ACMAT CORPORATION AND SUBSIDIARIES
DECEMBER 31, 2007

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ACMAT CORPORATION AND SUBSIDIARIES

Consolidated Statements of Earnings
Years Ended December 31, 2007 and 2006

	2007	2006
Earned premiums	$10,159,139	12,437,099
Contract revenues	5,676,191	6,086,702
Investment income, net	5,242,249	5,140,425
Net realized capital losses	(79,581)	(210,947)
Other income	959,268	746,052
	21,957,266	24,199,331
Cost of contract revenues	5,623,428	5,937,573
Losses and loss adjustment expenses	2,031,828	2,413,289
Amortization of policy acquisition costs	2,535,706	2,721,398
General and administrative expenses	4,920,525	4,662,019
Interest expense	725,485	891,568
	15,836,972	16,625,847
Earnings before income taxes	6,120,294	7,573,484
Income taxes	2,003,797	2,574,165
Net earnings	$4,116,497	4,999,319
Basic earnings per share	$2.21	2.43
Diluted earnings per share	$2.06	2.30

See Notes to Consolidated Financial Statements.

ACMAT CORPORATION AND SUBSIDIARIES

Consolidated Balance Sheets
December 31, 2007 and 2006

Assets	2007	2006
Investments:		
Fixed maturities – available for sale at fair value		
(Amortized cost of $65,672,276 in 2007 and $66,491,385 in 2006)	$64,211,281	66,297,715
Equity securities – available for sale at fair value		
(Cost of $3,463,359 in 2007 and $4,863,359 in 2006)	2,928,649	5,142,993
Short-term investments, at cost which approximates fair value	28,088,375	29,972,891
Total Investments	95,228,305	101,413,599
Cash and cash equivalents	6,239,190	7,584,783
Accrued interest receivable	235,923	270,410
Receivables, net of allowance for doubtful accounts of		
$101,231 in 2007 and 2006	2,193,739	892,046
Reinsurance recoverable:		
Unpaid losses	3,298,783	2,954,488
Paid losses	--	43,392
Prepaid expenses	191,511	203,487
Income taxes receivable	340,865	--
Property and equipment, net	10,409,649	10,672,517
Deferred policy acquisition costs	1,011,123	1,201,221
Other assets	703,790	1,837,031
Intangibles	1,920,360	1,920,360
Total Assets	$121,773,238	128,993,334
Liabilities & Stockholders' Equity		
Accounts payable	$2,456,855	1,538,035
Reserves for losses and loss adjustment expenses	22,845,815	22,080,301
Unearned premiums	3,574,057	4,636,637
Collateral held	30,718,628	36,547,528
Income tax payable	--	299,762
Deferred income taxes	111,225	24,677
Other accrued liabilities	4,438,842	2,573,272
Long-term debt	8,662,232	11,306,288
Total Liabilities	72,807,654	79,006,500
Stockholders' Equity:		
Common Stock (No par value; 3,500,000 shares authorized;		
478,692 and 481,585 shares issued and outstanding)	478,692	481,585
Class A Stock (No par value; 10,000,000 shares authorized;		
1,315,960 and 1,422,273 shares issued and outstanding)	1,315,960	1,422,273
Retained earnings	49,188,831	47,913,873
Accumulated other comprehensive income (loss)	(2,017,899)	169,103
Total Stockholders' Equity	48,965,584	49,986,834
	$121,773,238	128,993,334

See Notes to Consolidated Financial Statements.

ACMAT CORPORATION AND SUBSIDIARIES

Consolidated Statements of Stockholders' Equity
December 31, 2007 and 2006

	Common Stock par value	Class A Stock par value	Retained earnings	Accumulated other comprehensive income (loss)	Total stockholders' equity
Balance as of December 31, 2005	$510,585	1,699,848	49,220,834	(442,263)	50,989,004
Comprehensive income:					
Net unrealized gain on debt and equity securities, net of reclassification adjustment	---	---	---	611,836	611,836
Net unrealized loss on derivatives qualifying as hedges	---	---	---	(470)	(470)
Net earnings	---	---	4,999,319	---	4,999,319
Total comprehensive income					5,610,685
Stock based compensation	---	---	188,886	---	188,886
Acquisition and retirement of 29,000 shares of Common Stock	(29,000)	---	(658,100)	---	(687,100)
Acquisition and retirement of 308,575 shares of Class A Stock	---	(308,575)	(6,179,170)	---	(6,487,745)
Issuance of 31,000 shares of Class A Stock pursuant to stock options	---	31,000	342,104	---	373,104
Balance as of December 31, 2006	$481,585	1,422,273	47,913,873	169,103	49,986,834
Comprehensive income:					
Net unrealized loss on debt and equity securities, net of reclassification adjustment	$ ---	---	---	(2,085,081)	(2,085,081)
Net unrealized loss on derivatives qualifying as hedges	---	---	---	(101,921)	(101,921)
Net earnings	---	---	4,116,497	---	4,116,497
Total comprehensive income					1,929,495
Stock based compensation	---	---	117,420	---	117,420
Acquisition and retirement of 2,893 shares of Common Stock	(2,893)	---	(68,097)	---	(70,990)
Acquisition and retirement of 125,313 shares of Class A Stock	---	(125,313)	(3,164,339)	---	(3,289,652)
Issuance of 19,000 shares of Class A Stock pursuant to stock options	---	19,000	273,477	---	292,477
Balance as of December 31, 2007	$478,692	1,315,960	49,188,831	(2,017,899)	48,965,584

See Notes to Consolidated Financial Statements.

ACMAT CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows
Years ended December 31, 2007 and 2006

	2007	2006
Cash Flows From Operating Activities:		
Net earnings	$4,116,497	4,999,319
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Stock based compensation expense	117,420	188,886
Depreciation and amortization	253,216	382,946
Net realized capital losses	79,581	210,947
Deferred income taxes	115,773	366,340
Changes In:		
Accrued interest receivable	34,487	244,219
Receivables	(1,301,693)	826,336
Reinsurance recoverable	(300,903)	1,063,107
Deferred policy acquisition costs	190,098	17,988
Prepaid expenses and other assets	1,145,217	(574,829)
Accounts payable and other liabilities	2,682,469	(1,800,825)
Collateral held	(5,828,900)	38,929
Reserves for losses and loss adjustment expenses	765,514	(1,022,476)
Income taxes	(640,626)	16,222
Unearned premiums	(1,062,580)	(362,084)
Other	(32,626)	--
Net cash provided by operating activities	332,944	4,595,025
Cash Flows From Investing Activities:		
Proceeds from investments sold or matured:		
Fixed maturities – sold	12,354,015	38,717,728
Fixed maturities – matured	3,716,000	11,545,000
Equity securities	978,000	508,000
Purchases Of:		
Fixed maturities	(14,730,889)	(31,300,906)
Equity securities	---	(900,000)
Short-term investments, (purchases) sales, net	1,884,516	(20,691,050)
Capital expenditures	(167,958)	(238,862)
Net cash provided by (used for) investing activities	4,033,684	(2,360,090)
Cash Flows From Financing Activities:		
Repayments on long-term debt	(2,644,056)	(2,577,700)
Issuance of Common and Class A Stock	182,480	254,750
Tax benefit from exercise of stock options	109,997	118,354
Payments for acquisition and retirement of stock	(3,360,642)	(7,174,845)
Net cash used for financing activities	(5,712,221)	(9,379,441)
Net change in cash and cash equivalents	(1,345,593)	(7,144,506)
Cash and cash equivalents, beginning of year	7,584,783	14,729,289
Cash and cash equivalents, end of year	$6,239,190	7,584,783

See Notes to Consolidated Financial Statements.

