



ACMAT Annual Report 2016



STANDING OUT. *As a surety writer, we have always subscribed to a different school of thought. Obviously, we cannot write cases that are impossible. Nobody can. But unlike many “standard” sureties, we’ve succeeded by assisting with cases that may appear less than perfect, yet still have some merit.*

Other qualities have set us apart, as well. Our history – as a specialty contractor, a general contractor, an E&S insurer, and now a surety – has given us an in-depth understanding of the construction business and insight into the needs of contractors. This unique background has served us well in recognizing credible risks that others have overlooked.

Now, in a crowded market where more and more sureties chase fewer and fewer cases, we’re confident that the qualities that have always set us apart – our experience, credentials, flexibility, agility and stability – will continue to be advantages in our pursuit of opportunities.

Welcome Shareholders, Customers and Employees

What was striking about 2016 is that we accomplished the highest annual gain in book value per share since 2006. Book value per share jumped to \$34.47 at December 31, 2016 from \$32.91 at December 31, 2015. Per share earnings were also strong. For 2016, net income per share was \$0.84 compared to \$0.82 for 2015. Revenue increased to \$4.2 million in 2016 over \$3.9 million in 2015. Net income was \$766 thousand in 2016 vs. \$809 thousand in 2015. Not so good was earned premium which declined in 2016 to \$1.1 million from \$1.8 million in 2015. The construction industry is very soft and competition among sureties is fierce. Nonetheless, our loss experience continues to be excellent which resulted in a net reserve reduction of \$229 thousand during 2016. We are hoping to increase premium with the implementation of various initiatives. There are also some indications that the very long recession that has gripped the non-residential construction industry during the last 10 years might possibly revive into a recovery. Those indications include a growing public demand for upgrading the nation’s infrastructure and the White House plan to budget for such expenditures. However such a plan would need to survive a likely fusillade from the opposition. Should the industry remain in a slump, we believe we can continue to produce positive results.

The premium we write is mostly for surety bonds for construction contractors performing construction projects for towns, cities, states and the federal government. By statute, almost all such construction projects require the contractor to be bonded by an acceptable surety company. By policy, some private owners also require contractors to be bonded. Construction bonds, to an extent, assure the contractor's payment and performance obligations. We write what is known as non-standard surety bonds for contractors that usually cannot get approved by a standard surety market such as Travelers, CNA and Liberty Mutual. Therefore the bonds we write are higher risk so we usually charge more than the standard markets and we usually securitize a portion of our exposure to partially hedge our risk. There are other non-standard surety companies that compete with us. Competition is intense because of the long and extended lull in the construction industry, particularly in the public works sector. The huge challenge is to conflate premium growth with our exceptional historical loss experience. We are optimistic about the possibilities, however, we plan to maintain our disciplined underwriting standards even if our efforts to grow premium are foiled.

We had excellent investment results during 2016. Net investment income for 2016 was \$2.3 million compared to \$2.5 million in 2015. We were fortunate to generate \$683 thousand in net realized capital gains in 2016 compared to net realized capital losses of \$571 thousand in 2015. That success does not make us think any less about the risks associated with investing in common stocks. At December 31, 2016 we reduced our exposure to common stocks to approximately 9% of our investment portfolio.

Like most enterprises, we face risks. Although we apply conservative and disciplined underwriting standards, a defaulting contractor that we have bonded, could cause us to incur a significant loss. During the downturn, many contractors have been weakened, which could increase the risk of default. We often rely on bank letters of credit

to partially securitize the high risk associated with writing surety bonds. A financial industry meltdown could lead to possible bank defaults on letters of credit, which could result in greater exposure to contractor defaults in connection to the bonds we write. Defaults in payment of interest and/or principal by municipalities or states on debt securities we have purchased and hold, could adversely affect our investment portfolio and our investment income. With the open-ended court system that prevails in the nation, there is possible exposure to inflated and unreasonable plaintiff judgments pertaining to our surety business and to the run off of our casualty business. Since 1995, we have been named, along with many others, in third party bodily injury claims relating to materials containing asbestos. A large number of those claims have been dismissed or settled for nominal payments by us or our insurers.

In keeping with our more than 25 year stock repurchase program, during 2016 the Company purchased 74,433 shares of the Company's Class A stock and 1,220 shares of the Company's Common stock. The total for all purchases was \$2.1 million. The shares were cancelled and retired and the cost has been recorded as an offset to retained earnings. We expect to continue such purchases in the future.

As discussed, in a prodigious way, we again met our company plan and goal of increasing per share equity, which increased to \$34.47 at December 31, 2016 from \$32.91 at December 31, 2015.

Our shareholders, customers and employees have all contributed to the gains we have achieved. Thank you for your support.



Henry W. Nozko, Jr.
*Chairman, President and
Chief Executive Officer*
April 25, 2017



C

TION



HELPING TO

KEEP A CITY'S

WATER SAFE.



The drinking water for Grand Island, Nebraska is supplied mostly from the Platte River Well Field – a collection of twenty-one wells and a pumping station. When testing indicated the presence of uranium in several wells at levels that approached the EPA's Maximum Containment Level, the City's Utilities Department undertook a detailed study to determine the most effective means of removing the contamination. Once a method and a contractor had been determined, ACSTAR issued a \$2 million surety bond for the project. The new system is now online. The contamination levels are well within the EPA's requirements, and the City's water is once again safe for its citizens to enjoy.

RADIOA

TERIAL



TURNING AN ABANDONED AIRFIELD INTO A VIBRANT COMMUNITY



A long anticipated mixed-use community now occupies land that had once been part of Howard Hughes' aerospace empire. The Runway at Playa Vista, California – in the Westside neighborhood of Los Angeles – includes nearly 230,000 square feet of retail space, 25,000 square feet of office space, and 214 residential units. The complex offers its residents easy access to shopping, entertainment, medical services and more. ACSTAR played a role in bringing the development to life by providing a \$1 million bond for the installation of structural steel. Now, the Runway has become a favored location for younger workers in the technology, media and entertainment businesses.



