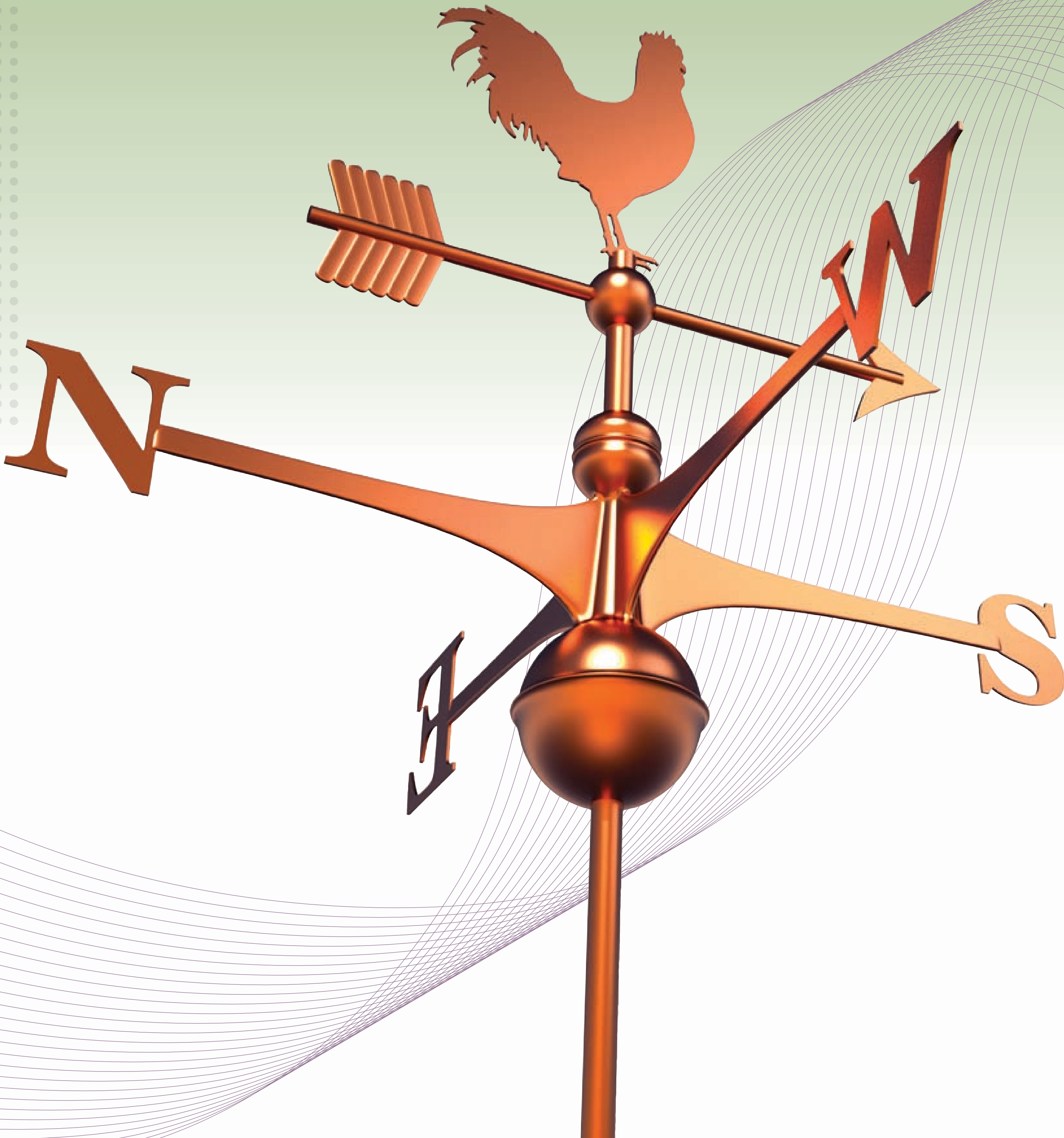
FRESH DIRECTIONS

ACMAT CORPORATION / 2010 ANNUAL REPORT



ACMAT CORPORATION

Right from the beginning, we have always been willing to take our company in a new direction. As economic or business conditions have changed, we've changed too. We have always been alert to new opportunities. And, we have changed the scope of our operations to make the most of them. This ability to adapt ... call it a refusal to remain static ... has served us well. It has helped us make the most of new opportunities. More recently, it has enabled us to weather the most challenging economic conditions in decades. As a result, we have emerged strong and well positioned to move ahead. Now, we look forward to what we anticipate will be more favorable economic conditions in the coming years. Once again, we are adapting our operations to take advantage of what we think will be lucrative new possibilities. As always, we are committed to the future and to pursuing "fresh directions" for our company.