ACMAT CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007 and 2006

(1) Summary of Significant Accounting Policies

(a) Basis of Presentation

The consolidated financial statements include ACMAT Corporation ("ACMAT" or the "Company"), its subsidiaries, including AMINS, Inc., ACSTAR Holdings, Inc. ("ACSTAR Holdings") and ACSTAR Holdings' wholly-owned subsidiary, ACSTAR Insurance Company ("ACSTAR").

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and claims and expenses during the reporting period. Actual results could differ from those estimates. Certain reclassifications have been made to prior years' financial statements to conform to the current year's presentation. All material intercompany transactions and balances have been eliminated.

(b) Business

The Company has two reportable operating segments: ACMAT Contracting and ACSTAR Bonding. The Company's reportable segments are primarily the 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 contractors, specialty trade, environmental remediation and asbestos abatement contractors and others. ACSTAR also offers other miscellaneous surety such as workers' compensation bonds, supply bonds, subdivision bonds and license and permit bonds.

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 subsidiary as well as to third parties.

During 2007 and 2006, customers who individually accounted for more than 10% of consolidated construction contracting revenue are as follows; in 2007 – 3 customers provided 43%, 43% and 10%, respectively and in 2006 - four customers provided 33%, 31%, 19% and 17%, respectively.

(c) Investments

Fixed maturities include bonds, notes and redeemable preferred stocks. Equity securities reflect investment in common stock, non-redeemable preferred stock and mutual funds. Investments are classified as "available for sale" and are reported at fair value, with unrealized gains or losses, net of tax, charged or credited directly to stockholders' equity.

The fair values of investment securities are based on quoted market prices and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates. Premiums and discounts on debt securities are amortized into interest income over the term of the securities in a manner that approximates the interest method. Realized gains and losses on sales of securities are computed using the specific identification method. Any security which management believes has experienced a decline in value which is other than temporary is written down to its fair value and a charge is recorded in net realized capital gains.

Short-term investments, consisting primarily of treasury bills maturing within one year are carried at cost which, along with accrued interest, approximates fair value. Cash and cash equivalents include cash on hand and short-term highly liquid investments of maturities of three months or less when purchased. These investments are carried at cost plus accrued interest which approximates fair value.

An investment in a debt or equity security is impaired if its fair value falls below its book value and the decline is considered to be other-than temporary. Factors considered in determining whether a decline is other-than-temporary include the length of time and the extent to which fair value has been below cost, the financial condition and the near-term prospects of the issuer; and the Company's ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery. Additionally, for certain securitized financial assets with contractual cash flows (including asset backed securities), EITF 99-20 requires the Company to periodically update

its best estimate of cash flows over the life of the security. If management determines that the fair value of its securitized financial asset is less than its carrying amount and there has been a decrease in the present value of the estimated cash flows since the last revised estimate, considering both timing and amount, then an other-than-temporary impairment charge is recognized. A debt security is impaired if it is probable that the Company will not be able to collect all amounts due under the security's contractual terms. Equity investments are impaired when it becomes apparent that the Company will not recover its cost over the expected holding period and consideration is given to the financial condition of the issue. Further, for securities expected to be sold, an other-than-temporary impairment charge is recognized if the Company does not expect the fair value of a security to recover the cost prior to the expected date of sale.

The Company's process for reviewing invested assets for impairments includes the following:

- Identification and evaluation of investments which have possible indications of impairment;
- Analysis of investments with gross unrealized investment losses that have fair value less than 80% of amortized cost during successive quarterly periods over a rolling one-year period;
- Management review of other-than-temporary impairments based on the investee's current financial condition, liquidity, near term recovery prospects and other factors, as well as consideration of other investments that were not recommended for other-than-temporary impairments;
- Consideration of evidential matter, including an evaluation of factors or triggers that would or could cause individual investments to qualify as having other-than-temporary impairment and those that would not support other-than-temporary impairments; and
- Determination of the status of each analyzed investment as other-than-temporary or not, with documentation of the rationale for the decision.

(d) Deferred Policy Acquisition Costs

Deferred policy acquisition costs, representing commissions and certain underwriting costs, are deferred and amortized pro rata over the contract periods in which the related premiums are earned. Deferred acquisition costs are reviewed to determine if they are recoverable from future income, and if not, are charged to expense. Future investment income attributable to related premiums is taken into account in measuring the recoverable of the carrying value of this asset.

(e) Property and Equipment

Property and equipment are stated at cost net of depreciation. Depreciation is computed using the straight-line method at rates based upon the respective estimated useful lives of the assets. Maintenance and repairs are expensed as incurred.

(f) Intangibles

Intangible assets relate to insurance operating licenses that are deemed to have an indefinite useful life. The Company performs an impairment test at least annually or more frequently if events or conditions indicate that the asset might be impaired. Based on these tests, the Company did not impair any intangible assets.

(g) Insurance Reserve Liabilities

Reserves for losses and loss adjustment expenses are established with respect to both reported and incurred but not reported claims for insured risks. The amount of loss reserves for reported claims is primarily based upon a case-by-case evaluation of the type of risk involved, knowledge of the circumstances surrounding the claim and the policy provisions relating to the type of claim. As part of the reserving process, historical data is reviewed and consideration is given to the anticipated impact of various factors such as legal developments and economic conditions, including the effects of inflation. Reserves are monitored and recomputed periodically using new information on reported claims.