Assets	2016	2015
Investments:		
Fixed maturities (Amortized cost of \$49,500,581 in 2016 and \$44,948,955 in 2015)	\$ 48,854,835	45,272,103
Equity securities (Historical cost of \$7,070,093 in 2016 and \$11,952,126 in 2015)	7,477,156	11,169,485
Short-term investments, at cost which approximates fair value	<u>551,855</u>	<u>1,476,613</u>
Total investments	<u>56,883,846</u>	<u>57,918,201</u>
Cash and cash equivalents	3,432,485	3,740,700
Accrued interest receivable	438,008	348,057
Premiums receivable, net of allowance for doubtful accounts of \$12,000 in 2016 and \$16,353 in 2015	22,768	32,903
Other receivables	124,588	168,955
Reinsurance recoverable	2,090,562	2,076,711
Prepaid expenses	131,420	126,996
Income taxes receivable	94,978	258,173
Deferred income taxes, net	947,967	1,022,380
Property and equipment, net	4,894,572	5,050,382
Deferred policy acquisition costs	80,255	82,279
Ceded unearned premiums	86,286	86,101
Other assets	1,108,648	1,137,169
Intangibles	<u>1,920,360</u>	<u>1,920,360</u>
Total assets	<u>\$ 72,256,743</u>	<u>73,969,367</u>
Liabilities and Stockholders' Equity		
Reserves for losses and loss adjustment expenses	\$ 14,349,448	14,718,196
Unearned premiums	592,625	591,355
Collateral held	17,794,400	16,705,694
Reinsurance premiums payable	29,926	39,730
Accounts payable and accrued liabilities	1,421,864	1,397,222
Long-term debt	<u>8,245,534</u>	<u>9,559,953</u>
Total liabilities	<u>42,433,797</u>	<u>43,012,150</u>
Common Stock (No par value; 3,500,000 shares authorized; 356,946 shares issued and outstanding)	356,746	357,966
Class A Stock (No par value; 10,000,000 shares authorized; 508,349 shares issued and outstanding)	508,349	582,782
Retained earnings	29,196,532	30,475,962
Accumulated other comprehensive loss	<u>(238,681)</u>	<u>(459,493)</u>
Total stockholders' equity	<u>29,822,946</u>	<u>30,957,217</u>
Total liabilities and stockholders' equity	<u>\$ 72,256,743</u>	<u>73,969,367</u>

See Notes to Consolidated Financial Statements

ACMAT CORPORATION AND SUBSIDIARIES
Consolidated Statements of Earnings — For the Years Ended December 31, 2016 and 2015

Revenues	2016	2015
Premiums	\$ 1,118,259	1,770,616
Net investment income	2,301,505	2,479,461
Net realized capital gains (losses)	682,946	(570,563)
Fee and other income	<u>135,633</u>	<u>177,528</u>
Total revenues	<u>4,238,343</u>	<u>3,857,042</u>
Expenses		
Incurred losses and loss adjustment expenses	(228,835)	(531,246)
Amortization of deferred acquisition costs	179,121	286,881
General and administrative expenses	2,978,380	2,887,055
Interest expense	<u>309,598</u>	<u>298,946</u>
Total expenses	<u>3,238,264</u>	<u>2,941,636</u>
Earnings before income taxes	1,000,079	915,406
Provision for income taxes	<u>234,301</u>	<u>106,117</u>
Net earnings	<u>\$ 765,778</u>	<u>809,289</u>
Earnings per share	\$ 0.84	\$ 0.82

See Notes to Consolidated Financial Statements
ACMAT CORPORATION AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income — For the Years Ended December 31, 2016 and 2015

	2016	2015
Net earnings	\$ 765,778	809,289
Change in net unrealized gains and losses on investment securities	220,812	(1,488,668)
Income tax expense (benefit) (Net of change in valuation allowance of \$74,525 and \$237,925 in 2016 and 2015, respectively)	<u>-</u>	<u>(744,073)</u>
Other comprehensive income (loss), net of taxes	<u>220,812</u>	<u>(744,595)</u>
Comprehensive income	<u>\$ 986,590</u>	<u>64,694</u>

See Notes to Consolidated Financial Statements

ACMAT CORPORATION AND SUBSIDIARIES
Consolidated Statements of Stockholders' Equity — For the Years Ended December 31, 2016 and 2015

	Common Stock Par value	Class A Stock Par value	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
Balance as of December 31, 2014	\$ 357,966	647,682	31,726,925	285,102	33,017,675
Comprehensive income					
Net change in unrealized capital gains and losses on investment securities, net of reclassification	-	-	-	(744,595)	(744,595)
Net earnings	-	-	809,289	-	809,289
Total comprehensive income	-	-	809,289	(744,595)	64,694
Issuance of 47,000 shares of Class A Stock pursuant to stock options	-	47,000	575,750	-	622,750
Acquisition and retirement of 111,900 shares of Class A Stock	-	(111,900)	(2,636,002)	-	(2,747,902)
Balance as of December 31, 2015	<u>\$ 357,966</u>	<u>582,782</u>	<u>30,475,962</u>	<u>(459,493)</u>	<u>30,957,217</u>
Comprehensive income					
Net change in unrealized capital gains and losses on investment securities, net of reclassification	-	-	-	220,812	220,812
Net earnings	-	-	765,778	-	765,778
Total comprehensive loss	-	-	765,778	220,812	986,590
Acquisition of 1,220 shares of common stock	(1,220)	-	(24,025)	-	(25,245)
Acquisition and retirement of 74,433 shares of Class A Stock	-	(74,433)	(2,021,183)	-	(2,095,616)
Balance as of December 31, 2016	<u>\$ 356,746</u>	<u>508,349</u>	<u>29,196,532</u>	<u>(238,681)</u>	<u>29,822,946</u>

See Notes to Consolidated Financial Statements

	2016	2015
Cash flows from operating activities		
Net earnings	\$ 765,778	809,289
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	449,958	230,666
Net investment income	13	(10,353)
Net realized capital gains and losses	(682,946)	570,563
Deferred income tax expense	74,413	(26,409)
Changes in:		
Accrued interest receivable	(89,951)	(19,218)
Receivables	54,502	49,448
Reinsurance recoverable	(13,851)	(263,527)
Income taxes	163,195	(259,357)
Deferred policy acquisition costs	2,024	8,530
Prepaid expenses and other assets	(10,410)	(233,958)
Reserves for losses and loss adjustment expenses	(368,748)	(209,096)
Unearned premiums, net	1,085	(44,248)
Collateral held	1,088,706	(1,330,843)
Reinsurance premiums payable	(9,804)	136
Accounts payable and accrued liabilities	(104,918)	167,535
Net cash provided by (used for) operating activities	<u>1,319,046</u>	<u>(560,842)</u>
Cash flows from investing activities		
Proceeds from investments sold, matured or redeemed:		
Fixed maturities sold	5,600,905	4,085,090
Maturities and redemptions	7,749,253	9,741,559
Equity securities	20,490,115	46,814,849
Purchases of:		
Fixed maturities	(18,411,906)	(14,920,070)
Equity securities	(14,508,127)	(51,106,885)
Short-term investments, net	924,758	4,547,529
Capital expenditures	(33,541)	(59,333)
Net cash provided by (used for) investing activities	<u>1,811,457</u>	<u>(897,261)</u>
Cash flows from financing activities		
Additional borrowing under term loan facility	-	2,020,117
Repayments of long-term debt	(1,317,857)	(489,286)
Acquisition of common shares	(25,245)	-
Issuance of Class A shares pursuant to stock options	-	622,750
Acquisition and retirement of Class A shares	(2,095,616)	(2,747,902)
Net cash used for financing activities	<u>(3,438,718)</u>	<u>(594,321)</u>
Net change in cash and cash equivalents	(308,215)	(2,052,424)
Cash and cash equivalents, beginning of year	3,740,700	5,793,124
Cash and cash equivalents, end of year	<u>\$ 3,432,485</u>	<u>3,740,700</u>
Supplemental disclosure of cash flows information:		
Cash received from income taxes	3,307	391,883
Cash paid for interest	273,174	248,218

(1) Summary of Significant Accounting Policies**(a) Basis of Presentation**

The consolidated financial statements include ACMAT Corporation (ACMAT), and its wholly-owned subsidiaries; AMINS, Inc., ACMAT Realty, ACSTAR Holdings, Inc. (ACSTAR Holdings) and ACSTAR Holdings' wholly-owned subsidiary, ACSTAR Insurance Company (ACSTAR); collectively referred to as "the Company".