TO OUR SHAREHOLDERS AND CUSTOMERS:

Against the assault of the recession, we generated strong results for 2010. Net income was $940,693 after absorbing a final pre-tax impairment loss of $401,624 in connection with the sale of our corporate headquarters building. That compares to a net loss of $2,723,748 for 2009, which included a pre-tax impairment loss of $6,484,548 in connection with the write down of the value of our building. The write downs were non cash charges. The building was owned free and clear without any debt. Excluding the building adjustments, pre-tax income for 2010 was $1,540,977 vs. $2,207,176 for 2009. Thus far, we have successfully withstood the punishment of a long recession. We've generated strong income throughout and the balance sheet is like a rock.

As expected, our revenue declined from $11,898,928 in 2009 to $8,063,085 in 2010. The lower revenue was mostly caused by a decrease in earned premiums of $2,008,043. The premiums were down because of the dearth of construction spending in the United States. The construction industry has been severely impacted by the recession. Much more than most other segments of the economy. Seasonally adjusted construction put in place has dropped from $1.2 trillion in 2006 to just $760 billion in early 2011 (source: U.S. Department of Commerce). The construction industry unemployment rate was at 22.5% as of January 2011 (source: U.S. Labor Department). Our premiums are mostly derived from writing bonds for construction contractors. Our surety premiums eerily follow the pattern of total construction spending. We expect premiums in 2011 to remain weak – somewhere similar to 2010. Although we expect 2011 to be a tough year, we expect to, again, be profitable throughout the year. We are cautiously optimistic about 2012, which might be the start of a recovery for the construction industry. From 2011 to 2015, construction put in place in the United States is forecasted to increase 57%, from $760 billion to $1.2 trillion (source: FMI 2011 U.S. Construction Market Overview). That is the first time an increase has been forecasted since 2005.

When the economy demanded rethinking, we didn't shy away from difficult choices and adjustments. During 2010, we decreased our overhead by $160,000 and we implemented other adjustments which will result in additional decreases during 2011. We decreased debt from $10 million to $8.6 million. We increased equity from $39.1 million to $40.5 million after the impairment charge. Unrealized gains on investments, net of taxes, increased from $258,000 to $666,000. Debt to equity is at an historic low of .2 to 1. We're as strong as ever.

We closed on the sale of our building on February 23, 2011 at a price of $2,800,000 in cash. There is no associated debt to retire. All adjustments relating to the sale were booked at December 31, 2010, including the impairment. As a result of the sale, the company will receive a tax loss refund of approximately $1,700,000. Most of that refund will be received in 2012. Therefore total cash generated from the sale is approximately $4,500,000.

Although premiums are down for now, our surety business continues to be a "franchise." Entry is quite difficult, requiring substantial capital, insurance licenses in 50 states, a high A.M. Best rating, and qualifying to be on the U.S. Treasury Department's limited list of approximately 200 approved sureties nationwide. The need for surety bonds is deep rooted. They usually are required by regulation, statute, contract or policy or required by lenders for project financing. Surety bonds are mostly provided by large financial institutions like Travelers or Liberty Mutual. For a lot of different reasons, some contractors cannot secure surety credit from such institutions. ACSTAR navigates around the underwriting road blocks and finds alternative means for providing surety credit to those contractors that otherwise may not be able to get a bond to secure a desirable contract. We provide excellent service and have a reputation for being consistent and fair. We have become a reliable resource for lower and middle market surety credit, even after attempts to secure surety credit elsewhere have failed.