Reserves for losses and loss adjustment expenses are estimates at any given point in time of what the Company may have to pay ultimately on incurred losses, including related settlement costs, based on facts and circumstances then known. The Company also reviews its claims reporting patterns, past loss experience, risk factors and current trends and considers their effect in the determination of estimates of incurred but not reported losses. Ultimate losses and loss adjustment expenses are affected by many factors which are difficult to predict, such as claim severity and frequency, inflation levels and unexpected and unfavorable judicial rulings. Reserves for surety claims also consider the amount of collateral held as well as the financial strength of the contractor and its indemnitors. Management believes that the reserves for losses and loss adjustment expenses are adequate to cover the unpaid portion of the ultimate net cost of losses and loss adjustment expenses incurred, including losses incurred but not reported.

(h) Collateral Held

Collateral held represents cash and investments retained by the Company for surety bonds issued by the Company to cover costs of claims or unpaid premiums. The carrying amount of collateral held approximates its fair value because of the short maturity of these instruments.

(i) Reinsurance

In the normal course of business, the Company may assume and cede reinsurance with other companies. Reinsurance ceded primarily represents excess of loss reinsurance with companies with "A" ratings from the insurance rating organization, A.M. Best Company, Inc. Reinsurance ceded also includes a facultative reinsurance treaty which is applicable to excess policies written over a primary policy issued by the Company for specific projects. Reinsurance is ceded to limit losses from large exposures and to permit recovery of a portion of direct losses; however, such a transfer does not relieve the originating insurer of its liability.

Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured business. The Company evaluates and monitors the financial condition of reinsurers under reinsurance arrangements to determine its exposure to significant losses from reinsurer insolvencies.

The Company cedes 80% of its bond exposure in excess of $1,000,000 up to $7,000,000 on a per principal basis.

Reinsurance recoverables include ceded reserves for losses and loss adjustment expenses. Ceded unearned premiums of $507,520 and $643,375 at December 31, 2007 and 2006 respectively, are included in other assets. All reinsurance contracts maintained by the Company qualify as short-duration prospective contracts. A summary of reinsurance premiums written and earned is provided below:

	Premiums Written		Premiums Earned	
	2007	2006	2007	2006
Direct	$10,754,715	14,318,226	$11,788,853	13,814,741
Assumed	56,250	(14,379)	84,694	851,189
Ceded	(1,578,553)	(2,133,071)	(1,714,408)	(2,228,831)
Totals	$9,232,412	12,170,776	$10,159,139	12,437,099

Ceded incurred losses and loss adjustment expenses totaled $445,766 and $432,481 for the years ended December 31, 2007 and 2006, respectively.

(j) Derivative Financial Instruments

The Company uses interest rate swaps as a means of hedging exposure to interest rate on its long-term debt. The Company does not hold or issue derivative instruments for trading purposes. The Company recognizes all derivatives as either assets or liabilities in the consolidated balance sheet and measures those instruments at fair value. Where applicable, hedge accounting is used to account for derivatives. To qualify for hedge accounting, the changes in value of the derivative must be expected to substantially offset the changes in value of the hedged item. Hedges are monitored to ensure that there is a high correlation between the derivative instruments and the hedged investment. Derivatives that do not qualify for hedge accounting, if any, would be marked to market with the changes in fair value reflected in the consolidated statement of earnings.

(k) Revenue Recognition

Revenue on construction contracts is recorded using the percentage of completion method. Under this method revenues with respect to individual contracts are recognized in the proportion that costs incurred to date relate to total estimated costs. Revenues and cost estimates are subject to revision during the terms of the contracts, and any required adjustments are made in the periods in which the revisions become known. Provisions are made, where applicable, for the entire amount of anticipated future losses on contracts in progress. Construction claims are recorded as revenue at the time of settlement and profit incentives and change orders are included in revenues when their realization is reasonably assured. General and administrative expenses are not allocated to contracts.

Insurance premiums are recognized over the coverage period. Unearned premiums represent the portion of premiums written that is applicable to the unexpired terms of policies in force, calculated on a pro-rata basis.

(l) Income Taxes

The provision for taxes comprises two components, current income taxes and deferred income taxes. Deferred income taxes arise from changes during the year in cumulative temporary differences between the tax basis and book basis of assets and liabilities.

Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred tax assets are reduced by a valuation allowance if it is more likely than not that all or some portion of the deferred tax assets will not be realized.

(m) Use of Estimates

The preparation of financial statements in conformity with U.S. Generally Accepted Accounting Principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from reported results using those estimates.

(n) Comprehensive Income

The following table summarizes reclassification adjustments for other comprehensive income and the related tax effects for the years ended December 31, 2007 and 2006:

	2007	2006
Unrealized holding gain (loss) arising during period, net of income tax expense of $29,225 in 2006	$(2,085,081)	472,611
Less reclassification adjustment for losses included in net earnings, net of income tax benefit of $27,058 in 2007 and $71,722 in 2006	(52,523)	(139,225)
Unrealized loss on derivatives qualifying as cash flow hedges	(101,921)	(470)
Other comprehensive income (loss)	$(2,187,002)	611,366

(o) Stock – Based Compensation

The Company periodically grants non-qualified stock options to officers and directors giving such individuals the right to purchase restricted shares of the Company's Common Stock and Class A Stock. Compensation cost is measured based on the grant-date fair value of the award determined pursuant to FAS 123R, Share Based Payment, utilizing the assumptions discussed in note 14. Compensation cost is recognized for financial reporting purposes over the period in which the employee is required to provide service in exchange for the award (generally the vesting period).

(p) Adoption of New Accounting Standards

Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts

In September 2005, the Accounting Standards Executive Committee (AcSEC) issued Statement of Position 05-1, Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts (SOP 05-1). SOP 05-1 provides guidance on accounting by insurance enterprises for deferred acquisition costs on internal replacements of insurance and investment contracts other than those specifically described in FAS 97, "Accounting and Reporting by Insurance Enterprises for Certain Long Duration Contracts and for Realized Gains and Losses from the Sale of Investments". SOP 05-1 defines an internal replacement as a modification of product benefits, features, rights, or coverages that occurs by the exchange of a contract for a new contract, or by amendment, endorsement, or order to a contract, or by the election of a feature or coverage within a contract. The adoption of SOP 05-1 effective January 1, 2007 did not have a material effect on operations, financial position or liquidity.

Accounting for Uncertainty in Income Taxes

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements and prescribes the recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

Under FIN 48, evaluation of a tax position is a two-step process. The first step is to determine whether it is more-likely-than-not that a tax position will be sustained upon examination, including the resolution of any related appeals or litigation based on the technical merits of the position. The second step is to measure a tax position that meets the more-likely-than-not threshold to determine the amount of benefit to be recognized in the financial statements. A tax position that meets the more-likely-than-not recognition threshold shall initially and subsequently be measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information.

Tax positions that previously failed to meet the more-likely-than not recognition threshold should be recognized in the first subsequent period in which the threshold is met. Previously recognized tax positions than no longer meet the more-likely-than-not criteria should be de-recognized in the first subsequent financial reporting period in which the threshold is no longer met.