These consolidated financial statements are prepared under U.S. generally accepted accounting principles (GAAP). 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, claims, and expenses during the reporting period. Actual results could differ from those estimates. All material intercompany transactions and balances have been eliminated. Certain prior period balances have been reclassified to conform to the current period presentation.

(b) Business

The Company, through ACSTAR, offers surety bonds for prime, sub-prime, specialty trade, environmental, asbestos and lead abatement contractors and miscellaneous obligations nationwide. ACSTAR also provides other miscellaneous surety such as workers' compensation bonds, supply bonds, subdivision bonds, and license and permit bonds. Prior to 2010, ACMAT provided construction contracting services to commercial and governmental customers.

(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 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 marketable debt instruments and redeemable preferred stocks. Equity securities reflect investments in common stock and non-redeemable preferred stock. Short-term investments, consisting of U.S. Government money market funds, 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.

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 or a portion thereof. 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. Purchase premiums and discounts on debt securities are amortized into interest income over the terms of the securities using the effective interest method. Purchase premium on debt securities having an explicit, non-contingent call feature is amortized to the earliest call date. If the call option is not exercised, amortization is reset based on the remaining terms. Purchase discount is amortized to maturity. 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 realized capital losses. 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 recognize an impairment loss on securities that were not written-down in prior reporting periods.

An investment in a debt or equity security is other-than-temporarily impaired if its cost basis is in excess of fair 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 the security's cost basis has been in excess of fair value, the financial condition and the near-term prospects of the issuer, and the Company's intent or obligation 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, 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. 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 amortized cost in excess of fair value during successive periods over a substantial timeframe, as determined by management;
- management review of other-than-temporary impairments based on the issuer'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 impairment 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 premium taxes, 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 straightline method based upon the respective estimated useful lives of the assets. Certain costs related to construction-in-progress are capitalized in property and equipment and commence depreciation upon being placed in-service. 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 suggest that the asset might be impaired. The Company has not impaired any intangible assets.

(g) **Reserves for Losses and Loss Adjustment Expenses**

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 casebycase 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 underwriting information, legal developments and economic conditions. 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, past experience 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 underlying contractor and its indemnitors.

Management believes that the reserves for losses and loss adjustment expenses are adequate to cover the unpaid portion of the ultimate net cost of losses and loss adjustment expenses incurred, including incurred but not reported claims.

(h) **Collateral Held**

The liability for collateral held represents cash retained 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.

(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 maintaining "A" ratings from creditable insurance rating organizations. 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 surety exposure in excess of \$1,000,000 up to \$7,000,000 on a per principal, per year basis.

Reinsurance recoverables include ceded reserves for losses and loss adjustment expenses. The Company had no reinsurance recoverables on paid losses and loss adjustment expenses as of December 31, 2016 or 2015. 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>2016</u>	<u>2015</u>	<u>2016</u>	<u>2015</u>
Direct	\$ 1,310,100	2,020,561	1,308,830	2,072,365
Assumed	-	-	-	-
Ceded	<u>190,756</u>	<u>294,193</u>	<u>190,571</u>	<u>301,749</u>
Net	<u>\$ 1,119,344</u>	<u>1,726,368</u>	<u>1,118,259</u>	<u>1,770,616</u>

Ceded incurred losses and loss adjustment expenses totaled \$19,056 and \$30,175 for the years ended December 31, 2016 and 2015, respectively.

(j) 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.

(k) Revenue Recognition

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

(l) Income Taxes

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

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

(m) Share Based Compensation

The Company periodically grants non-qualified stock options to officers and directors giving such individuals the right to purchase 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, utilizing the assumptions discussed in Note 11. 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).

(n) Adoption of Accounting Standards*Simplifying the Presentation of Debt Issuance Costs*

In April 2015, the FASB issued updated guidance to clarify the required presentation of debt issuance costs. The amended guidance requires that debt issuance costs be presented in the balance sheet as a direct reduction from the carrying amount of the recognized liability for long-term debt, consistent with the treatment of debt discounts. Amortization of debt issuance costs is to be reported as interest expense. The recognition and measurement guidance for debt issuance costs are not affected by the updated guidance.

The updated guidance became effective in 2016 and resulted in a retrospective reduction in Other Assets and Long-Term Debt of \$25,761 as of December 31, 2015. The adoption of this guidance did not have any effect on the Company's results of operations, financial position or liquidity. The table below illustrates the retrospective adjustments that have been recognized in the financial statements.

Improvements to Employee Share-Based Payment Accounting

In March 2016, the FASB issued updated guidance to simplify several aspects of accounting for share-based payment transactions and the related effects on income taxes. Under the updated guidance, excess tax benefits, or tax deficiencies, are reported as part of income tax expense or benefit in the income statement. The updated guidance also removed the requirement to delay recognition of any excess tax benefit when there are no current taxes payable to which the benefit would be applied. The tax-related cash flows resulting from share-based payments are to be included with other income tax cash flows as an operating activity rather than being reported separately as a financing activity.

ACMAT adopted the updated guidance in 2016. The following table illustrates retrospective adjustments that have been recognized in the financial statements:

As of, and for the year ended, December 31, 2015	Before adoption of Accounting Standards	Effect of adoption of Accounting Standards	Following adoption of Accounting Standards
Consolidated Balance Sheet:			
<i>Assets</i>			
Deferred income taxes, net	\$ 546,124	476,256	1,022,380
Other assets	1,162,930	(25,761)	1,137,169
Total assets	<u>\$ 73,518,872</u>		<u>73,969,367</u>
<i>Liabilities</i>			
Long-term debt	\$ 9,585,714	(25,761)	9,559,953
<i>Stockholders' Equity</i>			
Retained earnings	29,999,706	476,256	30,475,962
Total liabilities and stockholders' equity	<u>\$ 73,518,872</u>		<u>73,969,367</u>
Consolidated Statements of Earnings and Comprehensive Income:			
Income taxes	\$ 188,319	(82,202)	106,117
Net earnings	727,087		809,289
Comprehensive (loss) income	<u>\$ (17,508)</u>		<u>64,694</u>

Consolidated Statement of Stockholders' Equity:

