding to officers generally vest evenly over a five to ten year period and generally have a term of 10 years. The exercise price is equal to the fair value at the date of grant. The Company uses a variation of the Black-Scholes option pricing model to value stock options.

Compensation expense of \$30,745 and \$55,994 is reflected in net earnings for the nine months ended September 30, 2009 and 2008, respectively. The Company applied the recognition and measurement principles of SFAS 123R, Share Based Payment beginning January 1, 2006.

As of September 30, 2009 there were 332,500 stock options outstanding of which 38,335 were not yet vested. The compensation costs related to non-vested share compensation arrangements granted but not yet recognized was approximately \$27,000 as of September 30, 2009. The Company expects to recognize that cost over a weighted average period of 1.3 years.

(8) Investments

The amortized cost and estimated fair value of investments in fixed maturities classified as available for sale and equity securities at September 30, 2009 and December 31, 2008 were as follows:

	Amortized Cost	September 30, 2009		Fair Value
		Gross Gains	Gross Losses	
Fixed Maturities:				
States, municipalities and political subdivisions	\$16,260,720	416,529	(61,892)	16,615,357
U.S. Government and government agencies	3,883,889	122,056	--	4,005,945
Mortgage-backed securities	33,041,863	795,721	(889,922)	32,947,662
Industrial and miscellaneous	17,059,143	584,038	(52,573)	17,590,608
Redeemable preferred securities	<u>2,605,050</u>	<u>196,387</u>	<u>(284,529)</u>	<u>2,516,908</u>
	<u>\$72,850,665</u>	<u>2,114,731</u>	<u>(1,288,916)</u>	<u>73,676,480</u>
Equity Securities	\$ <u>2,258,579</u>	<u>503,778</u>	<u>(653,879)</u>	<u>2,108,478</u>

	Amortized Cost	December 31, 2008		Fair Value
		Gross Gains	Gross Losses	
Fixed Maturities:				
States, municipalities and political subdivisions	\$ 8,335,775	209,436	(52,551)	8,492,659
U.S. Government and government agencies	9,727,287	384,292	--	10,111,579
Mortgage-backed securities	30,939,508	433,264	(1,392,528)	29,980,244
Industrial and miscellaneous	7,827,142	98,532	(156,919)	7,768,755
Redeemable preferred securities	<u>3,967,550</u>	<u>--</u>	<u>(619,540)</u>	<u>3,348,010</u>
	<u>\$60,797,261</u>	<u>1,125,524</u>	<u>(2,221,538)</u>	<u>59,701,247</u>
Equity Securities	\$ <u>1,913,359</u>	<u>1,362</u>	<u>(918,999)</u>	<u>995,722</u>

Management has determined that the above unrealized losses were temporary.

(9) Fair Value Measurements

The Company's estimates of fair value for financial assets and financial liabilities are based on the framework established in FAS 157. The framework is based on the inputs used in valuation, gives the highest priority to quoted prices in active markets and requires that observable inputs be used in the valuations when available. The disclosure of fair value estimates in the FAS 157 hierarchy is based on whether the significant inputs into the valuation are observable. In determining the level of the hierarchy in which the estimate is disclosed, the highest priority is given to unadjusted quoted prices in active markets and the lowest priority to unobservable inputs that reflect the Company's significant market assumptions. The three levels of the hierarchy are as follows:

- Level 1 – Unadjusted quoted market prices for identical assets or liabilities in active markets that the Company has the ability to access.
- Level 2 – Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; or valuations based on models where the significant inputs are observable (e.g., interest rates, yield curves, prepayment speeds, default rates, loss severities, etc.) or can be corroborated by observable market data.
- Level 3 – Valuations based on models where significant inputs are not observable. The unobservable inputs reflect the Company's own assumptions about the assumptions that market participants would use.

