

ACMAT CORPORATION AND SUBSIDIARIES  
DECEMBER 31, 2009

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## To Our Shareholders and Customers

In spite of the persistent lethargy of the general economy and free fall of the construction industry, we again performed well during 2009 and demonstrated our stability and durability. We generated pretax income of \$2,207,177 prior to a \$6,484,548 non cash charge related to the write down of the value of our corporate headquarters building, which we own free and clear without a mortgage or other debt. We incurred an impairment in the value of the building because of collapsing commercial real estate values and because we believe the impairment is permanent.

After the \$6,484,548 non cash charge to income connected to the write down of the value of the building, net income was (\$2,723,748) for 2009 vs. \$1,954,459 for 2008 and revenue was \$11,898,928 for 2009 vs. \$14,955,477 for 2008. Aside from the building write down, we were very profitable in spite of the downslide in the general economy and plunge in the construction industry. The strong pretax income of \$2,207,177 prior to the building write down, was accomplished while non-residential building construction dropped 30.3% in 2009 from 2008 (source: McGraw-Hill Construction). Not surprisingly, earned premium decreased 31% from \$7,590,974 in 2008 to \$5,230,093 in 2009. The pretax income prior to the building write down was also accomplished while battling a near zero interest rate environment, which unfavorably affected our investment business. The 10 year Treasury bill remained below 4% throughout 2009, which was at the lowest point in over 30 years (source: Federal Reserve). As a consequence, net interest income decreased from \$3,872,781 in 2008 to \$3,340,883 in 2009, a decrease of 14%.

We do not expect the economy to improve much, if any, during 2010. However, we expect a strong profitable year. Our 60 year history is replete with a trial of transformations as we adapted to a changing world. During 2009, our proclivity for reinvention was again very apparent. "Simply pushing harder within the old boundaries will not do." During 2009, we strategically repositioned ourselves.

During 2009, we discontinued performing construction work. The last construction project was completed in the first quarter of 2010. Performing construction work has never been, is not, and never will be as profitable as surety (providing Performance and Payment Bonds to contractors). Both businesses, however, are not without considerable risks. This undertaking will reduce overhead by approximately \$300,000 or 6% during 2010 and allow management to concentrate on our more profitable businesses – surety and investments.

During 2009 we engaged a real estate broker to possibly sell our corporate headquarters building. If sold, we will purchase or construct a new headquarters building, which will better facilitate operations. We have occupied the same space for over 20 years and our requirements have changed and are different. Selling the building will effect a federal tax refund generating cash well in excess of \$1,000,000. Should we not receive what we deem to be an appropriate offer, we will simply remain in our current building and benefit from a decrease in our annual overhead expenses by approximately \$250,000 as a result of the decrease in depreciation expense related to the write down of the value of

the building at December 31, 2009. Either way, we will have a continuing and long term benefit from the action we took in 2009.

During 2009, we negotiated a new \$10,000,000 bank credit facility adding approximately \$5,000,000 to cash. There is no specific earmark for the funds and there is no other debt that exists or needs to be paid. The credit facility has a 7 year term and is amortized monthly with interest floating at 1.25% over LIBOR, with a cap of 6%. The rate at the time of this writing was 2.5%! We took advantage of the availability of very favorable terms, which we feel will not likely remain with or without a recovery in the economy. The resulting substantial liquidity provides great flexibility to purchase stock, grow surplus and support our high financial strength rating and to fully capitalize on an improving economy and industry when that eventual shift occurs.

During 2009, we reshuffled our investment portfolio. We converted a (\$2,100,544) unrealized capital loss at December 31, 2008 to a net unrealized capital gain of \$257,846 at December 31, 2009 and we converted a realized capital loss in 2008 of (\$2,011,496) to a realized capital gain of \$1,261,839 in 2009. During 2009, we reduced our holdings in preferred shares of financial institutions down to \$3,300,000 from a peak of \$8,000,000 in 2008. We also reduced our holding of private label, mortgage-backed securities to \$3,800,000 at December 31, 2009 down from \$6,000,000 at December 31, 2008. We increased our holdings of short term corporate bonds from approximately \$7,800,000 at December 31, 2009 to approximately \$16,500,000 at December 31, 2009 and we increased our holdings in mostly short term municipal bonds from approximately \$8,500,000 at December 31, 2008 to approximately \$20,100,000 at December 31, 2009. We have kept the average life of our investment portfolio painfully short, enduring current short term low investment yields with the prospect of reinvesting our money when interest rates rise. We think these modifications have reduced our exposure to risk and will allow us to quickly grow investment income if our guess is correct that interest rates are going to rise.

On January 20, 2010, A.M. Best Company re-affirmed our high financial strength rating of A (Excellent) of our surety subsidiary, ACSTAR insurance Company. A.M. Best stated that the "rating affirmation reflects ACSTAR's exceptionally strong risk-adjusted capitalization, historically strong operating performance, geographic diversification, effective risk management and experience in managing through market cycles." This exceptional rating takes years to establish and opens up opportunities across the nation where and when construction contracts require a high financial strength rating of the surety. We believe maintaining this high financial strength rating while many downgrades are occurring, could boost our market position.

During 2009, we purchased 200,598 shares of the Company's Class A and Common Stock below book value enhancing shareholder value. We continue to be interested in purchasing additional shares, if available at reasonable prices and at a time convenient for the company. In addition to enhancing shareholder value, this exercise improves shareholder liquidity.

Our capital base is very strong and our liquidity is exceptional. Even with the economy continuing to sag through 2010, we believe we will realize a strong and profitable year. We are a well known source for providing surety to thousands of contractors throughout the United States that find it difficult or impossible to gain surety credit from the major U.S. Insurance Companies. We have achieved wide spread market recognition by providing consistent and reliable underwriting terms, excellent service and a reputation for fair dealing

We believe we have repositioned ourselves to be profitable without any improvement in the economy and we are geared to take advantage of improving conditions whenever that happens.

Finally, in the midst of the ravaging effects of the worst recession since the Great Depression, we again met our operating plan and goal, which is to continue to increase per share equity. Even with the write down of the value of our building, book value per share increased from \$28.49 at December 31, 2008 to \$28.62 at December 31, 2009.

We could not succeed as we have without the dedication of our employees, the tremendous customer confidence we enjoy and the support of our shareholders.

We are refocused and recharged with great resources to seize the tremendous opportunities that will be available when market conditions improve.

Henry W. Nozko, Jr.  
Chairman, President and Chief Executive Officer  
April 21, 2010

**ACMAT CORPORATION AND SUBSIDIARIES**

Consolidated Statements of Earnings  
Years Ended December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Earned premiums	\$ 5,230,093	7,590,974
Contract revenues	1,134,730	4,590,997
Investment income, net	3,340,883	3,872,781
Net realized capital gains (losses)	1,261,839	(2,011,496)
Other income	<u>931,383</u>	<u>912,221</u>
	11,898,928	14,955,477
Cost of contract revenues	1,638,839	4,339,573
Losses and loss adjustment expenses	1,166,019	313,339
Amortization of policy acquisition costs	1,818,319	2,117,741
General and administrative expenses	4,820,394	4,710,923
Impairment loss on building	6,484,548	--
Interest expense	<u>248,181</u>	<u>449,553</u>
	16,176,300	11,931,129
Earnings (losses) before income taxes	(4,277,372)	3,024,348
Income taxes (benefit)	<u>(1,553,624)</u>	<u>1,069,889</u>
Net earnings (loss)	<u>\$(2,723,748)</u>	<u>1,954,459</u>
Basic earnings (losses) per share	\$ (1.98)	<u>1.19</u>
Diluted earnings (losses) per share	\$ (1.83)	<u>1.10</u>

See Notes to Consolidated Financial Statements.