<i>Retained earnings</i>			
Balance as of January 1, 2015	\$ 31,256,626	470,299	31,726,925
Net earnings	727,087	82,202	809,289
Excess benefit from stock options exercised	76,245	(76,245)	-
Other items	(2,060,252)		(2,060,252)
Balance as of December 31, 2015	<u>29,999,706</u>		<u>30,475,962</u>
Total Stockholders' equity	\$ <u>30,480,961</u>		<u>30,957,217</u>

Consolidated Statement of Cash Flows:

<i>Cash flows from operating activities</i>			
Net earnings	\$ 727,087	82,202	809,289
Deferred income tax expense	(20,452)	(5,957)	(26,409)
Net cash used for operating activities	\$ <u>(637,087)</u>		<u>(560,842)</u>
<i>Cash flows from financing activities</i>			
Excess benefit realized on share-based compensation	\$ 76,245	(76,245)	-
Net cash used for financing activities	\$ <u>(518,076)</u>		<u>(594,321)</u>

(o) **Accounting Standards Not Yet Adopted**

Disclosures about Short-Duration Contracts

In May 2015, the FASB issued updated disclosure requirements to increase transparency of significant estimates made in measuring liabilities associated with short-duration insurance contracts. The requirements will provide financial statement users with information to facilitate analysis of the amount, timing, and uncertainty of cash flows arising from contracts issued by insurance entities and the development of loss reserve estimates. The updated guidance is effective for reporting periods beginning after December 15, 2016. Early adoption is permitted. The adoption of this guidance will not have any effect on the Company's results of operations, financial position or liquidity.

Recognition and Measurement of Financial Assets and Financial Liabilities

In January 2016, the FASB issued updated guidance to address the recognition, measurement, presentation, and disclosure of certain financial instruments. The updated guidance requires equity investments, except those accounted for under the equity method of accounting, that have readily determinable fair value to be measured at fair value with changes in fair value recognized in net earnings. Equity investments that do not have readily determinable fair values may be remeasured at fair value either upon the occurrence of an observable price change or upon identification of an impairment. A qualitative assessment for impairment is required for equity investments without readily determinable fair values. The updated guidance is effective for the quarter ending March 31, 2018 and will require recognition of a cumulative effect adjustment at adoption. The Company will not be able to determine the impact that the updated guidance will have on its results of operations until the updated guidance is adopted, but does not currently expect the adoption of this guidance to impact its financial position or liquidity.

Financial Instruments—Credit Losses: Measurement of Credit Losses on Financial Instruments

In June 2016, the FASB issued updated guidance for the accounting for credit losses for financial instruments. The updated guidance applies a new credit loss model (current expected credit losses or CECL) for determining credit-related impairments for financial instruments measured at amortized cost (i.e. reinsurance recoverables) and requires an entity to estimate the credit losses expected over the life of an exposure or pool of exposures. The estimate of expected credit losses should consider historical information, current information, as well as reasonable and supportable forecasts, including estimates of prepayments. The expected credit losses, and subsequent adjustments to such losses, will be recorded through an allowance account that is deducted from the amortized cost basis of the financial asset, with the net carrying value of the financial asset presented on the consolidated balance sheet at the amount expected to be collected.

The updated guidance also amends the current other-than-temporary impairment model for available-for-sale debt securities by requiring the recognition of impairments relating to credit losses through an allowance account and limits the amount of credit loss to the difference between a security's amortized cost basis and its fair value. In addition, the length of time a security has been in an unrealized loss position will no longer impact the determination of whether a credit loss exists.

The updated guidance is effective for reporting periods beginning after December 15, 2019. Early adoption is permitted for reporting periods beginning after December 15, 2018. The Company will not be able to determine the impact that the updated guidance will have on its results of operations, financial position or liquidity until the updated guidance is adopted.

(2) Investments

a) *Fixed Maturities*

Fixed maturities at December 31, 2016 and 2015 are as follows:

2016	Amortized Cost	Gross Unrealized		Fair Value
		Gains	Losses	
United States government and other government obligations	\$ 4,035,138	222	14,319	4,021,041
States and municipalities	28,350,630	416,242	865,722	27,901,150
Industrial and miscellaneous	7,619,503	112,686	139,039	7,593,150
Mortgage-backed securities	6,369,683	113,161	114,005	6,368,839
Redeemable preferred stock	<u>3,125,627</u>	<u>5,362</u>	<u>160,334</u>	<u>2,970,655</u>
Total fixed maturities	\$ <u>49,500,581</u>	<u>647,673</u>	<u>1,293,419</u>	<u>48,854,835</u>

2015	Amortized Cost	Gross Unrealized		Fair Value
		Gains	Losses	
United States government and other government obligations	\$ 4,033,176	-	15,217	4,017,959
States and municipalities	21,861,945	702,346	188,304	22,375,987
Industrial and miscellaneous	6,520,163	101,901	233,655	6,388,409
Mortgage-backed securities	8,534,771	166,775	160,138	8,541,408
Redeemable preferred stock	3,998,900	91,650	142,210	3,948,340
Total fixed maturities	\$ 44,948,955	1,062,672	739,524	45,272,103

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.

2016	Amortized Cost	Fair Value
Due after one year through five years	7,627,187	7,648,536
Due after five years through ten years	7,814,781	7,838,365
Due after ten years	25,194,016	24,508,853
Mortgage-backed securities	6,369,683	6,368,839
	\$ 49,500,581	48,854,835

At December 31, 2016 and 2015, the Company held mortgage-backed securities with a fair value of \$6,368,839 and \$8,541,408, respectively. Approximately 13% and 16% of the Company's investments in mortgage-backed securities are backed by Government National Mortgage Association (GNMA), Federal National Mortgage Association (FNMA), Small Business Administration (SBA) or Federal Home Loan Mortgage Corporation (FHLMC) securities at December 31, 2016 and 2015, respectively.

Included in the Company's investments in mortgage-backed securities are residential collateralized mortgage obligations (CMOs) classified as available for sale with a fair value of \$3,806,858 and \$6,491,951 as of December 31, 2016 and 2015, respectively. The Company makes investments in CMOs that typically have high credit quality, offer 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 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. Approximately 4% and 7% of the Company's CMO holdings are fully collateralized by GNMA, FNMA, SBA, or FHLMC securities at December 31, 2016 and 2015, respectively.

Proceeds from sales of fixed maturities classified as available for sale were \$5,600,905 and \$4,085,090 in 2016 and 2015, respectively. Gross gains of \$367,670 and \$192,284 and gross losses of \$128,589 and \$247,367 were realized on fixed maturity sales for the years ended December 31, 2016 and 2015, respectively.