Our investment business is an important component of the company. The investment plan is simple and straightforward. First and foremost, our overall strategy is to preserve our investment assets. Approximately 65% of the portfolio is in either direct obligations of the United States Government, government sponsored agencies or state and municipal bonds. Second, we have maintained a relatively short average life of the portfolio approximately 4 years. We believe interest rates will rise so our plan is to maintain sufficient liquidity so that funds will be available to reinvest when and if yields improve. As a result, we are currently sacrificing some investment income by not stretching out longer on the yield curve. Third, in an effort to offset lower yields associated with more secure and shorter duration securities such as government obligations and state and municipal bonds, we have invested approximately 18% of the portfolio, in higher yielding corporate bonds. There is some risk, however, our exposure is moderate. Fourth, to augment our investment income, we have invested approximately 10% of the portfolio in either common stocks that provide generous dividends such as utility stocks, or we have purchased other common stocks that provide an opportunity for appreciation and capital gains. We have had a good run in the last few years creating more than $1,000,000 of capital gains each year. We got lucky from a jump in the stock market during the last two years. We are sensitive to and cautious about the risk associated with this component of the portfolio and therefore we have limited our exposure to common stocks.

As with most enterprises, we face risks. For example, we often rely on bank letters of credit to partially securitize the high risk associated with writing surety bonds. A financial industry melt down could lead to possible bank defaults on letters of credit, which could result in greater exposure to contractor defaults in connection with the bonds we write. Luckily, we only had minor disruption following the financial industry debacle in September, 2008. Writing surety bonds is inherently a risky business. A rash of contractor failures could cause a substantial increase in paid losses and erode surplus. So far, we have mitigated that exposure with cautious and conservative underwriting and by partially securing our exposures. With the open-ended tort system that currently prevails in the nation, there is possible exposure to inflated 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 the claims have been dismissed or settled for nominal payments by us or our insurers. At this time, we do not believe our exposure is significant. These are not all of the risks and some risks may be unknown. So far, we have managed and controlled our risks and we believe we will continue to do so in the future.

We believe our nation's beleaguered economy will eventually ameliorate. Our plan is to substantially grow our surety business when and as the recovery occurs in the construction industry. We completed 2010 with one of the best paid loss ratios in our history and our reserves are very strong. This might provide us an edge up on other sureties. The surety industry is experiencing rising loss ratios. Our people and resources most likely will be free to concentrate on new business vs. managing rising losses. We think we have correctly sized ourselves to maintain profitability even without the hoped-for improvement in the economy. In addition to the surety and investment operations, we are considering the possible purchase, redevelopment and resale of specific targeted distressed commercial properties, but only if we are able to conclude such purchases at bargain prices. It is widely known that because of the recession, many corporations are reluctant to invest in capital improvements. We've never been reluctant about our future. We have committed to either build or purchase, as soon as possible, a new headquarters building that will provide a state-of-the-art and efficient base for our operations. We hope to occupy our new headquarters within the next 18 months.

During 2010, we did not purchase any shares of the Company's Common or Class A stock, but we expect to make purchases in the future, provided the price is reasonable and the timing is convenient.

Again we accomplished our operating plan and goal, which is to continue to increase per share equity. Per share equity increased from $28.62 at December 31, 2009 to $29.62 at December 31, 2010.

We see new possibilities and opportunities. We're moving ahead – we're committed to the future.

We thank our customers, employees and shareholders for all of their important contributions to the successes we have achieved to date.

Henry W. Nozko, Jr.
Chairman, President and Chief Executive Officer
May 5, 2011

ACSTAR: HEADED IN THE RIGHT DIRECTION.

TO BE SURE, 2010 WAS A CHALLENGING TIME FOR THE CONSTRUCTION INDUSTRY. WE FACED A VERY DIFFICULT BUSINESS CLIMATE, DUE LARGELY TO THE SUBSTANTIAL DECLINE IN CONSTRUCTION, BUT ACSTAR REMAINED PROFITABLE AND STRONG. ALTHOUGH OUR REVENUES DECLINED OVERALL, OUR UNDERWRITING DISCIPLINE DIMINISHED LOSSES AND, IN FACT, INCREASED THE PROFITABILITY OF OUR CASES.