**ACMAT CORPORATION AND SUBSIDIARIES**

Consolidated Balance Sheets  
December 31, 2009 and 2008

<u>Assets</u>	<u>2009</u>	<u>2008</u>
Investments:		
Fixed maturities – available for sale at fair value (Amortized cost of \$75,453,859 in 2009 and \$60,797,261 in 2008)	\$ 75,929,659	59,701,247
Equity securities – available for sale at fair value (Cost of \$2,258,579 in 2009 and \$1,913,359 in 2008)	2,173,504	995,722
Short-term investments, at cost which approximates fair value	<u>3,436,351</u>	<u>15,963,120</u>
Total Investments	81,539,514	76,660,089
Cash and cash equivalents	10,074,955	12,554,590
Accrued interest receivable	680,580	338,486
Receivables, net of allowance for doubtful accounts of \$55,460 in 2009 and \$71,231 in 2008	567,521	1,323,415
Reinsurance recoverable:		
Unpaid losses	3,642,683	3,530,878
Paid losses	--	98,652
Prepaid expenses	114,618	192,317
Income taxes receivable	170,388	1,004,764
Deferred income taxes	1,831,331	--
Property and equipment, net	3,933,696	10,644,847
Deferred policy acquisition costs	589,454	940,700
Other assets	879,499	1,054,957
Intangibles	<u>1,920,360</u>	<u>1,920,360</u>
Total Assets	<u>\$105,944,599</u>	<u>110,264,055</u>
<u>Liabilities &amp; Stockholders' Equity</u>		
Accounts payable	\$ 609,334	1,923,689
Reserves for losses and loss adjustment expenses	21,597,746	23,064,539
Unearned premiums	1,647,703	2,911,613
Collateral held	31,364,696	28,541,360
Deferred income taxes	--	234,887
Other accrued liabilities	1,597,863	3,088,431
Long-term debt	<u>10,000,000</u>	<u>6,037,427</u>
Total Liabilities	66,817,342	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	37,502,210	45,001,854
Accumulated other comprehensive loss	<u>257,846</u>	<u>(2,100,544)</u>
Total Stockholders' Equity	<u>39,127,257</u>	<u>44,462,109</u>
	<u>\$105,944,599</u>	<u>110,264,055</u>

See Notes to Consolidated Financial Statements.

**ACMAT CORPORATION AND SUBSIDIARIES**

Consolidated Statements of Stockholders' Equity  
December 31, 2009 and 2008

	<u>Common Stock par value</u>	<u>Class A Stock par value</u>	<u>Retained earnings</u>	<u>Accumulated other comprehensive income (loss)</u>	<u>Total stockholders' 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 loss on debt and equity securities, net of reclassification adjustment	\$ ---	---	---	(17,942)	(17,942)
Net unrealized loss on derivatives qualifying as hedges	---	---	---	(64,703)	(64,703)
Net earnings	---	---	1,954,459	---	<u>1,954,459</u>
Total comprehensive income					1,871,814
Stock based compensation	---	---	70,461	---	70,461
Acquisition and retirement of 7,086 shares of Common Stock	(7,086)	---	(183,050)	---	(190,136)
Acquisition and retirement of 246,267 shares of Class A Stock	---	(246,267)	(6,304,949)	---	(6,551,216)
Issuance of 19,500 shares of Class A Stock pursuant to stock options	---	<u>19,500</u>	<u>276,102</u>	---	<u>295,602</u>
Balance as of December 31, 2008	<u>\$471,606</u>	<u>1,089,193</u>	<u>45,001,854</u>	<u>(2,100,544)</u>	<u>44,462,109</u>
Comprehensive income:					
Net unrealized gains on debt and equity securities, net of reclassification adjustment	\$ ---	---	---	2,271,534	2,271,534
Net unrealized gains on derivatives qualifying as hedges	---	---	---	86,856	86,856
Net earnings (loss)	---	---	(2,723,748)	---	<u>(2,723,748)</u>
Total comprehensive income (loss)					(365,358)
Stock based compensation	---	---	37,286	---	37,286
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>7,000</u>	<u>90,201</u>	---	<u>97,201</u>
Balance as of December 31, 2009	<u>\$468,546</u>	<u>898,655</u>	<u>37,502,210</u>	<u>257,846</u>	<u>39,127,257</u>

See Notes to Consolidated Financial Statements.

**ACMAT CORPORATION AND SUBSIDIARIES**

Consolidated Statements of Cash Flows  
Years ended December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
<b>Cash Flows From Operating Activities:</b>		
Net earnings (loss)	\$(2,723,748)	1,954,459
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Impairment loss on building	6,484,548	--
Stock based compensation expense	37,286	70,461
Depreciation and amortization	821,357	395,745
Net realized capital losses (gains)	(1,261,839)	2,011,496
Deferred income taxes	(2,199,063)	123,662
Changes In:		
Accrued interest receivable	(342,094)	(102,563)
Receivables	755,894	870,324
Reinsurance recoverable	(13,153)	(330,747)
Deferred policy acquisition costs	351,246	70,423
Prepaid expenses and other assets	253,157	(840,835)
Accounts payable and other liabilities	(2,718,067)	(1,459,418)
Collateral held	2,823,336	(2,177,268)
Reserves for losses and loss adjustment expenses	(1,466,793)	218,724
Income taxes	834,378	(663,900)
Unearned premiums	<u>(1,263,910)</u>	<u>(662,444)</u>
Net cash provided by (used for) operating activities	<u>372,535</u>	<u>(521,881)</u>
<b>Cash Flows From Investing Activities:</b>		
Proceeds from investments sold or matured:		
Fixed maturities – sold	46,620,212	53,895,552
Fixed maturities – matured	1,210,000	275,000
Equity securities	1,196,172	1,080,647
Purchases Of:		
Fixed maturities	(61,937,934)	(50,136,781)
Equity securities	(1,119,838)	(628,000)
Short-term investments, (purchases) sales, net	12,526,769	12,125,255
Capital expenditures	<u>(303,344)</u>	<u>(703,837)</u>
Net cash provided by (used for) investing activities	<u>(1,807,963)</u>	<u>15,907,836</u>
<b>Cash Flows From Financing Activities:</b>		
Issuance of long-term debt	10,000,000	--
Repayments on long-term debt	(6,037,427)	(2,624,805)
Issuance of Common and Class A Stock	63,000	186,700
Tax benefit from exercise of stock options	34,201	108,902
Payments for acquisition and retirement of stock	<u>(5,103,981)</u>	<u>(6,741,352)</u>
Net cash used for financing activities	<u>(1,044,207)</u>	<u>(9,070,555)</u>
Net change in cash and cash equivalents	(2,479,635)	6,315,400
Cash and cash equivalents, beginning of year	<u>12,554,590</u>	<u>6,239,190</u>
Cash and cash equivalents, end of year	<u>\$10,074,955</u>	<u>12,554,590</u>

See Notes to Consolidated Financial Statements.