Valuation of Investments

The fair value of a financial instrument is the estimated amount at which the instrument could be exchanged in an orderly transaction between knowledgeable, unrelated willing parties, i.e., not in a forced transaction. The estimated fair value of a financial instrument may differ from the amount that could be realized if the security was sold in an immediate sale, e.g., a forced transaction. Additionally, the valuation of fixed maturity investments is more subjective when markets are less liquid due to the lack of market based inputs, which may increase the potential that the estimated fair value (i.e., the carrying amount) of an investment is not reflective of the price at which an actual transaction would occur.

For investments that have quoted market prices in active markets, the Company uses the quoted market prices as fair value and includes these prices in the amounts disclosed in Level 1 of the hierarchy. The Company receives the quoted market prices from a third party nationally recognized pricing service (pricing service). When quoted market prices are unavailable, the Company utilizes a pricing service to determine an estimate of fair value, which is mainly for its fixed maturity investments. The fair value estimates provided from this pricing service are included in the amount disclosed in Level 2 of the hierarchy. If quoted market prices and an estimate from a pricing service are unavailable, the Company produces an estimate of fair value based on internally developed valuation techniques, which, depending on the level of observable market inputs, will render the fair value estimate as Level 2 or Level 3. The Company bases all of its estimates of fair value for assets on the bid price as it represents what a third party market participant would be willing to pay in an arm's length transaction. The following section describes the valuation methods used by the Company for each type of financial instrument it holds that is carried at fair value.

Fixed Maturities

The Company utilizes a pricing service to estimate fair value measurements for all of its fixed maturities. The pricing service utilizes market quotations for fixed maturity securities that have quoted prices in active markets. Since fixed maturities other than U.S. Treasury securities generally do not trade on a daily basis, the pricing service prepares estimates of fair value measurements for these securities using its proprietary pricing applications which include available relevant market information, benchmark curves, benchmarking of like securities, sector groupings and matrix pricing.

The fair value estimates of most fixed maturity investments are based on observable market information rather than market quotes. Accordingly, the estimates of fair value for such fixed maturities, other than U.S. Treasury securities, provided by the pricing service are included in the amount disclosed in Level 2 of the hierarchy. The estimated fair value U.S. Treasury securities are included in the amount disclosed in Level 1 as the estimates are based on unadjusted market prices.

Equities

For public common and preferred stocks, the Company receives prices from a nationally recognized pricing service that are based on observable market transactions and includes these estimates in the amount disclosed in Level 1. Infrequently, current market quotes in active markets are unavailable for certain non-redeemable preferred stocks held by the Company. In these instances, the Company receives an estimate of fair value from the pricing service that provides fair value estimates for the Company's fixed maturities. The service utilizes some of the same methodologies to price the non-redeemable preferred stocks as it does for the fixed maturities. The Company includes the estimate in the amount disclosed in Level 2.

Fair Value Hierarchy

The following table presents the level within the fair value hierarchy at which the Company's financial assets and financial liabilities are measured on a recurring basis at September 30, 2009.

(in millions)	Total	Level 1	Level 2	Level 3
Invested assets;				
Fixed maturities	73,676,480	4,005,945	69,670,535	--
Equity securities	2,108,478	854,260	1,183,360	--
Short-term investments	<u>8,443,254</u>	<u>8,443,254</u>	--	--
Total	<u>84,228,212</u>	<u>13,303,459</u>	<u>70,853,895</u>	--

The following tables summarize, for all investments in an unrealized loss position at September 30, 2009 and December 31, 2008. The aggregate fair value and gross unrealized losses by length of time those securities have been continuously in an unrealized position.