ACSTAR CONTINUES TO MAINTAIN ITS NICHE IN A FIELD OF MUCH LARGER SURETIES. OUR OUTSTANDING SERVICE AND WELL ESTABLISHED REPUTATION FOR CONSISTENCY AND FAIRNESS HAVE HELPED US BECOME A "GO-TO" RESOURCE FOR LOWER AND MIDDLE MARKET SURETY CREDIT THAT HAS BEEN UNDERSERVED BY THE LARGER INSURANCE COMPANIES. WE ARE CONFIDENT THAT ACSTAR IS HEADED IN THE RIGHT DIRECTION. AND, WE ANTICIPATE A GROWTH IN PREMIUMS IN THE COMING YEARS, AS COMMERCIAL CONSTRUCTION AND THE OTHER INDUSTRIES WE SERVE BEGIN TO REBOUND.

PROTECTING AN INVESTMENT IN AMERICA'S ENERGY INDUSTRY.

In 2010, ACSTAR bonded an $18,000,000 contract for Eastern Ship Building Group, Inc., of Panama City, Florida. The contract covered the construction of the M/V Harvey Supplier, a huge supply vessel that's designed to service offshore oil platforms in the Gulf of Mexico. Ships of this type typically transport goods and personnel to and from oil platforms and other offshore structures. The Harvey Supplier also has cargo tanks for carrying fuel, water and chemicals required by oil platforms, as well as other materials and chemicals that must be returned to shore for proper recycling or disposal. Ships like the Harvey Supplier can also be equipped to assist in the cleanup of oil spills.

CONNECTING TWO CITIES WITH A SAFER BRIDGE SYSTEM.

The Bay Bridge is actually a system of bridges that connect the cities of San Francisco and Oakland, California. ACSTAR issued a bond to cover a $4,000,000 contract to provide elastomeric bearings for the new "Skyway Segment" of the eastern span from Oakland, California to Yerba Buena Island (a natural outcropping that sits in the middle of the bay).

When complete in 2013, the "Skyway" will replace the existing double-deck steel bridge. The new bridge will be more than a mile long, with 452 precast concrete segments. The elastomeric bearings, which connect the deck of the bridge and 60-foot-long hinge-pipe beams to the substructure and foundation, are designed to help absorb the brunt of an earthquake's energy, enabling the bridge deck to withstand a greater range of motion.

INSURING THE SAFETY OF A CITY'S BUSY ROADS.

Last year, ACSTAR issued a bond to cover a $12,000,000 contract with the Massachusetts Highway Department to provide for the safety of motorists. The contract covered daily, continuous and immediate service to disabled vehicles, or accidents, as well as the removal of vehicles in hazardous locations on over 300 miles of major roadways in metropolitan Boston, Massachusetts.

TYPES OF BONDS:

- Performance & Payment Bonds: *For all classifications of construction*
- Subdivision Bonds
- Release of Lien Bonds
- Maintenance Bonds
- Warranty Bonds
- Workers' Compensation Bonds
- License Bonds
- Tax Bonds
- Appeal Bonds
- Reclamation Bonds
- Closure Bonds
- Lease Bonds

TYPES OF CLIENTS:

- General Building Contractors
- Site Contractors
- Road Contractors
- Bridge Contractors
- Mechanical (HVAC) Contractors
- Electrical Contractors
- Plumbing Contractors
- Steel Fabricators
- Steel Erectors
- Roofing Contractors
- Elevator Contractors
- Fire Protection Contractors
- Security Systems Contractors
- Ship Builders
- Software Systems Providers
- Hardware Systems Providers
- Demolition Contractors
- Waste Haulers
- Solid Waste Landfills
- Aircraft Charter Services
- Boiler Manufacturers & Installers
- Railroad Contractors
- Catastrophe Recovery Contractors
- Furniture Manufacturers
- Developers
- Health Services Providers
- Transportation Providers
- Hazardous Waste Transporters
- Environmental Remediation Contractors
- Chemical Manufacturers & Suppliers
- Water & Waste Water Systems Operators