**ACMAT CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2009 and 2008**

**(1) Summary of Significant Accounting Policies**

(a) Basis of Presentation

The consolidated financial statements include ACMAT Corporation ("ACMAT" or the "Company"), and 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. 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. During 2009, the Company discontinued performing construction work. 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. The Company has engaged a real estate broker to market the office building.

During 2009 and 2008, customers who individually accounted for more than 10% of consolidated construction contracting revenue are as follows; in 2009 – one customer provided 99% and in 2008 - two customers provided 57% and 43%, respectively.

(c) Investments

Management believes the Company has the ability to hold all fixed income securities to maturity. However, the Company may dispose of securities prior to their scheduled maturity due to changes in interest rates, prepayments, tax and credit considerations, liquidity or regulatory capital requirements or other similar factors. As a result, the Company considers all of its fixed income securities (bonds) and equity securities as available-for-sale, and as such, they are carried at fair value, with unrealized gains or losses, net of tax, charged or credited directly to stockholders' equity. Fixed maturities include bonds, notes and redeemable preferred stocks. Equity securities reflect investment in common stock, non-redeemable preferred stock and mutual funds.

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. The risks inherent in assessing the impairment of an investment security include the risk that market factors may differ from expectations and may change over time. Unexpected changes to these factors and circumstances in the future may result in a decision to sell or impair securities that were not impaired in prior reporting periods.

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.

## ACMAT CORPORATION AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

An investment in a debt or equity security is other-than-temporarily impaired (OTTI) 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 intent to sell the investment before its anticipated recovery in value.

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 recoverability 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.

**ACMAT CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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 \$211,257 and \$317,508 at December 31, 2009 and 2008 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:

	<u>Premiums Written</u>		<u>Premiums Earned</u>	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
Direct	\$4,731,597	8,286,189	\$5,995,507	8,918,784
Assumed	--	--	--	29,847
Ceded	<u>(659,163)</u>	<u>(1,167,645)</u>	<u>(765,414)</u>	<u>(1,357,657)</u>
Totals	<u>\$4,072,434</u>	<u>7,118,544</u>	<u>\$5,230,093</u>	<u>7,590,974</u>

Ceded incurred losses and loss adjustment expenses totaled \$170,645 and \$56,041 for the years ended December 31, 2009 and 2008, respectively.

(j) Derivative Financial Instruments

The Company uses interest rate caps and 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. Hedge accounting may be used to account for derivatives that qualify for hedge accounting. 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) Statutory Accounting Practices

The Company's insurance subsidiary, domiciled in the state of Illinois, prepares statutory financial statements in accordance with the accounting practices prescribed or permitted by the insurance department of the state of Illinois. Prescribed statutory accounting practices are those practices that are incorporated directly or by reference in state laws, regulations, and general administrative rules applicable to all insurance enterprises domiciled in a particular state. Permitted statutory accounting practices include practices not prescribed by the domiciliary state, but allowed by the domiciliary state regulatory authority. The Company does not have any permitted statutory accounting practices.

**ACMAT CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(l) 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.

(m) 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.

(n) Use of Estimates

The preparation of financial statements in conformity with GAAP 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.

(o) Comprehensive Income

The following table summarizes reclassification adjustments for other comprehensive income and the related tax effects for the years ended December 31, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Unrealized holding gain (loss) arising during period, net of income tax expense	\$3,104,347	(1,345,529)
Less reclassification adjustment for gains (losses) included in net earnings, net of income tax expense of \$429,026 in 2009 and benefit of \$683,909 in 2008	832,813	(1,327,587)
Unrealized loss on derivatives qualifying as cash flow hedges	<u>86,856</u>	<u>( 64,703)</u>
Other comprehensive income (loss)	<u>\$2,358,390</u>	<u>(82,645)</u>

(p) 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 (the vesting period).

(q) Adoption of Accounting Pronouncements

In February 2008, the FASB issued updated guidance on fair value measurements, which permitted a one-year deferral of the application of the fair value measurements and disclosures guidance 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 adoption of the fair value measurement guidance as it pertains to nonfinancial assets and nonfinancial liabilities on January 1, 2009 did not have a material effect on the Company's results of operations, financial position or liquidity.

## ACMAT CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In April 2008, the FASB issued update guidance that amended the factors that an entity should consider in determining the useful life of a recognized intangible asset 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 guidance 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. Disclosure of an entity's intent and/or ability to renew or extend the arrangement is also required.

The guidance is effective for financial statements issued for fiscal years beginning after December 15, 2008, and for interim periods within those fiscal years. The adoption of the guidance on January 1, 2009 did not have a material effect on the Company's results of operations, financial position or liquidity and did not require additional disclosures related to existing intangible assets.

In April 2009, the FASB issued updated guidance for determining when a transaction is not orderly and for estimating fair value when there has been a significant decrease in the volume and level of activity for an asset or liability. The guidance requires 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, the presentation of the fair value hierarchy is required to be presented by major security type. The provisions of the guidance were effective for annual and interim periods ending after June 15, 2009. The adoption of the guidance on April 1, 2009 did not have a material effect on the Company's results of operations, financial position or liquidity.

In April 2009, the FASB issued updated guidance, which provides clarification that an other-than-temporary impairment is recognized when an entity has the intent to sell a debt security or when it is more likely than not that an entity will be required to sell the debt security before its anticipated recovery in value.

Additionally, the guidance changes the presentation and amount of other-than-temporary impairment losses recognized in the income statement for instances in which the Company does not intend to sell a debt security, or it is more likely than not that the Company will not be required to sell a debt security prior to the anticipated recovery of its remaining cost basis. The Company separates the credit loss component of the impairment from the amount related to all other factors and reports the credit loss component in net realized investment gains (losses). The impairment related to all other factors is reported in "accumulated other changes in equity from non-owner sources."

In addition to the changes in measurement and presentation, the disclosures related to other-than-temporary impairments relating to debt securities are expanded, and all such disclosures are required to be included in both interim and annual periods.

The guidance was effective for interim periods ending after June 15, 2009. The adoption of the guidance on April 1, 2009 did not have a material effect on the Company's results of operations, financial position or liquidity.

In May 2009, the FASB issued guidance on the recognition and disclosure of events that occur after the balance sheet date, but before financial statements are issued or are available to be issued. This guidance was effective for interim and annual periods ending after June 15, 2009 and requires the disclosure of the date through which an entity has evaluated subsequent events and whether that date represents the date the financial statements were issued or were available to be issued. This guidance does not change previous guidance regarding recognition or disclosure of subsequent events, other than the additional requirement regarding the date through which subsequent events have been considered. The Company has disclosed the date through which subsequent events are evaluated.