	<u>Less than 12 months</u>		<u>12 months or longer</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Gross Unrealized Loss</u>	<u>Fair Value</u>	<u>Gross Unrealized Loss</u>	<u>Fair Value</u>	<u>Gross Unrealized Loss</u>
<u>September 30, 2009:</u>						
Fixed maturities:						
States, municipalities and political subdivisions	4,922,846	61,797	54,032	95	4,976,878	61,892
United States government and government agencies	--	--	--	--	--	--
Mortgage-backed securities	3,647,103	19,248	3,171,866	870,674	6,818,969	889,922
Industrial and miscellaneous	3,102,885	52,573	--	--	3,102,885	52,573
Redeemable preferred securities	--	--	<u>1,746,721</u>	<u>284,529</u>	<u>1,746,721</u>	<u>284,529</u>
Total fixed maturities	<u>11,672,834</u>	<u>133,618</u>	<u>4,972,619</u>	<u>1,155,298</u>	<u>16,645,453</u>	<u>1,288,916</u>
Equity securities – common stocks	70,858	4,439	--	--	70,858	4,439
Equity securities – perpetual preferred	--	--	<u>1,183,360</u>	<u>649,440</u>	<u>1,183,360</u>	<u>649,440</u>
Total equity	<u>70,858</u>	<u>4,439</u>	<u>1,183,360</u>	<u>649,440</u>	<u>1,254,218</u>	<u>653,879</u>
Total temporarily impaired securities	<u>11,743,692</u>	<u>138,057</u>	<u>6,155,979</u>	<u>1,741,038</u>	<u>17,899,671</u>	<u>1,942,795</u>
	<u>Fair Value</u>	<u>Gross Unrealized Loss</u>	<u>Fair Value</u>	<u>Gross Unrealized Loss</u>	<u>Fair Value</u>	<u>Gross Unrealized Loss</u>
<u>December 31, 2008:</u>						
Fixed maturities:						
States, municipalities and political subdivisions	\$251,495	12,617	482,595	39,934	734,090	52,551
United States government and government agencies	--	--	--	--	--	--
Mortgage-backed securities	3,372,538	466,418	6,100,500	926,110	9,473,038	1,392,528
Industrial and miscellaneous	4,191,100	126,664	469,745	30,255	4,660,845	156,919
Redeemable preferred securities	<u>997,600</u>	<u>2,400</u>	<u>2,350,410</u>	<u>617,140</u>	<u>3,348,010</u>	<u>619,540</u>
Total fixed maturities	<u>8,812,733</u>	<u>608,099</u>	<u>9,403,250</u>	<u>1,613,439</u>	<u>18,215,983</u>	<u>2,221,538</u>
Equity securities – common stocks	64,998	10,299	--	--	64,998	10,299
Equity securities – perpetual preferred	--	--	<u>924,100</u>	<u>908,700</u>	<u>924,200</u>	<u>908,700</u>
Total equity	<u>64,998</u>	<u>10,299</u>	<u>924,100</u>	<u>908,700</u>	<u>989,098</u>	<u>918,999</u>
Total temporarily impaired securities	<u>\$8,877,731</u>	<u>618,398</u>	<u>10,327,350</u>	<u>2,522,139</u>	<u>19,205,081</u>	<u>3,140,537</u>

(10) Segment Reporting

The Company has two reportable operating segments: ACMAT Contracting and ACSTAR Bonding. The Company's reportable segments are primarily the main legal entities of the Company, which offer different products and services. The accounting policies of the segments are the same as those described in the summary of significant accounting policies.

The Bonding operating segment provides surety bonds written for prime, specialty trade, environmental, asbestos and lead abatement contractors and miscellaneous obligations. ACSTAR also offers other miscellaneous surety such as workers' compensation bonds, supply bonds, subdivision bonds and license and permit bonds as well as some general liability.

ACMAT Contracting provides construction contracting services to commercial and governmental customers. ACMAT Contracting also provides underwriting services to its insurance subsidiaries. In addition, ACMAT Contracting owns a

commercial office building in New Britain Connecticut and leases office space to its insurance subsidiaries as well as third parties.