	2010	2009
Earned premiums	$3,222,050	$5,230,093
Contract revenues	20,787	1,134,730
Investment income, net	2,873,976	3,340,883
Net realized capital gains	1,174,081	1,261,839
Other income	772,191	931,383
	8,063,085	11,898,928
Cost of contract revenues	97,080	1,638,839
Losses and loss adjustment expenses	366,884	1,166,019
Amortization of policy acquisition costs	1,075,243	1,818,319
General and administrative expenses	4,660,274	4,820,394
Impairment loss on building	401,624	6,484,548
Interest expense	304,253	248,181
	6,905,358	16,176,300
Earnings (losses) before income taxes	1,157,727	(4,277,372)
Income taxes (benefit)	217,034	(1,553,624)
Net earnings (losses)	$ 940,693	(2,723,748)
Basic earnings (losses) per share	$ .69	(1.98)
Diluted earnings (losses) per share	$ .64	(1.83)

See Notes to Consolidated Financial Statements.

Assets	2010	2009
Investments:		
Fixed maturities – available for sale at fair value		
(Amortized cost of $68,673,253 in 2010 and $75,453,859 in 2009)	$69,091,471	75,929,659
Equity securities – available for sale at fair value		
(Cost of $5,320,369 in 2010 and $2,258,579 in 2009)	5,858,523	2,173,504
Short-term investments, at cost which approximates fair value	5,625,451	3,436,351
Total Investments	80,575,445	81,539,514
Cash and cash equivalents	7,058,631	10,074,955
Accrued interest receivable	662,445	680,580
Receivables, net of allowance for doubtful accounts of		
$48,266 in 2010 and $55,460 in 2009	786,082	567,521
Reinsurance recoverable:		
Unpaid losses	3,718,182	3,642,683
Paid losses	36,492	–
Prepaid expenses	76,435	114,618
Income taxes receivable	179,297	170,388
Deferred income taxes	1,808,332	1,831,331
Property and equipment, net	3,635,467	3,933,696
Deferred policy acquisition costs	508,850	589,454
Other assets	897,479	879,499
Intangibles	1,920,360	1,920,360
Total Assets	$101,863,497	105,944,599
Liabilities & Stockholders' Equity		
Accounts payable	$ 377,964	609,334
Reserves for losses and loss adjustment expenses	20,157,801	21,597,746
Unearned premiums	1,270,749	1,647,703
Collateral held	29,203,374	31,364,696
Other accrued liabilities	1,789,445	1,597,863
Long-term debt	8,571,429	10,000,000
Total Liabilities	61,370,762	66,817,342
Stockholders' Equity:		
Common Stock (No par value; 3,500,000 shares authorized;		
468,546 and 468,546 shares issued and outstanding)	468,546	468,546
Class A Stock (No par value; 10,000,000 shares authorized;		
898,655 and 898,655 shares issued and outstanding)	898,655	898,655
Retained earnings	38,459,801	37,502,210
Accumulated other comprehensive loss	665,733	257,846
Total Stockholders' Equity	40,492,735	39,127,257
	$101,863,497	105,944,599

See Notes to Consolidated Financial Statements.

	Common Stock par value	Class A Stock par value	Retained earnings	Accumulated other comprehensive income (loss)	Total stockholders' equity
Balance as of December 31, 2008	$471,606	1,089,193	45,001,854	(2,100,544)	44,462,109
Comprehensive income:					
Net unrealized gains on debt and equity securities, net of reclassification adjustment	$ –	–	–	2,271,534	2,271,534
Net unrealized gains on derivatives qualifying as hedges	–	–	–	86,856	86,856
Net loss	–	–	(2,723,748)	–	(2,723,748)
Total comprehensive 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	–	7,000	90,201	–	97,201
Balance as of December 31, 2009	$468,546	898,655	37,502,210	257,846	39,127,257
Comprehensive income:					
Net unrealized gains on debt and equity securities, net of reclassification adjustment	$ –	–	–	407,887	407,887
Net earnings	–	–	940,693	–	940,693
Total comprehensive income					1,348,580
Stock based compensation	–	–	16,898	–	16,898
Balance as of December 31, 2010	$468,546	898,655	38,459,801	665,733	40,492,735

See Notes to Consolidated Financial Statements.