In August 2009, the FASB issued updated guidance for the accounting for the fair value measurement of liabilities. The guidance provides clarification that in certain circumstances, in which a quoted price in an active market for the identical liability is not available, a company is required to measure fair value using one or more of the following valuation techniques: the quoted price of the identical liability when traded as an asset, the quoted prices for similar liabilities or similar liabilities when traded as assets, and/or another valuation technique that is consistent with the principles of fair value measurements. The guidance also clarifies that a company is not required to include an adjustment for restrictions that prevent the transfer of the liability and, if an adjustment is applied to the quoted price used in a valuation technique, the result is a Level 2 or 3 fair value measurement. The guidance was effective for interim and annual periods beginning after August 27, 2009. The adoption of the guidance on October 1, 2009 did not have any effect on the Company's results of operations, financial position or liquidity.

### (r) Accounting Standards Not Yet Adopted

In June 2009, the FASB issued updated guidance on the accounting for variable interest entities that eliminates the concept of a qualifying special-purpose entity and the quantitative-based risks and rewards calculation of the previous guidance for determining which company, if any, has a controlling financial interest in a variable interest entity. The guidance requires an analysis of whether a company has: (1) the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and

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(2) the obligation to absorb the losses that could potentially be significant to the entity or the right to receive benefits from the entity that could potentially be significant to the entity. An entity is required to be re-evaluated as a variable interest entity when the holders of the equity investment at risk, as a group, lose the power from voting rights or similar rights to direct the activities that most significantly impact the entity's economic performance. Additional disclosures are required about a company's involvement in variable interest entities and an ongoing assessment of whether a company is the primary beneficiary.

The guidance is effective for all variable interest entities owned on or formed after January 1, 2010. The Company does not expect that the provisions of the guidance will have a material effect on its results of operations, financial position or liquidity.

(s) Subsequent Events

The Company has evaluated subsequent events since the date of these consolidated financial statements through the issuance date of April 21, 2010. In February 2010, the Company formed a wholly-owned subsidiary, ACMAT Realty Corporation, and purchased land in Farmington, Connecticut for possible development of a future corporate headquarters.

(2) Investments

Fixed maturities at December 31, 2009 and 2008 follows:	AMORTIZED COST	GROSS UNREALIZED GAINS	LOSSES	FAIR VALUE
<u>2009</u>				
Fixed maturities – available for sale:				
Bonds:				
States, municipalities and political subdivisions	\$20,088,164	247,533	(179,231)	20,156,466
United States government and government agencies	3,882,864	83,816	--	3,966,680
Mortgage-backed securities	33,013,588	284,042	(460,434)	32,837,196
Industrial and miscellaneous	15,864,193	630,107	(6,653)	16,487,647
Redeemable preferred stock	<u>2,605,050</u>	<u>172,228</u>	<u>(295,608)</u>	<u>2,481,670</u>
Total fixed maturities	<u>\$75,453,859</u>	<u>1,417,726</u>	<u>(941,926)</u>	<u>75,929,659</u>
	AMORTIZED COST	GROSS UNREALIZED GAINS	LOSSES	FAIR VALUE
<u>2008</u>				
Fixed maturities – available for sale:				
Bonds:				
States, municipalities and political subdivisions	\$ 8,335,774	209,436	(52,551)	8,492,659
United States 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 stock	<u>3,967,550</u>	<u>--</u>	<u>(619,540)</u>	<u>3,348,010</u>
Total fixed maturities	<u>\$60,797,261</u>	<u>1,125,524</u>	<u>(2,221,538)</u>	<u>59,701,247</u>

The amortized cost and fair value of fixed maturities by contractual maturity follow. 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.

	<u>2009</u>	
	Amortized Cost	Fair Value
Due in one year or less	\$ 8,119,036	8,205,095
Due after one year through five years	15,425,826	15,765,502
Due after five years through ten years	12,084,981	12,306,026
Due after ten years	6,810,428	6,815,840
Mortgage-backed securities	<u>33,013,588</u>	<u>32,837,196</u>
Total	<u>\$75,453,859</u>	<u>75,929,659</u>

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The Company makes investments in residential 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. While prepayment risk (either shortening or lengthening of duration) and its effect on total return cannot be fully controlled, particularly when interest rates move dramatically, the investment process generally favors securities that control this risk within expected interest rate ranges. The Company does invest in other types of CMO tranches if a careful assessment indicates a favorable risk/return tradeoff. The Company does not purchase residual interests in CMOs.

At December 31, 2009 and 2008, the Company held CMOs classified as available for sale with a fair value of \$32,837,196 and \$29,978,938, respectively. Approximately 88% and 83% of the Company's CMO holdings are fully collateralized by GNMA, FNMA or FHLMC securities at December 31, 2009 and 2008, respectively. In addition, the Company held \$1,306 of FNMA mortgage-backed pass-through securities classified as available for sale at December 31, 2008.

Proceeds from sales of fixed maturities classified as available for sale were \$46,620,212 and \$53,895,552 in 2009 and 2008, respectively. Gross gains of \$948,670 and \$1,359,723 and gross losses of \$108,385 and \$2,273,906 were realized on fixed maturity sales for the years ended December 31, 2009 and 2008, respectively.

On December 31, 2009 and 2008, the Company's insurance subsidiary had securities with an aggregate fair value of approximately \$4,100,000 on deposit with various state regulatory authorities.

Equity securities at December 31, 2009 and 2008 follows:	AMORTIZED COST	GROSS UNREALIZED		FAIR VALUE
		GAINS	LOSSES	
<u>2009</u>				
Common stocks:				
Banks, trusts and insurance	\$ 272,779	433,701	(25,016)	681,464
Industrial and miscellaneous	153,000	92,500	--	245,500
Perpetual preferred stocks:				
Banks, trusts and insurance	<u>1,832,800</u>	<u>--</u>	<u>(586,260)</u>	<u>1,246,540</u>
Total equity securities	<u>\$ 2,258,579</u>	<u>526,201</u>	<u>(611,276)</u>	<u>2,173,504</u>
<u>2008</u>				
Common stocks:				
Banks, trusts and insurance	\$ 80,559	1,362	(10,299)	71,622
Perpetual preferred stocks:				
Banks, trust and insurance	<u>1,832,800</u>	<u>--</u>	<u>(908,700)</u>	<u>924,100</u>
Total Equity Securities	<u>\$ 1,913,359</u>	<u>1,362</u>	<u>(918,999)</u>	<u>995,722</u>

Proceeds from sales of equity securities were \$1,196,172 and \$1,080,647 in 2009 and 2008, respectively. Gross gains of \$421,554 and \$61,020 were realized on the sale of equity securities for the years ended December 31, 2009 and 2008, respectively, and gross losses of \$ -0- and \$1,158,333 were realized on equity security sales for the years ended December 31, 2009 and 2008, respectively.