At December 31, 2016 and 2015, the Company's insurance subsidiary had securities with fair values of \$4,021,041 and \$4,017,959, respectively, on deposit with government authorities, as required by various states.

b) Equity Securities

Equity securities at December 31, 2016 and 2015 are as follows:

2016	Historical Cost	Gross Unrealized		Fair Value
		Gains	Losses	
Perpetual preferred stocks	\$ 2,175,000	25,960	55,330	2,145,630
Common stocks	4,895,093	737,227	300,794	5,331,526
Total equity securities	\$ 7,070,093	763,187	356,124	7,477,156

2015	Historical Cost	Gross Unrealized		Fair Value
		Gains	Losses	
Perpetual preferred stocks	\$ 2,040,755	98,461	480	2,138,736
Common stocks	9,911,371	699,452	1,580,074	9,030,749
Total equity securities	\$ 11,952,126	797,913	1,580,554	11,169,485

Proceeds from sales of equity securities were \$20,490,115 and \$46,814,849 in 2016 and 2015, respectively. Gross gains of \$1,181,257 and \$1,236,405 were realized on the sale of equity securities for the years ended December 31, 2016 and 2015, respectively, and gross losses of \$737,392 and \$1,751,885 were realized on the sale of equity securities for the years ended December 31, 2016 and 2015, respectively.

c) Other-than-Temporary Impairment

The following tables summarize, for all investments in an unrealized loss position at December 31, 2016 and 2015, the aggregate fair value and gross unrealized loss by length of time those securities have been continuously in an unrealized loss position:

	Less than 12 Months			
	2016		2015	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Fixed maturities:				
United States government and other government obligations	\$ 3,616,026	14,319	4,017,959	15,217
States and municipalities	14,983,676	830,014	5,110,974	75,707
Industrial and miscellaneous	3,307,610	135,070	2,635,688	123,989
Mortgage-backed securities	2,475,206	50,030	2,176,135	101,005
Redeemable preferred stock	2,232,117	155,129	746,950	128,050
Total fixed maturities	<u>26,614,635</u>	<u>1,184,562</u>	<u>14,687,706</u>	<u>443,968</u>
Equity securities:				
Perpetual preferred stock	932,170	55,330	199,520	480
Common stock	1,014,445	131,722	4,966,260	936,515
Total equity securities	<u>1,946,615</u>	<u>187,052</u>	<u>5,165,780</u>	<u>936,995</u>
Total	<u>\$ 28,561,250</u>	<u>1,371,614</u>	<u>19,853,486</u>	<u>1,380,963</u>

	Greater than 12 Months			
	2016		2015	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Fixed maturities:				
States and municipalities	\$ 1,731,882	35,708	2,839,218	112,597
Mortgage-backed securities	148,959	3,969	516,156	109,666
Industrial and miscellaneous	706,343	63,975	596,879	59,133
Redeemable preferred stock	38,170	5,205	448,340	14,160
Total fixed maturities	<u>2,625,354</u>	<u>108,857</u>	<u>4,400,593</u>	<u>295,556</u>
Equity securities:				
Common stock	1,305,276	169,072	1,291,204	643,559
Total equity securities	<u>1,305,276</u>	<u>169,072</u>	<u>1,291,204</u>	<u>643,559</u>
Total	<u>\$ 3,930,630</u>	<u>277,929</u>	<u>5,691,797</u>	<u>939,115</u>

	Total			
	2016		2015	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Fixed maturities:				
United States government and other government obligations	\$ 3,616,026	14,319	4,017,959	15,217
States and municipalities	16,715,558	865,722	7,950,192	188,304
Industrial and miscellaneous	3,456,569	139,039	3,151,844	233,655
Mortgage-backed securities	3,181,549	114,005	2,773,014	160,138
Redeemable preferred stock	2,270,287	160,334	1,195,290	142,210
Total fixed maturities	<u>29,239,989</u>	<u>1,293,419</u>	<u>19,088,299</u>	<u>739,524</u>
Equity securities:				
Perpetual preferred stock	932,170	55,330	199,520	480
Common stock	2,319,721	300,794	6,257,464	1,580,074
Total equity securities	<u>3,251,891</u>	<u>356,124</u>	<u>6,456,984</u>	<u>1,580,554</u>
Total	<u>\$ 32,491,880</u>	<u>1,649,543</u>	<u>25,545,283</u>	<u>2,320,078</u>

The following table summarizes for all fixed maturity and equity securities available for sale for which fair value is less than 80% of amortized cost at December 31, 2016, 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:

Period for Which Fair Value is Less than 80% of Amortized Cost

	Less Than 3 Months	Greater Than 3 Months, Less Than 6 Months	Greater Than 6 Months, Less Than 12 Months	Greater Than 12 Months	Total
States and municipalities	\$ 49,184	-	-	-	49,184
Mortgage-backed securities	-	17,164	-	-	17,164
Total fixed maturities	<u>49,184</u>	<u>17,164</u>	<u>-</u>	<u>-</u>	<u>66,348</u>
Common stock	-	78,690	-	1,371	80,061
Total	<u>\$ 49,184</u>	<u>95,854</u>	<u>-</u>	<u>1,371</u>	<u>146,409</u>

Management considers the declines to be temporary in nature and have the ability and intent to hold the positions through recovery. The unrealized losses attributable to States and Municipalities relate entirely to pre-refunded discount notes having short duration. The unrealized losses related to mortgage-backed securities reflect discount pricing on these securities due to short weighted average life. At the current repayment rates, principal will have been returned to the Company well in advance of the contractual maturity date associated with the instrument disclosed above. Substantially of the declines noted under common stock relate to a global auto manufacturer that has experienced price recovery in 2016.

d) Net Investment Income

A summary of net investment income for the years ended December 31, 2016 and 2015 is as follows:

	2016	2015
Taxable interest	\$ 1,108,771	1,258,904
Tax-exempt interest	501,279	465,400
Dividend income	716,604	836,046
Investment expenses	<u>(25,149)</u>	<u>(80,889)</u>
Net investment income	<u>\$ 2,301,505</u>	<u>2,479,461</u>

(3) Fair Value Measurements

The Company's estimates of fair value for financial assets and financial liabilities are based on a fair value hierarchy. The hierarchy is based on the inputs used in valuation and gives the highest priority to quoted prices in active markets, requiring that observable inputs be used in the valuations when available. The fair value 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 instrument was sold in an immediate sale (i.e., 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.

The Company utilizes one pricing service as its primary source for obtaining pricing information for substantially all of its financial instruments that are carried at fair value. In the event prices are not available from the primary pricing service, secondary pricing services are used to obtain pricing information based on a price source hierarchy. The Company then uses its third-party investment accounting service provider to analyze prices received from the pricing services to determine that they represent a reasonable estimate of fair value. Then management employs additional analysis (including a weekly review of fair value changes and comparison of price changes to external indices and trends) to assess the reasonableness of prices provided by pricing services. The following section describes the valuation methods underlying each type of financial instrument held by the Company that is carried at fair value.

Fixed Maturities

The pricing service utilizes market quotations for fixed maturity securities that have quoted prices in active markets. Because 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 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 of U.S. Treasury securities are included in the amount disclosed in Level 1, as the estimates are based on unadjusted market prices.