	2010	2009
Cash Flows From Operating Activities:		
Net earnings (loss)	$940,693	(2,723,748)
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Impairment loss on building and lease	401,624	6,484,548
Stock based compensation expense	16,898	37,286
Depreciation and amortization	1,325,337	821,357
Net realized capital gains	(1,174,081)	(1,261,839)
Deferred income taxes	(170,758)	(2,199,063)
Changes In:		
Accrued interest receivable	18,135	(342,094)
Receivables	(218,561)	755,894
Reinsurance recoverable	(111,991)	(13,153)
Deferred policy acquisition costs	80,604	351,246
Prepaid expenses and other assets	20,203	253,157
Accounts payable and other liabilities	(39,788)	(2,718,067)
Collateral held	(2,161,322)	2,823,336
Reserves for losses and loss adjustment expenses	(1,439,945)	(1,466,793)
Income taxes	(8,910)	834,378
Unearned premiums	(376,954)	(1,263,910)
Net cash provided by (used for) operating activities	(2,898,816)	372,535
Cash Flows From Investing Activities:		
Proceeds from investments sold or matured:		
Fixed maturities – sold	26,121,963	46,620,212
Fixed maturities – matured	9,612,500	1,210,000
Equity securities	3,593,066	1,196,172
Purchases Of:		
Fixed maturities	(28,941,970)	(61,937,934)
Equity securities	(6,235,177)	(1,119,838)
Short-term investments, (purchases) sales, net	(2,189,100)	12,526,769
Capital expenditures	(650,219)	(303,344)
Net cash provided by (used for) investing activities	1,311,063	(1,807,963)
Cash Flows From Financing Activities:		
Issuance of long-term debt	–	10,000,000
Repayments on long-term debt	(1,428,571)	(6,037,427)
Issuance of Common and Class A Stock	–	63,000
Tax benefit from exercise of stock options	–	34,201
Payments for acquisition and retirement of stock	–	(5,103,981)
Net cash used for financing activities	(1,428,571)	(1,044,207)
Net change in cash and cash equivalents	(3,016,324)	(2,479,635)
Cash and cash equivalents, beginning of year	10,074,955	12,554,590
Cash and cash equivalents, end of year	$ 7,058,631	10,074,955

See Notes to Consolidated Financial Statements.

(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 provided 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 owned a commercial office building in New Britain, Connecticut through 2010 and leased office space to its insurance subsidiary as well as to third parties. The Company sold the office building in February 2011. See footnote 17 for more details.

(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.

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.

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 $150,808 and $211,257 at December 31, 2010 and 2009 respectively, are included in other assets. All reinsurance contracts maintained by the Company qualify as short-duration prospective contracts. A summary of reinsurance premiums written and earned is provided below:

	Premiums Written		Premiums Earned	
	2010	2009	2010	2009
Direct	$3,405,052	4,731,597	$3,782,006	5,995,507
Assumed	–	–	–	–
Ceded	(499,508)	(659,163)	(559,956)	(765,414)
Totals	$2,905,544	4,072,434	$3,222,050	5,230,093

Ceded incurred losses and loss adjustment expenses totaled $63,761 and $170,645 for the years ended December 31, 2010 and 2009, 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.

(l) 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.

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.

(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, 2010 and 2009:

	2010	2009
Unrealized holding gain arising during period, net of income tax expense	$1,182,780	3,104,347
Less reclassification adjustment for gains included in net earnings, net of income tax expense of $399,188 in 2010 and $429,026 in 2009	774,893	832,813
Unrealized loss on derivatives qualifying as cash flow hedges	–	86,856
Other comprehensive income	$ 407,887	2,358,390

(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 ASC 715, 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) Accounting Standards

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 (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 adopted this guidance and there has been no material impact as a result of adoption.

(r) Subsequent Events

The Company has evaluated subsequent events since the date of these consolidated financial statements through the issuance date of May 5, 2011.