The Company's investments in perpetual preferred stocks included two investment grade securities in an unrealized loss position totaling \$76,420 at December 31, 2009 compared to an unrealized loss of \$233,500 at December 31, 2008. The balance of the Company's investment in perpetual preferred stocks included two non-investment grade securities in an unrealized loss position totaling \$509,840 at December 31, 2009 compared to an unrealized loss of \$675,200 at December 31, 2008. The perpetual preferred stocks were issued by diversified financial institutions which have fallen out of favor in the current market conditions. 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. The Company has no current intent to sell these securities, nor is it more likely than not that it will be required to sell prior to recovery of its cost. The Company does not believe the unrealized losses on these securities are indicative of credit losses and, as such, has not recorded an OTTI loss on these securities at December 31, 2009.

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The following tables summarize, for all investments in an unrealized loss position at December 31, 2009 and 2008, the aggregate fair value and gross unrealized loss by length of time those securities have been continuously in an unrealized loss position, were as follows:

	<u>Less than 12 months</u>		<u>12 months or longer</u>		<u>Total 2009</u>	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
Fixed maturities:						
States, municipalities and political subdivisions	\$10,021,512	176,490	51,300	2,741	10,072,812	179,231
United States government and government agencies	--	--	--	--	--	--
Mortgage-backed securities	10,696,725	82,433	3,793,423	378,001	14,490,148	460,434
Industrial and miscellaneous	1,369,439	6,653	--	--	1,369,439	6,653
Redeemable preferred stock	--	--	<u>1,671,942</u>	<u>295,608</u>	<u>1,671,942</u>	<u>295,608</u>
Total fixed maturities	<u>22,087,676</u>	<u>265,576</u>	<u>5,516,665</u>	<u>676,350</u>	<u>27,604,341</u>	<u>941,926</u>
Equity securities – common stocks	--	--	14,428	25,016	14,428	25,016
Equity securities – perpetual preferred	--	--	<u>1,246,540</u>	<u>586,260</u>	<u>1,246,540</u>	<u>586,260</u>
Total equity securities	--	--	<u>1,260,968</u>	<u>611,276</u>	<u>1,260,968</u>	<u>611,276</u>
Total temporarily impaired securities	<u>\$22,087,676</u>	<u>265,576</u>	<u>6,777,633</u>	<u>1,287,626</u>	<u>28,865,309</u>	<u>1,553,202</u>

	<u>Less than 12 months</u>		<u>12 months or longer</u>		<u>Total 2008</u>	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
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 stock	<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>924,100</u>	<u>908,700</u>
Total equity securities	<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>



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The following table summarizes for all fixed maturities and equity securities available for sale and for equity securities reported at fair value for which fair value is less than 80% of amortized cost at December 31, 2009, the gross unrealized investment loss by length of time those securities have continuously been in an unrealized loss position of greater than 20% of amortized cost:

(in millions)	<u>Period For Which Fair Value Is Less Than 80% of Amortized Cost</u>				Total
	Less Than 3 Months	Greater Than 3 Months, Less Than 6 Months	Greater Than 6 Months, Less Than 12 Months	Greater Than 12 Months	
Fixed maturities:					
Mortgage-backed securities	\$ --	--	--	100,589	100,589
Redeemable preferred stock	--	--	--	<u>122,060</u>	<u>122,060</u>
Total fixed maturities	--	--	--	222,649	222,649
Equity securities	--	--	--	<u>534,856</u>	<u>534,856</u>
Total	<u>\$ --</u>	<u>--</u>	<u>--</u>	<u>757,505</u>	<u>757,505</u>

These unrealized losses at December 31, 2009 represented less than 1% of the combined fixed maturity and equity security portfolios on a pretax basis and less than 2% of shareholders' equity on an after-tax basis.

The following table summarizes fixed maturity securities in a gross unrealized loss position by investment category and by credit rating as of December 31, 2009. The table also discloses the corresponding count of securities in an unrealized position and estimated fair value by category:

	<u>AAA</u>	<u>AA</u>	<u>A</u>	<u>BBB</u>	<u>Total</u>	<u>Estimated Fair Value</u>
Investment grade (a):						
States, municipalities and political subdivisions (34)	\$14,296	77,956	54,081	32,898	179,231	10,072,812
United States government and government agencies	--	--	--	--	--	--
Mortgage-backed securities (23)	241,259	--	118,586	--	359,845	14,394,244
Industrial and miscellaneous (5)	--	--	1,640	5,013	6,653	1,369,439
Redeemable preferred stock (2)	--	--	--	<u>75,714</u>	<u>75,714</u>	<u>866,786</u>
Total investment grade	<u>255,555</u>	<u>77,956</u>	<u>174,307</u>	<u>113,625</u>	<u>621,443</u>	<u>26,703,281</u>
Non-investment grade:						
Mortgage-backed securities (1)	--	--	--	--	100,590	95,904
Redeemable preferred stock (4)	--	--	--	--	<u>219,894</u>	<u>805,156</u>
Total non-investment grade	--	--	--	--	<u>320,484</u>	<u>901,060</u>
Total	<u>\$ 255,555</u>	<u>77,956</u>	<u>174,307</u>	<u>113,625</u>	<u>941,927</u>	<u>27,604,341</u>

(a) Securities are categorized using the Moody's rating. If a security is not rated by Moody's, the S&P's rating is used.

As of December 31, 2009, the Company's investments in states, municipalities and political subdivisions included thirty-four securities in an unrealized loss position of \$179,231, none of which exceeded 13% of the security's amortized cost. The unrealized loss position of the states, municipalities and political subdivisions at December 31, 2008 were \$52,551. All of the Company's investments securities in states, municipalities and political subdivisions were investment grade securities and the unrealized losses are due to changes in credit spreads and rising interest rates. The Company has no current intent to sell these securities, nor is it more likely than not that it will be required to sell prior to recovery of amortized cost. The Company does not believe the unrealized losses on these securities are indicative of credit losses and, as such, has not recorded an OTTI loss on these securities at December 31, 2009.

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The unrealized losses on the Company's investments in mortgage-backed securities included twenty-three investment grade securities in an unrealized loss position of \$359,845 at December 31, 2009. Sixteen of these mortgage-backed securities are guaranteed by an agency of the U.S. Government, none of which had an unrealized loss which exceeded 2% of the securities amortized cost. Seven mortgage-backed securities are collateralized mortgage obligations (CMOs) typically collateralized with prime residential mortgages and corporate asset-backed structured securities. At December 31, 2009, these seven securities were in a gross unrealized loss position of \$378,001 which represented 9% of their aggregate amortized cost. None of these seven mortgage-backed securities exceeded 9% of their individual amortized cost and they have improved from an unrealized loss position of \$815,158 at December 31, 2008. The Company believes these seven mortgage-backed securities will recover in value based on the current performance of the underlying collateral and the amount of credit support available to these holdings. The Company has no current intent to sell these securities, nor is it more likely than not that it will be required to sell prior to recovery of amortized cost. The Company does not believe the unrealized losses on these securities are indicative of credit losses and, as such, has not recorded an OTTI loss on these securities at December 31, 2009.