Equity Securities

For publicly-traded common stocks, the Company receives prices from the pricing service that are based on observable market transactions and includes these estimates in the amount disclosed in Level 1. Under certain circumstances, current market quotes in active markets are unavailable for certain perpetual 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 perpetual preferred stocks as it does for fixed maturities. The Company includes the estimate in the amount disclosed in Level 2.

The Company holds certain mutual funds that are priced based on net asset values, which are the basis for current transactions on a public exchange and represent fair value. The assets' classifications within the fair value hierarchy are determined based on the lowest level input of the underlying investments that is significant to each instrument's individual measurement.

Short-Term Investments

The Company's short-term investment instruments are priced based on net asset values, which are the basis for current transactions and represent fair value. The assets' classifications within the fair value hierarchy are determined based on the lowest level input of the underlying investments that is significant to each instrument's individual measurement.

The following tables present the level within the fair value hierarchy at which the Company's financial assets are measured on a recurring basis at December 31, 2016 and 2015:

2016	Level 1	Level 2	Level 3	Total
Fixed maturities:				
United States government and government obligations	\$ 4,021,041	-	-	4,021,041
States and municipalities	-	27,901,150	-	27,901,150
Industrial and miscellaneous	-	7,593,150	-	7,593,150
Mortgage-backed securities	-	6,368,839	-	6,368,839
Redeemable preferred stock	-	2,970,655	-	2,970,655
Total fixed maturities	<u>4,021,041</u>	<u>44,833,794</u>	<u>-</u>	<u>48,854,835</u>
Equity securities:				
Perpetual preferred stock	-	2,145,630	-	2,145,630
Common stock	5,072,821	258,705	-	5,331,526
Total equity securities	<u>5,072,821</u>	<u>2,404,335</u>	<u>-</u>	<u>7,477,156</u>
Short-term investments	-	551,855	-	551,855
Total	<u>\$ 9,093,862</u>	<u>47,789,984</u>	<u>-</u>	<u>56,883,846</u>

2015	Level 1	Level 2	Level 3	Total
Fixed maturities:				
United States government and government obligations	\$ 4,017,959	-	-	4,017,959
States and municipalities	-	22,375,987	-	22,375,987
Industrial and miscellaneous	-	6,388,409	-	6,388,409
Mortgage-backed securities	-	8,541,408	-	8,541,408
Redeemable preferred stock	-	3,948,340	-	3,948,340
Total fixed maturities	<u>4,017,959</u>	<u>41,254,144</u>	<u>-</u>	<u>45,272,103</u>
Equity securities:				
Perpetual preferred stock	-	2,138,736	-	2,138,736
Common stock	9,030,749	-	-	9,030,749
Total equity securities	<u>9,030,749</u>	<u>2,138,736</u>	<u>-</u>	<u>11,169,485</u>
Short-term investments	-	1,476,613	-	1,476,613
Total	<u>\$ 13,048,708</u>	<u>44,869,493</u>	<u>-</u>	<u>57,918,201</u>

There were no significant transfers between Level 1 and 2 or from level 3 in 2016 or 2015. The Company had no material assets or liabilities that were measured at fair value on a non-recurring basis during the years ended December 31, 2016 and 2015.

(4) Property and Equipment

A summary of property and equipment at December 31, 2016 and 2015 is as follows:

	2016	2015
Building	\$ 4,275,535	4,275,535
Land	562,397	562,397
Equipment and automobiles	995,290	973,459
Furniture and office fixtures	654,653	642,943
	<u>6,487,875</u>	<u>6,454,334</u>
Accumulated depreciation	1,593,303	1,403,952
Property and equipment, net	<u>\$ 4,894,572</u>	<u>5,050,382</u>

Useful lives are three to five years for equipment and vehicles, seven years for furniture and fixtures and forty years for the occupied office building. Depreciation expense in 2016 and 2015 was \$189,351 and \$167,872, respectively.

(5) 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:

	2016	2015
Balance, January 1	\$ 14,718,196	14,927,292
Less: Reinsurance recoverable	<u>2,076,711</u>	<u>1,813,184</u>
Net balance, January 1	12,641,485	13,114,108
Incurred related to:		
Current year	675,142	1,012,071
Prior years	<u>(903,977)</u>	<u>(1,543,317)</u>
Total incurred	(228,835)	(531,246)
Payments (recoveries) related to:		
Current year	69,034	12,832
Prior years	<u>84,730</u>	<u>(71,455)</u>
Total (recovered) paid	153,764	(58,623)
Net balance, December 31	12,258,886	12,641,485
Plus: Reinsurance recoverable	<u>2,090,562</u>	<u>2,076,711</u>
Balance, December 31	<u>\$ 14,349,448</u>	<u>14,718,196</u>

The decrease in the reserves for losses and loss adjustment expenses represents the payment and settlement of claims and expenses in the normal course of the Company's operations as well as the recognition of favorable experience in prior accident years. Surety and certain casualty products continue to experience favorable claim development, emergence and frequency patterns, which has prompted management to reduce loss and loss adjustment expense reserves. Current accident year incurred losses and loss adjustment expenses decreased from \$1,012,071 in 2015 to \$675,142 in 2016. However, the loss and LAE ratios increased relative to earned premium from 57% in 2015 to 60% in 2016, in response to reduced volume and to provide for resulting risk of increased severity. While management continually evaluates the potential for changes in loss estimates, due to the uncertainty inherent in the casualty and 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 expenses are adequate to cover the unpaid portion of the ultimate net cost of losses and loss adjustment expenses, including losses incurred but not reported.

Among other lines of insurance, the Company provided asbestos and environmental liability insurance products, primarily to contractors and consultants involved in remediation, removal or treatment of hazardous environmental and asbestos conditions. The Company has no exposure to any asbestos or environmental claims associated with general and product liability policies written with the pre-1986 pollution exclusion, which are typically associated with the mass tort environmental and asbestos claims. The Company specifically insured asbestos and environmental exposures, which related to third party losses arising out of a contractor's or consultant's operations. Employees of the contractor, consultant, subcontractor, and premises owner are generally excluded from coverage. Most environmental policies were written on a claims-made basis while asbestos liability was written on both claims-made and occurrence basis.

(6) Long-Term Debt

A summary of long-term debt at December 31, 2016 and 2015 is as follows:

	2016	2015
Term loan	\$ 7,042,857	8,285,714
Mortgage note	<u>1,225,000</u>	<u>1,300,000</u>
Principal outstanding	8,267,857	9,585,714
Unamortized loan costs	<u>22,323</u>	<u>25,761</u>
Long-term debt	<u>\$ 8,245,534</u>	<u>9,559,953</u>

At December 31, 2016, the Company has a term loan with an outstanding principal balance of \$7,042,857 with a financial institution. As of December 31, 2016, \$8,700,000 has been borrowed under a term loan credit facility, which converted to a term loan August 1, 2015, following the Company's draw of \$2,020,117. Under the term loan agreement, principal is payable through 84 equal monthly installments, which commenced following the conversion of the term loan credit facility. Principal repayments of \$1,242,857 and \$414,286 were made in 2016 and 2015, respectively. Interest accrues at the lesser of the one-month U.S. Dollar London Inter-Bank Offering Rate (LIBOR) plus 225 basis points or the financial institution's prime rate. Interest payments of \$211,542 and \$184,175 were made in 2016 and 2015, respectively. Interest is payable monthly in arrears. At December 31, 2016 and 2015 accrued interest payable was \$18,507 and \$19,515, respectively.