(2) Investments

Fixed maturities at December 31, 2010 and 2009 follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2010				
Fixed maturities – available for sale:				
Bonds:				
States, municipalities and political subdivisions	$23,445,912	248,005	(304,470)	23,389,447
United States government and government agencies	4,105,455	30,959	(254)	4,136,160
Mortgage-backed securities	27,231,262	564,576	(223,043)	27,572,795
Industrial and miscellaneous	12,407,424	253,570	(70,523)	12,590,471
Redeemable preferred stock	1,447,200	6,513	(51,115)	1,402,598
Total fixed maturities	$68,637,253	1,103,623	(649,405)	69,091,471
2009				
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	2,605,050	172,228	(295,608)	2,481,670
Total fixed maturities	$75,453,859	1,417,726	(941,926)	75,929,659

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.

	2010 Amortized Cost	2010 Fair Value
Due in one year or less	$ 8,618,726	8,686,686
Due after one year through five years	22,997,764	23,158,457
Due after five years through ten years	6,315,622	6,256,282
Due after ten years	3,473,879	3,417,251
Mortgage-backed securities	27,231,262	27,572,795
Total	$68,637,253	69,091,471

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, 2010 and 2009, the Company held CMOs classified as available for sale with a fair value of $21,492,708 and $32,837,196, respectively. Approximately 81% and 83% of the Company's CMO holdings are fully collateralized by GNMA, FNMA, SBA or FHLMC securities at December 31, 2010 and 2009, respectively.

Proceeds from sales of fixed maturities classified as available for sale were $26,121,963 and $46,620,212 in 2010 and 2009, respectively. Gross gains of $812,902 and $948,670 and gross losses of $58,498 and $108,385 were realized on fixed maturity sales for the years ended December 31, 2010 and 2009, respectively.

On December 31, 2010 and 2009, 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, 2010 and 2009 follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2010				
Common stocks:				
Industrial and miscellaneous	$3,953,969	749,756	(156,622)	4,547,103
Perpetual preferred stocks:				
Industrial and miscellaneous	1,366,400	34,940	(89,920)	1,311,420
Total equity securities	$ 5,320,369	784,696	(246,542)	5,858,523
2009				
Common stocks:				
Industrial and miscellaneous	$ 425,779	526,201	(25,016)	926,964
Perpetual preferred stocks:				
Industrial and miscellaneous	1,832,800	–	(586,260)	1,246,540
Total equity securities	$ 2,258,579	526,201	(611,276)	2,173,504

Proceeds from sales of equity securities were $3,593,066 and $1,196,172 in 2010 and 2009, respectively. Gross gains of $733,489 and $421,554 were realized on the sale of equity securities for the years ended December 31, 2010 and 2009, respectively, and gross losses of $313,810 and $-0- were realized on equity security sales for the years ended December 31, 2010 and 2009, respectively.

The Company's investments in perpetual preferred stocks included two investment grade securities in an unrealized loss position totaling $35,520 at December 31, 2010 compared to and unrealized loss of $76,420 at December 31, 2009. The balance of the Company's investment in perpetual preferred stocks included one non-investment grade security (two at December 31, 2009) in an unrealized loss position totaling $54,400 at December 31, 2010 compared to an unrealized loss of $509,840 at December 31, 2009. 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, 2010.

The following tables summarize, for all investments in an unrealized loss position at December 31, 2010 and 2009, 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:

	Less than 12 months		12 months or longer		Total 2010	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
Fixed maturities:						
States, municipalities and political subdivisions	$11,040,794	286,812	1,256,255	17,658	12,297,049	304,470
United States government and government agencies	276,623	254	–	–	276,623	254
Mortgage-backed securities	4,547,205	59,348	1,472,984	163,695	6,020,189	223,043
Industrial and miscellaneous	3,549,408	70,523	–	–	3,549,408	70,523
Redeemable preferred stock	–	–	973,935	51,115	973,935	51,115
Total fixed maturities	19,414,030	416,937	3,703,174	232,468	23,117,204	649,405
Equity securities – common stocks	896,900	156,622	–	–	896,900	156,622
Equity securities – perpetual preferred	–	–	651,480	89,920	651,480	89,920
Total equity securities	$896,900	156,222	651,480	89,920	1,548,380	246,542
Total temporarily impaired securities	$20,310,930	573,559	4,354,654	322,388	24,665,584	895,947