At December 31, 2009, the Company holds one non-investment grade CMO security with an unrealized loss of \$100,590 and an amortized cost of \$196,493. The unrealized loss on this security has improved slightly from an unrealized loss of \$105,690 at December 31, 2008. The Company believes this mortgage-backed security will recover in value based on the current performance of the underlying collateral and the amount of credit support available to these holdings. The Company has no current intent to sell this security, nor is it more likely than not that it will be required to sell prior to recovery of amortized cost. The Company does not believe the unrealized loss on this security is indicative of a credit loss and, as such, has not recorded an OTTI loss on these securities at December 31, 2009.

As of December 31, 2009, the Company's investments in redeemable preferred stocks included two investment grade securities in an unrealized loss position totaling \$75,714, one at less than 3% of the security's amortized cost and the other at less than 12% of amortized cost. The unrealized loss on these securities has improved from a loss of \$205,930 at December 31, 2008. The Company has no current intent to sell these securities, nor is it more likely than not that it will be required to sell prior to recovery of amortized cost. The Company does not believe the unrealized losses on these securities are indicative of credit losses and, as such, has not recorded an OTTI loss on these securities at December 31, 2009.

The Company's investments in redeemable preferred stocks included four non-investment grade securities in an unrealized loss position totaling \$219,894 at December 31, 2009. The unrealized loss on these four securities has improved from a loss of \$407,210 at December 31, 2008. The unrealized losses on these securities represent ranges of 18% to 27% of their amortized cost primarily because these securities were issued by diversified financial institutions which have fallen out of favor in the current market conditions. 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. The Company has no current intent to sell these securities, nor is it more likely than not that it will be required to sell prior to recovery of amortized cost. The Company does not believe the unrealized losses on these securities are indicative of credit losses and, as such, has not recorded an OTTI loss on these securities at December 31, 2009.

Based on the current facts and circumstances discussed above for the Company's securities in an unrealized loss position, the Company has determined that no OTTI losses related to the securities in an unrealized loss position are required to be recorded at December 31, 2009.

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A summary of net investment income for the years ended December 31, 2009 and 2008 follows:

	<u>2009</u>	<u>2008</u>
Tax-exempt interest	\$ 425,514	68,895
Taxable interest	2,613,113	3,169,086
Dividends on equity securities	341,173	673,301
Investment expenses	<u>(38,917)</u>	<u>(38,501)</u>
Net investment income	<u>\$3,340,883</u>	<u>3,872,781</u>

Net realized capital gains (losses) for the years ended December 31, 2009 and 2008 follows:

	<u>2009</u>	<u>2008</u>
Fixed maturities	\$ 840,285	(914,183)
Equity securities	<u>421,554</u>	<u>(1,097,313)</u>
Net realized capital losses	<u>\$1,261,839</u>	<u>(2,011,496)</u>

**(3) 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.

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.

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*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 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.

The following table present the level within the fair value hierarchy at which the Company's financial assets and financial liabilities are measured on a recurring basis at December 31, 2009.

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Fixed maturities:				
States, municipalities and political subdivisions	\$ --	20,156,466	--	20,156,466
United States government and government agencies	3,966,680	--	--	3,966,680
Mortgage-backed securities	--	32,837,196	--	32,837,196
Industrial and miscellaneous	--	16,487,647	--	16,487,647
Redeemable preferred stock	--	<u>2,481,670</u>	--	<u>2,481,670</u>
Total fixed maturities	3,966,680	71,962,979	--	75,929,659
Equity securities – common stocks	926,964	--	--	926,964
Equity securities – perpetual preferred	--	<u>1,246,540</u>	--	<u>1,246,540</u>
Total equity securities	926,964	1,246,540	--	2,173,504
Short-term investments	<u>3,436,351</u>	--	--	<u>3,436,351</u>
Total	<u>\$8,329,995</u>	<u>73,209,519</u>	--	<u>81,539,514</u>

**(4) Receivables**

A summary of receivables at December 31, 2009 and 2008 follows:

	<u>2009</u>	<u>2008</u>
Insurance premiums due from agents	\$212,127	380,293
Receivables under construction contracts:		
Amounts billed	1,056	219,685
Recoverable costs in excess of billings on uncompleted contracts	--	140,121
Billings in excess of costs on uncompleted contracts	--	(10,457)
Retainage, due on completion of contracts	<u>213,388</u>	<u>582,441</u>
Total receivables under construction contracts	214,444	931,790
Other	<u>196,410</u>	<u>82,563</u>
Total receivables	622,981	1,394,646
Less allowances for doubtful accounts	<u>(55,460)</u>	<u>(71,231)</u>
Total receivables, net	<u>\$567,521</u>	<u>1,323,415</u>

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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 2010.

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, 2009 and 2008 follows:

	<u>2009</u>	<u>2008</u>
Building	\$17,041,203	16,950,163
Land	800,000	800,000
Equipment and vehicles	829,726	868,206
Furniture and fixtures	<u>876,205</u>	<u>899,802</u>
	19,547,134	19,518,171
Less accumulated depreciation	9,128,890	8,873,324
Less impairment allowance on the building	<u>6,484,548</u>	<u>--</u>
	<u>\$ 3,933,696</u>	<u>10,644,847</u>

At December 31, 2009, as a result of the Company's decision to sell the office building, the Company recognized an impairment loss of \$6,484,548 on the carrying value of its corporate headquarters. Although management engaged a broker to sell the building, the likelihood that the building will be sold within one year is unknown given the current real estate market conditions.

Useful lives for depreciation purposes are five years for equipment and vehicles, seven years for furniture and fixtures and forty years for the building. Depreciation expense in 2009 and 2008 was \$734,818 and \$468,639, respectively.

Future minimum rental income to be generated by leasing a portion of the building under non-cancelable operating leases as of December 31, 2009 are estimated to be \$584,676 for 2010, \$584,676 for 2011, \$584,676 for 2012, \$561,576 for 2013 and \$619,438 thereafter. Rental income earned in 2009 and 2008 was \$529,946 and \$505,909, 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.

	<u>2009</u>	<u>2008</u>
Balance at January 1	\$23,064,539	22,845,815
Less reinsurance recoverable	<u>3,530,878</u>	<u>3,298,783</u>
Net balance at January 1	19,533,661	19,547,032
Incurred related to:		
Current year	3,200,000	1,435,000
Prior years	<u>(2,033,981)</u>	<u>(1,121,661)</u>
Total incurred	1,166,019	313,339
Payments related to:		
Current year	212,000	118,000
Prior years	<u>2,532,617</u>	<u>208,710</u>
Total payments	2,744,617	326,710
Net balance at December 31	17,955,063	19,533,661
Plus reinsurance recoverable	<u>3,642,683</u>	<u>3,530,878</u>
Balance at December 31	<u>\$21,597,746</u>	<u>23,064,539</u>

The decrease in reserves for unpaid losses and loss adjustment expenses in 2009 from 2008 primarily resulted from an increase in claim payments due to several large claim settlements in 2009. The increase in incurreds for 2009 represents normal loss development on

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general liability and surety exposures in 2009 compared to exceptionally favorable loss development in 2008. The increase in reserves for unpaid losses and loss adjustment expenses in 2008 from 2007 primarily resulted from a decrease in claim payments due to a decrease in claim activity. 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, 2009, the Company has a \$7,000,000 bank line of credit with a financial institution. 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, 2009 and 2008. 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 225 basis points in effect during the borrowing period. The Company pays an annual commitment fee of .375% of the unused portion of the bank line.