The Company's term 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, 2016.

At December 31, 2016, the Company has a mortgage note with an outstanding principal balance of \$1,225,000 with a financial institution. The mortgage note is backed by the Company's property in Farmington, CT. The mortgage note features a twenty year term and principal is payable in monthly installments of \$6,250. Principal repayments of \$75,000 were made in both 2016 and 2015. Interest is fixed at 3.47% through April 2018 and resets thereafter. Interest payments of \$44,653 and \$47,168 were made in 2016 and 2015, respectively. Interest is payable monthly in arrears. At December 31, 2016 and 2015, accrued interest payable was \$3,897 and \$4,260, respectively.

The Company's mortgage note is subject to limitations on borrowings, minimum statutory capital levels and maintenance of certain ratios identical to those of the term loan. The Company was in compliance with these covenants at December 31, 2016.

At December 31, 2016, the Company has a \$4,500,000 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, 2016 and 2015. Under the terms of the line of credit, interest on the outstanding balance is calculated based upon LIBOR plus 200 basis points in effect during the borrowing period or the financial institution's prime rate. The Company pays a quarterly commitment fee of 0.375% on the unused portion of the bank line which amounted to \$16,979 and \$16,875 in 2016 and 2015, respectively. Accrued commitment fees payable were \$4,242 and \$4,392 at December 31, 2016 and 2015.

The Company's interest rate ceiling expired December 1, 2016, and has not been renewed. The interest rate ceiling capped the LIBOR component of the interest rate on the Company's term loan at 3.75%. Amortization related to the interest rate ceiling was \$34,507 and \$37,644 in 2016 and 2015, respectively, and is a component of interest expense.

The Company has deferred certain borrowing costs associated with the term loan and mortgage note. Unamortized borrowing costs are \$22,323 and \$25,761 at December 31, 2016 and 2015. Amortization of deferred borrowing costs was \$3,438 in 2016 and 2015, respectively.

(7) Income Taxes

The components of income tax expense for the years ended December 31, 2016 and 2015 were as follows:

	2016	2015
Current income tax expense:		
Federal	\$ 99,973	64,522
States	<u>59,915</u>	<u>68,004</u>
	<u>159,888</u>	<u>132,526</u>
Deferred Federal income tax expense (benefit)	<u>74,413</u>	<u>(26,409)</u>
Income tax expense	<u>\$ 234,301</u>	<u>106,117</u>

The effective income tax rate, as a percentage of earnings before income taxes for the years ended December 31, 2016 and 2015 are as follows:

	2016	2015
Federal income tax rate	34.0%	34.0%
Effect of state income taxes	4.0%	5.0%
Tax-exempt interest and dividends	(15.9%)	(18.4%)
Officers' life insurance	1.3%	(0.2%)
Excess benefit on stock options exercised	-	(9.0%)
Effect of prior year's tax return and other	-	0.2%
Effective income tax rate	<u>23.4%</u>	<u>11.6%</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, 2016 and 2015 are as follows:

	2016	2015
Deferred tax assets:		
Reserves for losses and loss adjustment expenses	\$ 182,871	233,302
Unearned premiums	36,827	35,887
Allowance for doubtful accounts	4,080	5,560
Unrealized investment losses	81,703	156,228
Federal net operating loss carryforward	360,008	476,256
Federal alternative minimum tax credit	438,356	338,381
State net operating loss carryforward	1,553,873	1,541,819
Other	868	18,497
Total gross deferred tax assets	<u>2,658,586</u>	<u>2,805,930</u>
Valuation allowance	<u>1,635,576</u>	<u>1,698,047</u>
Adjusted deferred tax assets	1,023,010	1,107,883
Deferred tax liabilities:		
Accumulated depreciation	28,459	24,588
Deferred policy acquisition costs	27,287	27,975
Discount on investments	19,297	32,940
Total gross deferred tax liabilities	<u>75,043</u>	<u>85,503</u>
Net deferred tax asset	<u>\$ 947,967</u>	<u>1,022,380</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, 2016 and 2015.

ACMAT realized a net capital loss in 2015, all of which was utilized through a capital loss carryback to offset net short term capital gains realized in 2014 and 2013. ACMAT recovered \$104,905 related to tax years 2014 and 2013 in 2016.

As of December 31, 2016 the Company had Federal net operating loss carryforwards of \$1,058,847 available to offset future taxable income, all of which relates to stock option deductions recognized from 2012 through 2015.

As of December 31, 2016 the Company had Federal alternative minimum tax credit carryforwards of \$438,356. Federal alternative minimum tax credits represent amounts paid under the Federal alternative minimum tax mechanism. These credits can be applied to offset regular Federal taxable income and do not expire.

As of December 31, 2016 the Company had state net operating loss carryforwards of \$31,077,453 available to offset future taxable income. These net operating loss carryforwards relate entirely to income recognized in the State of Connecticut and expire between 2020 and 2035. In 2016 and 2015, a valuation allowance is provided to offset the deferred tax asset as management believes that these deferred tax assets are currently unrealizable. The increase of \$241,074 in the carryforward and corresponding valuation allowance is due to a net operating loss recognized by ACMAT and its Connecticut domiciled subsidiaries on the 2015 Connecticut state income tax return.

As of December 31, 2016 and 2015 the Company had net unrealized capital losses on debt and equity securities available for sale of \$238,681 and \$459,493, respectively, which resulted in a gross deferred tax asset of \$81,703 and \$156,228, respectively. The decline in fair value below cost basis is considered to be temporary and the Company has the ability and intent to hold these positions through recovery. Accordingly, the net deferred tax asset associated with unrealized capital losses is not realizable and a valuation allowance of \$81,703 and \$156,228 has been recognized as of December 31, 2016 and 2015, respectively, the offset of which is recorded in comprehensive income.

The IRS has conducted an examination of the Company's U.S. income tax returns for the 2008, 2012 and 2013 tax years. The Company does not have any material uncertain tax positions as of December 31, 2016 and 2015.

(8) Employee Benefit Plan

The Company maintains the ACMAT 401(k) Plan (the Plan) for the benefit of its employees. The Company made profit-sharing contributions of \$75,000 to the Plan in both 2016 and 2015. Costs associated with operating the Plan are borne by the Company and were insignificant for each of the years ended December 31, 2016 and 2015.