The adoption of FIN 48 effective January 1, 2007 did not have a material effect on the Company's results of operations, financial position or liquidity.

The Company recognizes accrued interest and penalties, if any, related to unrecognized tax benefits in income taxes.

The Company does not have a liability nor does it expect any significant changes in unrecognized tax benefits during the next twelve months.

In May 2007, the FASB issued FASB Staff Position (FSP) FIN 48-1. Definition of Settlement in FASB Interpretation No. 48 (FSP FIN 48-1). The FSP addressed whether it is appropriate for a company to recognize a previously unrecognized tax benefit when the only factor that has changed, since determining that a benefit should not be recognized, was the completion of an examination or audit by a taxing authority. The FSP is effective January 1, 2007, the date the Company's initial adoption of FIN 48. The adoption of FSP FIN 48-1 did not have a material effect on the Company's results of operations, financial position or liquidity.

Accounting for Corporate-Owned Life Insurance

In September 2006, the FASB issued Emerging Issues Task Force Issue No. 06-5, Accounting for Purchase of Life Insurance – Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulleting No. 85-4 (EITF06-5). EITF 06-5 provides additional guidance on determining the amount that can be realized under a corporate-owned life insurance contract (that is, converted to cash) based upon how the contract is assumed to be hypothetically settled. The adoption of EITF 06-5 effective January 1, 2007 did not have a material effect on the Company's results of operations, financial position or liquidity.

(q) Accounting Standards Not Yet Adopted

Fair Value Measurements

In September 2006, the 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 is effective for fiscal years beginning after November 15, 2007.

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

The Company will adopt FAS 157 and FSP FAS 157-2 effective January 1, 2008. Accordingly, the provisions of FAS 157 will not be applied to goodwill and other intangible assets held by the Company and measured annually for impairment testing purposes only. The adoption of FAS 157, for all other assets and liabilities held by the Company, is not expected to 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 attribute 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 up-front 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 aggregating those amounts and disclosing 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 will 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 will not have an impact on the Company's results of operations, financial position or liquidity.

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. EITF 06-10 is effective for fiscal years beginning after December 15, 2007. The Company does not expect the adoption of EITF 06-10 effective January 1, 2008 to have a material effect on its results of operations, financial position or liquidity.

ACMAT CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(2) Investments

Investments at December 31, 2007 and 2006 follows:

	AMORTIZED COST	ESTIMATED FAIR VALUE
2007		
Fixed maturities – available for sale:		
Bonds:		
States, municipalities and political subdivisions	$ 738,060	733,002
United States government and government agencies	14,022,728	14,664,268
Mortgage-backed securities	37,306,488	36,961,777
Industrial and miscellaneous	2,500,000	2,472,015
Redeemable preferred stock	11,105,000	9,380,219
Total fixed maturities	65,672,276	64,211,281
Equity securities – common stocks:		
Banks, trusts and insurance	80,559	181,029
Equity securities perpetual preferreds:		
Industrial and miscellaneous	3,382,800	2,747,620
Total equity securities	3,463,359	2,928,649
Short-term investments	28,088,375	28,088,375
Total investments	$97,224,010	95,228,305

	AMORTIZED COST	ESTIMATED FAIR VALUE
2006		
Fixed maturities – available for sale:		
Bonds:		
States, municipalities and political subdivisions	$ 743,676	729,561
United States government and government agencies	10,281,601	10,184,110
Mortgage-backed securities	41,566,108	41,473,679
Industrial and miscellaneous	4,000,000	3,913,345
Redeemable preferred stock	9,900,000	9,997,020
Total fixed maturities	66,491,385	66,297,715
Equity securities – common stocks:		
Banks, trusts and insurance	80,559	197,293
Equity securities - perpetual preferreds:		
Banks, trusts and insurance	550,000	585,200
Industrial and miscellaneous	4,232,800	4,360,500
Total equity securities	4,863,359	5,142,993
Short-term investments	29,972,891	29,972,891
Total investments	$101,327,635	101,413,599

On December 31, 2007 and 2006, the Company's insurance subsidiary had securities with an aggregate fair value of approximately $4 million deposit with various state regulatory authorities.

The amortized cost and fair value of fixed maturities at December 31, 2007, by effective maturity, follows:

	2007	
	Amortized Cost	Fair Value
Due in one year or less	$ 273,457	275,342
Due after one year through five years	13,277,648	13,914,840
Due after five years through ten years	2,209,683	2,201,057
Due after ten years	12,605,000	10,858,265
Mortgage-backed securities	37,306,488	36,961,777
Total	$65,672,276	64,211,281

Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

The Company's fixed maturity portfolio is comprised primarily of fixed maturity securities rated AA or better by Standard and Poor's and includes mostly U.S. Treasuries and mortgage-backed securities.

The Company makes investments in collateralized mortgage obligations (CMOs) that typically have high credit quality, offer good liquidity and are expected to provide an advantage in yield compared to U.S. Treasury securities. The Company's investment strategy is to purchase CMO tranches which offer the most favorable return given the risks involved. One significant risk evaluated is prepayment sensitivity. The Company does not purchase residual interests in CMOs.

At December 31, 2007 and 2006, the Company held CMOs classified as available for sale with a fair value of $36,920,692 and $41,363,934, respectively. Approximately 84% and 83% of the Company's CMO holdings are fully collateralized by GNMA, FNMA or FHLMC securities at December 31, 2007 and 2006, respectively. In addition, the Company held $41,085 and $109,745 of FNMA mortgage-backed pass-through securities classified as available for sale at December 31, 2007 and 2006, respectively. Virtually all of these securities are rated Aaa.

A summary of gross unrealized gains and losses at December 31, 2007 and 2006 follows:

	2007		2006	
	Gains	Losses	Gains	Losses
Fixed maturities:				
States, municipalities and political subdivision	$ 214	(5,272)	--	(14,115)
United States government and government agencies	644,350	(2,810)	2,944	(100,435)
Mortgage-backed securities	166,219	(510,931)	170,382	(262,811)
Industrial and miscellaneous	--	(27,985)	--	(86,655)
Redeemable preferred stock	--	(1,724,780)	129,880	(32,860)
Total	810,783	(2,271,778)	303,206	(496,876)
Equity securities	100,470	(635,180)	279,634	--
Total	$911,253	(2,906,958)	582,840	(496,876)

The unrealized losses on the Company's investments in mortgage-backed securities were caused by a combination of factors during 2007 related to the market disruption caused by credit concerns surrounding the sub-prime issue, but also extended into other asset-backed securities in the market and specifically in the Company's portfolio.