**(8) Long-term Debt**

A summary of long-term debt at December 31, 2009 and 2008 follows:

	<u>2009</u>	<u>2008</u>
Term Loan due 2016	\$10,000,000	---
Mortgage Note due 2009	---	92,983
Term Loan due 2009	---	<u>5,944,444</u>
	<u>\$10,000,000</u>	<u>6,037,427</u>

On December 23, 2009, the Company obtained a \$10,000,000 term loan from a financial institution, which is payable in monthly installments of \$119,048. The term loan, due 2016 has a balance of \$10,000,000 at December 31, 2009. The interest rate varies based on LIBOR plus 225 basis points in effect during the borrowing period. In connection with this term loan, the Company entered into an interest rate cap that establishes an interest rate cap of 6% on the entire loan balance. 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, 2009. The proceeds were used to pay the \$5,388,888 balloon payment of the term loan due 2009.

On November 22, 2002, the Company obtained a \$10,000,000 term loan from two financial institutions, which was payable in monthly installments of \$55,556 with a balloon payment of \$5,388,888 due on November 22, 2009. The term loan matured and was fully paid in 2009.

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% was payable in monthly installments of principal and interest over 10 years. The mortgage note matured and was fully paid in 2009. The loan agreements contain certain limitations on borrowings, minimum statutory capital levels and require maintenance of certain ratios.

Principal payments on long-term debt are \$1,428,571 for each of the years 2010 through 2016. Interest expense paid in 2009 and 2008 amounted to \$248,181 and \$454,657, respectively.

The fair value at December 31, 2009 of the term loan approximates carrying value.

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**(9) Income Taxes**

The components of income tax expense (benefit) for the years ended December 31, 2009 and 2008 were as follows:

	<u>2009</u>	<u>2008</u>
Current Taxes:		
Federal	\$ 594,964	806,227
State	<u>50,475</u>	<u>140,000</u>
	<u>645,439</u>	<u>946,227</u>
Deferred Taxes:		
Federal	(2,199,063)	123,662
State	--	---
	<u>(2,199,063)</u>	<u>123,662</u>
Total	<u>\$(1,553,624)</u>	<u>1,069,889</u>

The effective income tax rate, as a percentage of earnings before income taxes for the years ended December 31, 2009 and 2008 was as follows:

	<u>2009</u>	<u>2008</u>
Federal statutory tax rate	34.0%	34.0%
State income tax (benefit)	(.8)	3.1
Tax exempt interest	2.7	(.6)
Other, net	<u>.4</u>	<u>(1.1)</u>
Effective income tax rate	<u>36.3%</u>	<u>35.4%</u>

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2009 and 2008 are presented below:

	<u>2009</u>	<u>2008</u>
Deferred Tax Assets:		
Reserves for losses and loss adjustment expenses	\$ 449,215	545,779
Unearned premiums	97,678	176,399
Allowance for doubtful accounts	18,856	24,218
Impairment Allowance on building	2,204,746	--
State effect of net operating loss carryforward	1,201,150	1,056,129
Unrealized losses in investments	--	684,641
Stock based compensation	<u>140,778</u>	<u>128,101</u>
Total gross deferred tax assets	4,112,423	2,615,267
Less valuation allowance	<u>(1,201,150)</u>	<u>(1,740,770)</u>
Net deferred tax assets	\$2,911,273	874,497
Deferred Tax Liabilities:		
Plant and equipment	\$ 686,352	645,401
Deferred policy acquisition costs	200,414	319,838
Discount on investments	60,150	143,966
Unrealized gains on investments	132,847	--
Other	<u>179</u>	<u>179</u>
Total gross deferred tax liabilities	<u>1,079,942</u>	<u>1,109,384</u>
Net deferred tax assets (liabilities)	<u>\$1,831,331</u>	<u>(234,887)</u>

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, 2009 and 2008.

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### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

The most significant component of the state gross deferred asset is the net operating loss carryforward for the State of Connecticut which amounted to \$24,023,006 as of December 31, 2009 which expires in 2020 through 2027. In 2009 and 2008, 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 in the prior year there was a valuation allowance for unrealized losses on investments. The change of \$539,620 in the valuation allowance is due to the current tax loss generated by the Connecticut domiciled companies as well as decreases in unrealized losses in the investment portfolio.

The IRS has conducted an examination of the Company's U.S. income tax returns for the 2006, 2007 and 2008 tax years and no adjustments were required. The Company does not have any tax positions for which the ultimate deductibility is certain, but for which there is uncertainty about the timing of deductibility

Taxes received in 2009 were \$223,139 and taxes paid in 2008 were \$1,501,225.

#### **(10) Pension and Profit Sharing Plans**

The Company maintains ACMAT 401(k) plan for the benefit of non-union employees. The Company contributed \$80,000 and \$100,000 to the ACMAT 401(k) Plan in 2009 and 2008, respectively. Costs associated with operating the Plan are borne by the Company and were insignificant for each of the years ended December 31, 2009 and 2008.

#### **(11) Derivative Financial Instruments**

The Company uses interest rate caps and 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 year ended December 31, 2009, the amounts included in AOCI for these changes were gains of \$86,856 in 2009. The interest rate swap expired in November 2009 with the repayment of the associated debt.

#### **(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 2009 and 2008, ACMAT repurchased and retired, in the open market and in privately negotiated transactions, 3,060 and 7,086, respectively, shares of its Common Stock at an average price of \$22.63 and \$26.83 per share, respectively. The Company also repurchased and retired during 2009 and 2008, in the open market and in privately negotiated transactions, 197,538 and 246,267, respectively, shares of its Class A Stock at an average price of \$25.49 and \$26.60 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 \$3,683,040 in 2010.

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 \$30,404,590 and \$30,841,403 at December 31, 2009 and 2008 respectively, and their statutory net income for the years ended December 31, 2009 and 2008 was \$3,683,040 and \$3,735,814, 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 (Loss) Per Share**

The following is a reconciliation of the numerators and denominators of the basic and diluted earnings (loss) per share (“EPS”) computations for the years ended December 31, 2009 and 2008:

	<u>Earnings (Loss)</u>	<u>Weighted Average Shares Outstanding</u>	<u>Per-Share Amount</u>
<u>2009:</u>			
Basic EPS:			
Earnings (loss) available to stockholders	\$(2,723,747)	1,373,741	(\$1.98)
Effect of Dilutive Securities:			
Stock options	<u>---</u>	<u>116,918</u>	
Diluted EPS:			
Earnings (loss) available to stockholders	<u>\$(2,723,747)</u>	<u>1,490,659</u>	<u>(\$1.83)</u>
<u>2008:</u>			
Basic EPS:			
Earnings available to stockholders	\$1,954,459	1,643,175	\$1.19
Effect of Dilutive Securities:			
Stock options	<u>---</u>	<u>127,390</u>	
Diluted EPS:			
Earnings available to stockholders	<u>\$1,954,459</u>	<u>1,770,565</u>	<u>\$1.10</u>

**(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 weighted average fair value of the outstanding options was \$10.75 for the year ended December 31, 2009. Total stock-based compensation expense totaled \$37,286 and \$70,461 for the year ended December 31, 2009 and 2008, respectively. The tax benefit recognized on stock-based compensation totaled \$12,677 and \$23,957 for the year ended December 31, 2009 and 2008, respectively.