(9) Stockholders' Equity

The Company has two classes of common stock; Common Stock and 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.

ACMAT'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.

Under applicable insurance regulations, ACSTAR is restricted as to the amount of dividends it may pay to its shareholder, without the prior approval of any insurance department and is limited to \$2,712,104 in 2017.

In accordance with statutory accounting practices, ACSTAR's statutory capital and surplus was \$27,121,047 and \$26,344,387 at December 31, 2016 and 2015, respectively, and its statutory net income for the years ended December 31, 2016 and 2015 was \$2,210,570 and \$1,844,637, respectively. The primary differences between amounts reported in accordance with GAAP and amounts reported in accordance with statutory accounting practices are the carrying value of fixed maturity investments; deferred taxes; the inadmissibility of certain assets for statutory reporting purposes; and the deferred recognition of policy acquisition costs in earnings.

The NAIC has a risk-based capital (RBC) requirement for most property and casualty insurance companies. The RBC computation determines minimum capital requirements and is intended to raise the level of protection for policyholder obligations. Under laws adopted by individual states, insurers having total adjusted capital less than that required by the RBC computation will be subject to varying degrees of regulatory action, depending on the level of capital inadequacy. At December 31, 2016, ACSTAR had total adjusted capital in excess of the RBC requirement.

(10) Earnings Per Share

The following details the earnings per share computations for the years ended December 31, 2016 and 2015:

	2016	2015
Net earnings	\$ 765,778	809,289
Weighted average shares outstanding	<u>912,791</u>	<u>983,312</u>
Earnings per share	<u>\$ 0.84</u>	<u>0.82</u>

There were no dilutive instruments or events as of, or for the years ended, December 31, 2016 and 2015.

(11) Share 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 options vest evenly over a finite period and typically feature a term of 10 years. The exercise price is equal to the fair value at the date of grant. The Company uses a variation of the Black-Scholes option pricing model to value stock options.

The Company incurred no expense related to share based compensation in net earnings during 2016 or 2015. ACMAT neither paid, nor received, amounts related to stock options exercised in 2016. Cash received from stock options exercised in 2015 was \$622,750. Cash paid to settle shares issued pursuant to options in 2015 was \$893,000. As of December 31, 2016, the Federal net operating loss carryforward arising from the excess tax benefit on stock options exercised is \$360,008.

As of December 31, 2016 there were no remaining stock options outstanding.

The following table shows the stock option activity for the Company during 2016 and 2015:

	Option Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (In Years)	Average Intrinsic Value
Outstanding at December 31, 2014	52,000	13.25	0.50	255,164
2015				
Exercised	47,000	13.25		230,629
Cancelled	5,000	13.25		24,535
Outstanding at December 31, 2015	-	-	-	-
2016				
Exercised	-	-		-
Cancelled	-	-		-
Outstanding at December 31, 2016	-	-	-	-

(12) 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 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.

(13) Comprehensive Income and Loss

The following table presents the changes in the Company's accumulated other comprehensive loss for the years ended December 31, 2016 and 2015:

	Net Unrealized Gains and Losses	Accumulated Other Comprehensive Loss
Balance as of December 31, 2014	\$ 285,102	285,102
Other comprehensive (loss) before reclassifications to earnings, net	(1,477,853)	(1,477,853)
Reclassifications, net	733,258	733,258
Other comprehensive loss, net of taxes	(744,595)	(744,595)
Balance as of December 31, 2015	(459,493)	(459,493)
Other comprehensive income before reclassifications to earnings, net	302,238	302,238
Reclassifications, net	(81,426)	(81,426)
Other comprehensive income, net of taxes	220,812	220,812
Balance as of December 31, 2016	\$ (238,681)	(238,681)

The following table presents the pretax and related income tax component of the amounts reclassified from the Company's accumulated other comprehensive income and loss to the Company's consolidated statement of earnings for the years ended December 31, 2016 and 2015:

	2016	2015
Net realized capital gains and (losses) reclassified to net earnings during the period	\$ 123,373	(1,110,997)
Income tax expense (benefit)	41,947	(377,739)
Reclassifications, net	\$ 81,426	(733,258)

The following table presents the pretax components of other comprehensive income and loss and the related income tax expense and benefit for the years ended December 31, 2016 and 2015:

	2016	2015
Unrealized holding gain (loss) arising during the period	\$ 344,184	(2,599,664)
Tax (expense) benefit on unrealized holding gains and losses arising during the period	(116,471)	883,886
Valuation allowance	74,525	237,925
Less: Reclassification adjustment for gains and losses included in earnings, net of income taxes	<u>(81,426)</u>	<u>733,258</u>
Changes included in comprehensive income (loss)	<u>\$ 220,812</u>	<u>(744,595)</u>

(14) Subsequent Events

There were no subsequent events requiring adjustment to the consolidated financial statements or disclosure through April 25, 2017, the date the Company's consolidated financial statements were issued.

Our Services

Stock Market Information

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

	2016		2015	
	<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>
Common Stock				
First quarter	\$ 20.25	\$ 20.25	\$ 22.25	\$ 21.90
Second quarter	\$ 20.25	\$ 20.25	\$ 22.50	\$ 21.00
Third quarter	\$ 21.01	\$ 21.01	\$ 22.00	\$ 20.25
Fourth quarter	\$ 21.01	\$ 21.01	\$ 20.25	\$ 20.25
Class A Stock				
First quarter	\$ 18.50	\$ 16.00	\$ 21.00	\$ 17.50
Second quarter	\$ 19.05	\$ 16.80	\$ 18.25	\$ 17.40
Third quarter	\$ 21.73	\$ 17.30	\$ 18.10	\$ 17.75
Fourth quarter	\$ 21.73	\$ 21.73	\$ 18.83	\$ 16.50

Annual Meeting

The annual meeting of stockholders will be held on June 29, 2017 at 12:00 P.M. at 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 14, 2017 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,
6201 15th Avenue
Brooklyn, NY 11219
(718) 921 8200

INDEPENDENT AUDITORS' REPORT

The Board of Directors

ACMAT Corporation:

We have audited the accompanying consolidated financial statements of ACMAT Corporation and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of earnings, comprehensive income, stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

/s/ KPMG LLP

Hartford, Connecticut
April 25, 2017

DIRECTORS

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

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

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

OFFICERS

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

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

Gary M. Case, Esq.
Vice President & General Counsel

Brian P. Marshall, CPA
Vice President of Finance

Maurice C. Shea
Controller

ACSTAR Insurance Company

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

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

Gary M. Case, Esq.
Vice President & General Counsel

Brian P. Marshall, CPA
Vice President of Finance

Carmen Carlton
Assistant Vice President



ACMAT CORPORATION

30 South Road
Farmington, CT 06050
860.946.4800

www.acmatcorp.com

SUBSIDIARY COMPANIES
ACSTAR Insurance Company
ACMAT Realty Corporation
AMINS, Inc.