The majority of the holdings in this mortgage-backed security category includes mortgage-backed securities guaranteed by an agency of the U.S. Government. There were 12 agency mortgage-backed securities in an unrealized loss position of $329,585 as of December 31, 2007. The aggregate severity of the unrealized losses on these securities was approximately 3% of amortized cost. These securities do not tend to be influenced by the credit of the issuer but rather the characteristics and projected cash flows of the underlying collateral.

The remainder of the holdings in this mortgage-backed security category are collateralized mortgage obligations (CMOs) typically collateralized with prime residential mortgages and corporate asset-backed structured securities. The holdings in these sectors include 7 securities in a gross unrealized loss position of $181,346. All of the securities in a gross unrealized loss position are rated AAA. The aggregate severity of the unrealized loss was approximately 4% of amortized cost.

The Company believes the decline in fair value was primarily attributable to the market disruption caused by sub-prime related issues and other temporary market conditions. Because the Company has the ability and intent to hold these investments until an anticipated recovery of fair value, which may be maturity, the Company considers these investments to be temporarily impaired at December 31, 2007.

The unrealized losses on the Company's investments in redeemable preferred stock were caused by similar factors as those that affected the Company's corporate bond portfolio. The holdings in this category have been adversely impacted by significant credit spread widening brought on by a combination of factors in the capital markets. Many of the securities in this category have fallen out of favor in the current market conditions. Virtually all of the gross unrealized losses in this category come from securities issued by diversified financial institutions. The holdings in this category include 16 securities in a gross unrealized loss position of $1,724,780. The aggregate severity of the unrealized losses on these securities was approximately 16% of amortized costs. All of these securities in a gross unrealized loss position are rated A or higher. The Company believes the decline in fair value was primarily due to the market disruption caused by sub-prime related issues and other temporary market conditions. Because the Company has the ability and intent to hold these

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investments until an anticipated recovery of fair value, which may be maturity, the Company considers these investments to be temporarily impaired at December 31, 2007. The unrealized losses on the Company's investments in equity securities were caused by similar factors as those that affected the Company's fixed maturities. Many of the securities in this category have fallen out of favor in the current market condition. All of the gross unrealized losses in this category come from five securities issued by diversified financial institutions. The Company has the ability and intent to hold these securities until market conditions improve.

The gross unrealized investment losses and related fair value for fixed maturities and equity securities at December 31, 2007 and 2006 were as follows:

	Less than 12 months		12 months or longer		Total 2007	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
Fixed maturities:						
States, municipalities and political subdivisions	$ --	--	523,105	5,272	523,105	5,272
United States government and government agencies	--	--	997,190	2,810	997,190	2,810
Mortgage-backed securities	7,635,167	245,702	8,631,897	265,229	16,267,064	510,931
Industrial and miscellaneous	--	--	2,472,015	27,985	2,472,015	27,985
Redeemable preferred stock	8,415,490	1,524,510	964,730	200,270	9,380,220	1,724,780
Total fixed maturities	16,050,657	1,770,212	13,588,937	501,566	29,639,594	2,271,778
Equity securities – common stocks	--	--	--	--	--	--
Equity securities – perpetual preferred	2,747,620	635,180	--	--	2,747,620	635,180
Total equity	2,747,620	635,180	--	--	2,747,620	635,180
Total temporarily impaired securities	$18,798,277	2,405,392	13,588,937	501,566	32,387,214	2,906,958

	Less than 12 months		12 months or longer		Total 2006	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
Fixed maturities:						
States, municipalities and political subdivisions	$ --	--	729,561	14,115	729,561	14,115
United States government and government agencies	5,439,459	23,841	4,140,433	76,594	9,579,892	100,435
Mortgage-backed securities	2,045,155	10,090	22,230,571	252,721	24,275,726	262,811
Industrial and miscellaneous	1,466,900	33,100	2,446,445	53,555	3,913,345	86,655
Redeemable preferred stock	733,140	16,860	1,484,000	16,000	2,217,140	32,860
Total fixed maturities	9,684,654	83,891	31,031,010	412,985	40,715,664	496,876
Equity securities – common stocks	--	--	--	--	--	--
Equity securities – perpetual preferred	--	--	--	--	--	--
Total equity	--	--	--	--	--	--
Total temporarily impaired securities	$9,684,654	83,891	31,031,010	412,985	40,715,664	496,876

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(3) Investment Income and Realized Capital Gains and Losses

A summary of net investment income for the years ended December 31, 2007 and 2006 follows:

	2007	2006
Tax-exempt interest	$ 24,444	26,444
Taxable interest	4,288,455	4,456,801
Dividends on equity securities	952,202	710,674
Investment expenses	(22,852)	(53,494)
Net investment income	$5,242,249	5,140,425

Net realized capital losses for the years ended December 31, 2007 and 2006 follows:

	2007	2006
Fixed maturities	$(63,181)	(218,947)
Equity securities	(16,400)	(8,000)
Net realized capital losses	$(79,581)	(210,947)

Proceeds from sales of fixed maturities classified as available for sale were $12,354,015 and $38,717,728 in 2007 and 2006, respectively. Gross gains of $8,733 and $28,968 and gross losses of $71,914 and $247,915 were realized on fixed maturity sales for the years ended December 31, 2007 and 2006, respectively. Proceeds from sales of equity securities were $978,000 and $508,000 in 2007 and 2006, respectively. Gross gains of $5,600 and $8,000 were realized on the sale of equity securities for the years ended December 31, 2007 and 2006, respectively, and gross losses of $22,000 and $0 were realized on equity security sales for the years ended December 31, 2007 and 2006, respectively.

(4) Receivables

A summary of receivables at December 31, 2007 and 2006 follows:

	2007	2006
Insurance premiums due from agents	$743,082	179,997
Receivables under construction contracts:		
Amounts billed	902,075	483,146
Recoverable costs in excess of billings on uncompleted contracts	207,517	40,000
Billings in excess of costs on uncompleted contracts	--	(210,389)
Retainage, due on completion of contracts	422,293	453,041
Total receivables under construction contracts	1,531,885	765,798
Other	20,003	47,482
Total receivables	2,294,970	993,277
Less allowances for doubtful accounts	(101,231)	(101,231)
Total receivables, net	$2,193,739	892,046

The balances billed but not paid by customers pursuant to retainage provisions in construction contracts will be due upon completion of the contracts and acceptance by the owner. In management's opinion, the majority of contract retainage is expected to be collected in 2008.

Recoverable costs in excess of billings on uncompleted contracts are comprised principally of revenue recognized on contracts for which billings had not been presented to the contract owners as of the balance sheet date. These amounts will be billed in accordance with the contract terms.