The Company evaluates performance based on earnings before income taxes and excluding interest expense. The Company accounts for intersegment revenue and expenses as if the products/services were to third parties. Information relating to the three segments for the three and nine-month periods ended September 30, 2009 and 2008 is summarized as follows:

	<u>Three Months ended</u>		<u>Nine Months ended</u>	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
Revenues:				
ACSTAR Bonding	\$2,596,770	1,584,867	7,136,935	7,236,039
ACMAT Contracting	<u>720,276</u>	<u>1,396,988</u>	<u>2,671,603</u>	<u>4,801,002</u>
	<u>\$3,317,046</u>	<u>2,981,855</u>	<u>9,808,538</u>	<u>12,037,041</u>
Operating Earnings (Loss):				
ACSTAR Bonding	\$1,570,955	1,406,450	3,789,042	4,154,989
ACMAT Contracting	<u>(552,228)</u>	<u>(843,392)</u>	<u>(2,064,753)</u>	<u>(1,621,822)</u>
	<u>\$1,018,727</u>	<u>563,058</u>	<u>1,724,289</u>	<u>2,533,167</u>
Depreciation and Amortization:				
ACSTAR Bonding	\$130,922	(697)	144,571	(58,214)
ACMAT Contracting	<u>121,401</u>	<u>112,549</u>	<u>364,254</u>	<u>334,643</u>
	<u>\$252,323</u>	<u>111,852</u>	<u>508,825</u>	<u>276,429</u>
Identifiable Assets:	<u>September 30, 2009</u>		<u>December 31, 2008</u>	
ACSTAR Bonding	\$96,196,443		90,303,757	
ACMAT Contracting	<u>13,609,639</u>		<u>19,960,298</u>	
	<u>\$109,806,082</u>		<u>110,264,055</u>	

The components of revenue for each segment for the three and nine-month periods ended September 30, 2009 and 2008 are as follows:

	<u>Three Months ended</u>		<u>Nine Months ended</u>	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
ACSTAR Bonding:				
Premiums	\$1,315,629	2,004,632	4,115,543	6,088,731
Investment income, net	734,593	755,362	2,168,033	2,473,918
Capital gains (losses)	572,062	(1,185,684)	862,113	(1,326,575)
Other	<u>(25,514)</u>	<u>10,557</u>	<u>(8,754)</u>	<u>(35)</u>
	<u>\$2,596,770</u>	<u>1,584,867</u>	<u>7,136,935</u>	<u>7,236,039</u>
ACMAT Contracting:				
Contract revenues	\$195,273	1,420,256	1,260,740	3,483,091
Investment income, net	8,203	78,975	37,266	357,074
Capital gains (losses)	--	(531,548)	1,493	(513,069)
Intersegment revenue:				
Rental income	79,149	79,149	237,448	237,448
Underwriting services, agency commissions and funds administration services	282,635	252,906	697,732	900,839
Other	<u>155,016</u>	<u>97,250</u>	<u>436,924</u>	<u>335,619</u>
	<u>\$720,276</u>	<u>1,396,988</u>	<u>2,671,603</u>	<u>4,801,002</u>

The following is a reconciliation of segment totals for revenue and operating income to corresponding amounts in the Company's statement of earnings:

	<u>Three Months ended</u>		<u>Nine Months ended</u>	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
Revenue:				
Total revenue for reportable segments	\$3,317,046	2,981,855	9,808,538	12,037,041
Intersegment eliminations	<u>(206,188)</u>	<u>(213,473)</u>	<u>(566,236)</u>	<u>(728,068)</u>
	<u>\$3,110,858</u>	<u>2,768,382</u>	<u>9,242,302</u>	<u>11,308,973</u>

The adjustments and eliminations required to arrive at consolidated amounts shown above consist principally of the elimination of the intersegment revenues related to the performance of certain services and rental charges. Identifiable assets are those assets that are used by each segment's operations. Foreign revenues are not significant.

Operating Earnings:	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
Total operating earnings for reportable segments	\$1,018,727	563,058	1,724,289	2,533,167
Interest expense	<u>(65,655)</u>	<u>(101,893)</u>	<u>(203,052)</u>	<u>(353,230)</u>
	<u>\$953,072</u>	<u>461,165</u>	<u>1,521,237</u>	<u>2,179,937</u>

Operating earnings for ACMAT contracting are operating revenues less cost of contract revenues and identifiable selling, general and administrative expenses. Operating earnings for the bonding and liability insurance segments are revenues less losses and loss adjustment expenses, amortization of policy acquisition costs and identifiable, general and administrative expenses.