As of December 31, 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 \$20,714 as of December 31, 2009. The Company expects to recognize that cost over a weighted average period of 1.0 years.

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The following table shows the stock option activity for the Company during 2009 and 2008.

	Option Shares	Weighted average exercise price	Weighted average remaining contractual term (in years)	Aggregate intrinsic value
Outstanding at December 31, 2007	359,000	\$10.65		
2008 activity:				
Granted	--			
Exercised	(19,500)	\$ 9.57		
Canceled	--			
Outstanding at December 31, 2008	<u>339,500</u>	\$10.71		
2009 activity:				
Granted	--			
Exercised	(7,000)	\$ 9.00		
Canceled	--			
Outstanding at December 31, 2009	<u>332,500</u>	\$10.75	3.59	\$1,631,578
Exercisable at December 31, 2009	<u>294,165</u>	\$10.83	3.63	\$1,443,468
Expected to Vest	<u>38,335</u>	\$10.15	3.28	\$ 188,110

Of the 339,500 outstanding options at December 31, 2008, 261,600 were exercisable. During 2009 and 2008, officers and directors exercised 7,000 and 19,500 stock options, respectively. Proceeds from stock options exercised in 2009 and 2008 were \$63,000 and \$186,700, respectively. Tax benefits related to stock options exercised in 2009 and 2008 were \$34,201 and \$108,902, respectively.

The following table summarizes information about stock options outstanding at December 31, 2009:

Range of exercise price	Number Outstanding	Weighted average remaining contractual life	Weighted average exercise price	Grant Year	Number exercisable
\$ 7.25	20,000	0.95	\$ 7.25	2000	20,000
\$ 9.00	144,000	2.47	\$ 9.00	2002	116,000
\$12.22	61,500	4.20	\$12.22	2004	61,500
\$11.40	20,000	4.20	\$11.40	2004	20,000
\$13.25	<u>87,000</u>	5.48	\$13.25	2005	<u>76,665</u>
\$7.25-13.25	<u>332,500</u>	3.59	\$10.75		<u>294,165</u>

**(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 had been engaged 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 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.

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Since 1995, 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 or negligence claims relating to materials containing asbestos. No specific claims for monetary damages are asserted in these actions. Many of these actions have been dismissed or settled for nominal payments by the Company or its insurers. At this time, 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:

	<u>2009</u>	<u>2008</u>
Revenues:		
ACSTAR Bonding	\$ 9,473,765	9,570,058
ACMAT Contracting	<u>3,260,582</u>	<u>6,386,958</u>
	<u>\$12,734,347</u>	<u>15,957,016</u>
Operating Earnings (Loss):		
ACSTAR Bonding	\$4,904,557	5,380,366
ACMAT Contracting	<u>(2,449,199)</u>	<u>(1,906,465)</u>
	<u>\$2,455,358</u>	<u>3,473,901</u>
Depreciation and Amortization:		
ACSTAR Bonding	\$ 333,806	(60,699)
ACMAT Contracting	<u>487,551</u>	<u>456,444</u>
	<u>\$821,357</u>	<u>395,745</u>
Identifiable Assets:		
ACSTAR Bonding	\$ 90,236,704	90,303,757
ACMAT Contracting	<u>15,707,895</u>	<u>19,960,298</u>
	<u>\$105,944,599</u>	<u>110,264,055</u>
Capital Expenditures:		
ACSTAR Bonding	\$57,273	109,819
ACMAT Contracting	<u>246,071</u>	<u>594,018</u>
	<u>\$303,344</u>	<u>703,837</u>

The components of revenue for each segment are as follows:

	<u>2009</u>	<u>2008</u>
ACSTAR Bonding:		
Premiums	\$5,230,093	7,590,974
Investment income, net	2,953,886	3,161,487
Capital gains (losses)	1,260,346	(1,363,808)
Other income (expense)	<u>29,440</u>	<u>181,405</u>
	<u>\$9,473,765</u>	<u>9,570,058</u>
ACMAT Contracting:		
Contract revenues	\$1,134,730	4,590,997
Investment income, net	77,829	422,571
Capital gains (losses)	1,493	(647,688)
Inter-segment revenue:		
Rental income	384,713	316,598
Underwriting services and agency commissions	920,964	1,240,161
Other income	<u>740,854</u>	<u>464,319</u>
	<u>\$3,260,582</u>	<u>6,386,958</u>

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

Revenue:	<u>2009</u>	<u>2008</u>
Total revenue for reportable segments	\$12,734,347	15,957,016
Inter-segment eliminations	<u>(835,419)</u>	<u>(1,001,539)</u>
	<u>\$11,898,928</u>	<u>14,955,477</u>
Operating Earnings (loss):		
Total operating earnings for reportable segments	\$2,455,358	3,473,901
Impairment loss on building	(6,484,548)	--
Interest expense	<u>(248,181)</u>	<u>(449,553)</u>
	<u>\$(4,277,371)</u>	<u>3,024,348</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 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.

## **INDEPENDENT AUDITORS' REPORT**

The Board of Directors  
ACMAT Corporation:

We have audited the consolidated balance sheets of ACMAT Corporation and its subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of earnings, stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ACMAT Corporation and its subsidiaries as of December 31, 2009 and 2008, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

/s/ KPMG LLP

Hartford, Connecticut  
April 21, 2010

## Our Services

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### **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.

	<u>2009</u>		<u>2008</u>	
	<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>
<b>Common Stock</b>				
1st Quarter	26.00	26.00	27.00	27.00
2nd Quarter	26.00	26.00	27.00	27.00
3rd Quarter	26.00	21.75	27.00	27.00
4th Quarter	25.00	23.05	27.00	23.00
<b>Class A Stock</b>				
1st Quarter	28.00	18.25	29.60	22.00
2nd Quarter	25.00	18.05	28.50	24.00
3rd Quarter	27.00	21.00	28.00	24.15
4th Quarter	25.00	23.00	33.00	15.76

### **Annual Meeting**

The annual meeting of stockholders will be held on June 23, 2010 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 16, 2010 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.

### **Transfer Agent**

American Stock Transfer & Trust Company  
59 Maiden Lane  
New York, NY 10007  
(718)-921-8200

## Directors

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

**Henry W. Nozko III**  
Vice President, Secretary

**John C. Creasy**  
Former Chief Executive Officer  
Danbury Hospital

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

**Andrew M. Sullivan, Jr.**  
Retired Partner of KPMG LLP

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## 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

## Managers

**Maurice C. Shea**  
Controller

**Robert Winchell**  
Building Manager

## ACSTAR Insurance Company

**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

**Joan C. Fortier**  
Assistant Vice President

**Underwriting Managers**  
Carmen Carlton  
Susan Deriso, CPCU, AFSB