(5) Property and Equipment

A summary of property and equipment at December 31, 2007 and 2006 follows:

	2007	2006
Building	$16,371,597	16,246,615
Land	800,000	800,000
Equipment and vehicles	1,200,321	1,488,938
Furniture and fixtures	866,355	856,771
	19,238,273	19,392,324
Less accumulated depreciation	8,828,624	8,719,807
	$10,409,649	10,672,517

Useful lives for depreciation purposes are five years for equipment and vehicles, fifteen years for furniture and fixtures and forty years for the building. Depreciation expense in 2007 and 2006 was $430,826 and $440,678, respectively.

Future minimum rental income to be generated by leasing a portion of the building under non-cancelable operating leases as of December 31, 2007 are estimated to be $466,909 for 2008, $521,115 for 2009, $485,115 for 2010, $485,115 for 2011 and $1,261,975 thereafter. Rental income earned in 2007 and 2006 was $438,047 and $396,526, respectively.

(6) Reserves for Losses and Loss Adjustment Expenses

The following table sets forth a reconciliation of beginning and ending reserves for unpaid losses and loss adjustment expenses for the periods indicated on a GAAP basis for the business of the Company.

	2007	2006
Balance at January 1	$22,080,301	23,102,777
Less reinsurance recoverable	2,954,488	3,896,869
Net balance at January 1	19,125,813	19,205,908
Incurred related to:		
Current year	3,059,000	2,942,000
Prior years	(1,027,172)	(528,711)
Total incurred	2,031,828	2,413,289
Payments related to:		
Current year	33,000	17,000
Prior years	1,577,609	2,476,384
Total payments	1,610,609	2,493,384
Net balance at December 31	19,547,032	19,125,813
Plus reinsurance recoverable	3,298,783	2,954,488
Balance at December 31	$22,845,815	22,080,301

The increase in reserves for unpaid losses and loss adjustment expenses in 2007 from 2006 primarily resulted from a decrease in claim payments. The reduction in prior year incurreds for 2007 represents favorable loss development on general liability exposures. The decrease in reserves for unpaid losses and loss adjustment expenses in 2006 from 2005 primarily resulted from favorable claim settlement and reduced incurred losses and loss adjustment expenses. While management continually evaluates the potential for changes in loss estimates, due to the uncertainty inherent in the surety business, the emergence of net favorable development may or may not continue to occur. Management believes that the reserves for losses and loss adjustment expense are adequate to cover the unpaid portion of the ultimate net cost of losses and loss adjustment expenses, including losses incurred but not reported.

The Company has no exposure to any asbestos or environmental claims associated with general liability policies issued with the pre-1986 pollution exclusion. Policies written with the exclusion are typically associated with mass tort environmental and asbestos claims. The Company has never issued a policy with the pre-1986 pollution exclusion. The Company's exposure to asbestos and environmental liability claims is primarily limited to asbestos and environmental liability insurance for contractors and consultants involved in the remediation, removal, storage, treatment and/or disposal of environmental and asbestos hazards.

(7) Notes Payable to Banks

At December 31, 2007, the Company has a $10,000,000 bank line of credit with two financial institutions. The line of credit does not require the Company to maintain a compensating balance. There were no outstanding borrowings under this line of credit at December 31, 2007 and 2006. Under the terms of the line of credit, interest on the outstanding balance is calculated based upon the London Inter-Bank Offering Rate (LIBOR) plus 160 basis points in effect during the borrowing period. The Company pays an annual commitment fee of .25% of the unused portion of the bankline.

(8) Long-term Debt

A summary of long-term debt at December 31, 2007 and 2006 follows:

	2007	2006
Term Loan II due 2008	$1,000,000	2,000,000
Term Loan III due 2009	6,611,110	7,277,777
Mortgage Note due 2009	1,051,122	2,028,511
	$8,662,232	11,306,288

On November 22, 2002, the Company obtained a $10,000,000 term loan from two financial institutions, which is payable in monthly installments of $55,556 with a balloon payment of $5,388,888 due on November 22, 2009. The term loan has a balance of $6,611,110 at December 31, 2007. The interest rate for this term loan varies based on LIBOR plus 200 basis points in effect during the borrowing period. In connection with this term loan, the Company also entered into an interest rate swap that establishes a fixed interest rate for half of the loaned amount at 6.08%. The loan agreement contains certain limitations on borrowing, minimum statutory capital levels and requires maintenance of certain ratios. The Company was in compliance with these covenants at December 31, 2007.

On December 17, 2001, the Company obtained a $5,000,000 term loan from a financial institution, which is payable in quarterly installments of $250,000. The term loan, due 2008 has a balance of $1,000,000 at December 31, 2007. The interest rate varies based on LIBOR plus 190 basis points in effect during the borrowing period. The interest rate cannot exceed 7.4%. The loan agreement contains certain limitations on borrowings, minimum statutory capital levels and requires maintenance of certain ratios. The Company was in compliance with these covenants at December 31, 2007.

On December 23, 1998, the Company obtained a permanent mortgage loan from a financial institution. The $7,800,000 mortgage note, with interest fixed at 6.95% is payable in monthly installments of principal and interest over 10 years. The mortgage note, due 2009, has a balance of $1,051,122 at December 31, 2007. The loan agreements contain certain limitations on borrowings, minimum statutory capital levels and require maintenance of certain ratios. The Company was in compliance with these covenants at December 31, 2007.

Principal payments on long-term debt are $2,700,103 and $5,962,129 for the years 2008 and 2009, respectively. Interest expense paid in 2007 and 2006 amounted to $731,384 and $891,939, respectively.

The fair value at December 31, 2007 of the mortgage and the term loans approximate carrying value.

(9) Income Taxes

The components of income tax expense for the years ended December 31, 2007 and 2006 were as follows:

	2007	2006
Current Taxes:		
Federal	$1,688,024	2,122,825
State	200,000	85,000
	1,888,024	2,207,825
Deferred Taxes:		
Federal	115,773	366,340
State	--	--
	115,773	366,340
Total	$2,003,797	2,574,165

The effective income tax rate, as a percentage of earnings before income taxes for the years ended December 31, 2007 and 2006 was as follows:

	2007	2006
Federal statutory tax rate	34.0%	34.0%
State income tax	2.2	.7
Prior year effect	(2.6)	--
Other, net	(.9)	(.7)
Effective income tax rate	32.7%	34.0%

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2007 and 2006 are presented below:

	2007	2006
Deferred Tax Assets:		
Reserves for losses and loss adjustment expenses	$ 629,694	726,032
Unearned premiums	208,524	271,542
Allowance for doubtful accounts	34,418	34,418
State effect of temporary differences and net operating loss carryforward	852,261	761,284
Unrealized losses in investments	678,540	--
Stock based compensation	104,144	64,221
Total gross deferred tax assets	2,507,581	1,857,497
Less valuation allowance	(1,530,801)	(761,284)
Net deferred tax assets	$ 976,780	1,096,213
Deferred Tax Liabilities:		
Plant and equipment	$ 580,828	547,701
Deferred policy acquisition costs	343,782	408,415
Unrealized gains on investments	--	29,225
Discount on investments	163,216	114,873
Other	179	20,676
Total gross deferred tax liabilities	1,087,647	1,120,890
Net deferred tax assets (liabilities)	$ (111,225)	(24,677)

In assessing the realization of deferred tax assets, management considers whether it is more likely than not that the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, tax planning strategies and anticipated future taxable income in making this assessment and believes it is more likely than not the Company will realize the benefits of its deductible temporary differences, net of the valuation allowance, at December 31, 2007 and 2006.

The most significant component of the state gross deferred asset is the net operating loss carryforward for the State of Connecticut which amounted to $17,045,229 as of December 31, 2007 which expires in 2020 through 2027. In 2007 and 2006, a valuation allowance is provided to offset the deferred tax asset related to the state deferred tax assets as management believes that these deferred tax assets are unrealizable. In addition there is a valuation allowance for unrealized losses on investments. The change of $769,517 in the valuation allowance is due to the current tax loss generated by the Connecticut domiciled companies as well as increases in unrealized losses in the investment portfolio.

Taxes paid in 2007 and 2006 were $2,418,653 and $2,072,304, respectively.

(10) Pension and Profit Sharing Plans

The Company maintains ACMAT 401(k) plan for the benefit of non-union employees. The Company contributed $100,000 to the ACMAT 401(k) Plan in 2007 and 2006. Costs associated with operating the Plan are borne by the Company and were insignificant for each of the years ended December 31, 2007 and 2006.

The Company participated in various multi-employer defined contribution plans for its union employees. Upon withdrawal from these plans, the Company may be liable for its share of the unfunded vested liabilities of the plans. Such obligations, if any, of the Company are not determinable at December 31, 2007.

(11) Derivative Financial Instruments

The Company uses interest rate swaps as a means of hedging exposure to interest rate risk on its long-term debt. To qualify as a hedge, the hedge relationship must be designated and documented at inception and be highly effective in accomplishing the objective of offsetting the changes in cash flows for the risk being hedged. To the extent these derivatives are effective in offsetting the variability of the hedged cash flows, changes in the derivatives' fair value are not to be included in current earnings but are reported in accumulated other comprehensive income ("AOCI"). For the years ended December 31, 2007 and 2006, the amounts included in AOCI for these losses of $101,921 in 2007 and losses of $470 in 2006 and would be included in the earnings of future periods when those earnings are also affected by the variability of the hedged cash flows.

During the year ending December 31, 2008, the amount of losses the Company expects to reclassify from AOCI into interest expense for its cash flow hedges is not significant. To the extent these hedges are not effective, changes in their fair value would be immediately included in earnings.

(12) Stockholders' Equity

The Company has two classes of common stock; the Common Stock and the Class A Stock, each without par value. The rights of the Common Stock and the Class A Stock are identical, except with respect to voting rights. Holders of the Class A Stock are entitled to one-tenth vote per share in relation to the Common Stock, holders of which are entitled to one vote per share.

During 2007 and 2006, ACMAT repurchased and retired, in the open market and in privately negotiated transactions, 2,893 and 29,000, respectively, shares of its Common Stock at an average price of $24.54 and $23.69 per share, respectively. The Company also repurchased and retired during 2007 and 2006, in the open market and in privately negotiated transactions, 125,313 and 308,575 , respectively, shares of its Class A Stock at an average price of $26.25 and $21.02 per share, respectively.

Under applicable insurance regulations, ACMAT's insurance subsidiary is restricted as to the amount of dividends it may pay, without the prior approval of any insurance department and is limited to approximately $5,200,000 in 2008.

The Company's insurance subsidiary ACSTAR, is domiciled in Illinois. The statutory financial statements of ACSTAR are prepared in accordance with accounting practices prescribed by the Illinois Department of Insurance. Prescribed statutory accounting practices include a variety of publications of the National Association of Insurance Commissioners (NAIC), as well as the state laws, regulations, and general administrative rules. Permitted statutory accounting practices encompass all accounting practices not so prescribed of which the Company has none.

In accordance with statutory accounting practices, ACMAT's insurance subsidiaries' statutory capital and surplus was $31,609,906 and $31,679,692 at December 31, 2007 and 2006 respectively, and their statutory net income for the years ended December 31, 2007 and 2006 was $5,241,538 and $5,842,852, respectively. The primary differences between amounts reported in accordance with GAAP and amounts reported in accordance with statutory accounting practices are carrying value of fixed maturity investments; deferred taxes; assets not admitted for statutory purposes such as agents balances over 90 days, furniture and fixtures and certain notes receivable; and deferred acquisition costs recognized for GAAP only.

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(13) Earnings Per Share

The following is a reconciliation of the numerators and denominators of the basic and diluted earnings per share ("EPS") computations for the years ended December 31, 2007 and 2006:

	Earnings	Weighted Average Shares Outstanding	Per-Share Amount
2007:			
Basic EPS:			
Earnings available to stockholders	$4,116,497	1,859,820	$2.21
Effect of Dilutive Securities:			
Stock options	--	137,400	
Diluted EPS:			
Earnings available to stockholders	$4,116,497	1,997,220	$2.06
2006:			
Basic EPS:			
Earnings available to stockholders	$4,999,319	2,056,421	$2.43
Effect of Dilutive Securities:			
Stock options	--	114,813	
Diluted EPS:			
Earnings available to stockholders	$4,999,319	2,171,234	$2.30

(14) Stock – Based Compensation

The Company periodically grants non-qualified stock options to officers and directors 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.

The Company applied the recognition and measurement principles of SFAS 123R, Share Based Payments, beginning January 1, 2006. The weighted average fair value of the options was $10.60. Total stock-based compensation expense totaled $117,420 and $188,886 for the year ended December 31, 2007 and 2006, respectively. The tax benefit recognized on stock-based compensation totaled $39,923 and $64,221 for the year ended December 31, 2007 and 2006, respectively.

As of December 31, 2007 there were 359,000 stock options outstanding of which 97,400 were not yet vested. The compensation costs related to non-vested share compensation arrangements granted but not yet recognized was approximately $128,000 as of December 31, 2007. The Company expects to recognize that cost over a weighted average period of 2.5 years.

The following table shows the stock option activity for the Company during 2007 and 2006.

	Option Shares	Weighted average exercise price	Weighted average remaining contractual term (in years)	Aggregate intrinsic value
Outstanding at December 31, 2005	409,000	$10.42		
2006 activity:				
Granted	--			
Exercised	(31,000)	$ 8.22		
Canceled	--			
Outstanding at December 31, 2006	378,000	$10.60		
2007 activity:				
Granted	--			
Exercised	(19,000)	$ 9.60		
Canceled	--			
Outstanding at December 31, 2007	359,000	$10.65	5.52	$1,761,613
Exercisable at December 31, 2007	261,600	$10.64	5.49	$1,283,671
Expected to Vest	97,400	$10.66	5.61	$ 477,942

Of the 378,000 outstanding options at December 31, 2006, 245,865 were exercisable. During 2007 and 2006, officers and directors exercised 19,000 and 31,000 stock options, respectively. Proceeds from stock options exercised in 2007 and 2006 were $182,480 and $254,750, respectively. Tax benefits related to stock options exercised in 2007 and 2006 were $109,997 and $118,354, respectively.

The following table summarizes information about stock options outstanding at December 31, 2007:

Range of exercise price	Number Outstanding	Weighted average remaining contractual life	Weighted average exercise price	Grant Year	Number exercisable
$ 7.25	20,000	2.95	$ 7.25	2000	20,000
$ 9.00	167,000	4.47	$ 9.00	2002	111,000
$12.22	65,000	6.20	$12.22	2004	58,600
$11.40	20,000	6.20	$11.40	2004	16,000
$13.25	87,000	7.48	$13.25	2005	56,000
$7.25-13.25	359,000	5.52	$10.65		261,600

(15) Commitments and Contingencies

The Company is a party to legal actions arising in the ordinary course of its business. In management's opinion, the Company has adequate legal defenses respecting those actions where the Company is a defendant, has appropriate insurance reserves recorded, and does not believe that their settlement will materially affect the Company's operations or financial position.

Many construction projects in which the Company has been engaged have included asbestos exposures which the Company believes to involve a particularly high degree of risk because of the hazardous nature of asbestos. The Company believes it has reduced the risks associated with asbestos through proper training of its employees and by maintaining general liability and workers' compensation insurance. From 1986 to 1996, the Company obtained its general liability insurance from its insurance subsidiaries. Since 1996, the

Company obtained its general liability insurance from unaffiliated insurance companies. Since 1989, the Company has obtained its surety bonds from its insurance subsidiary.

The Company has, together with many other defendants, been named as a defendant in actions by injured or deceased individuals or their representatives based on product liability claims relating to materials containing asbestos. No specific claims for monetary damages are asserted in these actions. Although it is early in the litigation process, the Company does not believe that its exposure in connection with these cases is significant.

(16) 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 insurance.

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.

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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 is summarized as follows:

	2007	2006
Revenues:		
ACSTAR Bonding	$14,203,769	16,204,242
ACMAT Contracting	9,030,286	9,520,262
	$23,237,055	25,724,504
Operating Earnings (Loss):		
ACSTAR Bonding	$7,608,216	8,930,386
ACMAT Contracting	(762,437)	(465,334)
	$6,845,779	8,465,052
Depreciation and Amortization:		
ACSTAR Bonding	$(192,569)	(99,988)
ACMAT Contracting	445,785	482,934
	$ 253,216	382,946
Identifiable Assets:		
ACSTAR Bonding	$ 94,782,182	100,630,884
ACMAT Contracting	26,991,056	28,362,450
	$121,773,238	128,993,334
Capital Expenditures:		
ACSTAR Bonding	$ 27,145	13,359
ACMAT Contracting	140,813	225,503
	$167,958	238,862

The components of revenue for each segment are as follows:

	2007	2006
ACSTAR Bonding:		
Premiums	$10,159,139	12,437,099
Investment income, net	4,231,443	4,047,782
Capital losses	(76,808)	(179,435)
Other income (expense)	(110,005)	(101,204)
	$16,204,242	16,204,242
ACMAT Contracting:		
Contract revenues	$5,676,191	6,086,702
Investment income, net	701,989	772,068
Capital losses	(2,773)	(31,512)
Inter-segment revenue:		
Rental income	366,961	316,598
Underwriting services and agency commissions	1,809,779	1,980,422
Other income	478,139	395,984
	$9,030,286	9,520,262

ACMAT CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

	2007	2006
Revenue:		
Total revenue for reportable segments	$23,237,055	25,724,504
Inter-segment eliminations	(1,276,789)	(1,525,173)
	$21,957,266	24,199,331
Operating Earnings:		
Total operating earnings for reportable segments	$6,845,779	8,465,052
Interest expense	(725,485)	(891,568)
	$6,120,294	7,573,484

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 selling, general and administrative expenses. 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.

Our Services

Stock Market Information

The Company's Common Stock and Class A Stock trade over-the-counter in the "Pink Sheets" quotation service. The following table sets forth the quarterly high and low closing prices of the Company's Common Stock and Class A Stock.

	2007		2006	
	High	Low	High	Low
Common Stock				
1st Quarter	35.00	23.50	25.25	17.00
2nd Quarter	26.00	24.10	22.00	17.20
3rd Quarter	27.00	26.00	22.00	20.00
4th Quarter	27.00	27.00	23.50	22.00
Class A Stock				
1st Quarter	27.80	23.50	17.00	16.15
2nd Quarter	28.00	24.25	19.25	16.55
3rd Quarter	26.00	24.80	22.05	18.80
4th Quarter	26.30	23.00	25.00	21.50

Annual Meeting

The annual meeting of stockholders will be held on June 26, 2008 at 12:00 P.M on the third floor of the Company's corporate headquarters. All holders of ACMAT Common Stock and Class A Stock at the close of business on the record date of April 23, 2008 are entitled to vote.

Dividends

No cash dividends have been paid in the past five years and there is no intention of paying dividends in the near future.

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Directors

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Chairman, President &
Chief Executive Officer

Henry W. Nozko III
Vice President, Secretary

Victoria C. Nozko

John C. Creasy
Former Chief Executive Officer
Danbury Hospital

Arthur R. Moore
Former General President
Sheet Metal Workers' International Association

Andrew W. Sullivan, Jr.
Retired Partner of KPMG LLP

Officers

Henry W. Nozko, Jr.
Chairman, President &
Chief Executive Officer

Michael P. Cifone
Senior Vice President,
Chief Financial Officer

Henry W. Nozko III
Vice President, Secretary

Gary M. Case, Esq.
General Counsel

Robert H. Frazer, Esq.
Vice President,
General Counsel Emeritus

David A. Price
Vice President

Managers

Maurice C. Shea
Controller

Ray A. Suite
Estimating Manager

Project Managers
Lawrence J. Chevian
J. Marshall Reed
J. Parris Reed

Robert Winchell
Building Manager

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Chairman, President &
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