	Less than 12 months		12 months or longer		Total 2009	
	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	–	–	1,671,942	295,608	1,671,942	295,608
Total fixed maturities	22,087,676	265,576	5,516,665	676,350	27,604,341	941,926
Equity securities – common stocks	–	–	14,428	25,016	14,428	25,016
Equity securities – perpetual preferred	–	–	1,246,540	586,260	1,246,540	586,260
Total equity securities	–	–	1,260,968	611,276	1,260,968	611,276
Total temporarily impaired securities	$22,087,676	265,576	6,777,633	1,287,626	28,865,309	1,553,202

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, 2010, 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
(in millions)					
Fixed maturities:					
Mortgage-backed securities	$ –	–	–	(80,763)	(80,763)
Redeemable preferred stock	–	–	–	–	–
Total fixed maturities	–	–	–	(80,763)	(80,763)
Equity securities	(67,600)	–	–	–	(67,600)
Total	$ (67,600)	–	–	(80,763)	(148,363)

These unrealized losses at December 31, 2010 represented less than 1% of the combined fixed maturity and equity security portfolios on a pretax basis and less than 1% 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, 2010. The table also discloses the corresponding count of securities in an unrealized position and estimated fair value by category:

	AAA	AA	A	BBB	Total	Estimated FairValue
Investment grade (a):						
States, municipalities and political subdivisions (41)	$24,303	177,670	90,891	11,606	304,470	12,297,049
United States government and government agencies (1)	254	–	–	–	254	276,623
Mortgage-backed securities (5)	14,106	–	–	13,000	27,106	4,685,968
Industrial and miscellaneous (4)	–	–	–	18,236	18,236	1,136,870
Redeemable preferred stock (1)	–	–	–	28,000	28,000	222,000
Total investment grade	38,663	177,670	90,891	70,842	378,066	18,618,510
Non-investment grade:						
Mortgage-backed securities (4)	–	–	–	–	195,937	1,334,221
Industrial and miscellaneous (10)	–	–	–	–	52,287	2,412,538
Redeemable preferred stock (3)	–	–	–	–	23,115	751,935
Total non-investment grade	–	–	–	–	271,339	4,498,694
Total	$ 38,663	177,670	90,891	70,842	649,405	23,117,204

(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, 2010, the Company's investments in states, municipalities and political subdivisions included forty-one securities in an unrealized loss position of $304,470, none of which exceeded 12% of the security's amortized cost. The unrealized loss position of the states, municipalities and political subdivisions at December 31, 2009 were $179,231. 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, 2010.

At December 31, 2010, the Company holds four non-investment grade CMO securities with an unrealized loss of $195,937 and an amortized cost of $1,530,166. The Company believes that these 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 loss on these securities is indicative of a credit loss and, as such, has not recorded an OTTI loss on these securities at December 31, 2010

Based on the current facts and circumstances discussed above and for the remainder of 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, 2010.

A summary of net investment income for the years ended December 31, 2010 and 2009 follows:

	2010	2009
Tax-exempt interest	$517,644	425,514
Taxable interest	2,143,999	2,613,113
Dividends on equity securities	289,698	341,173
Investment expenses	(77,365)	(38,917)
Net investment income	$2,873,976	3,340,883

Net realized capital gains for the years ended December 31, 2010 and 2009 follows:

	2010	2009
Fixed maturities	$754,404	840,285
Equity securities	419,677	421,554
Net realized capital gains	$1,174,081	1,261,839

(3) Fair Value Measurements

The Company's estimates of fair value for financial assets and financial liabilities are based on the framework established in ASC 820. 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 ASC 820 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.

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, 2010.

	Level 1	Level 2	Level 3	Total
Fixed maturities:				
States, municipalities and political subdivisions	$ –	23,389,447	–	23,389,447
United States government and government agencies	4,136,160	–	–	4,136,160
Mortgage-backed securities	–	27,572,795	–	27,572,795
Industrial and miscellaneous	–	12,590,471	–	12,590,471
Redeemable preferred stock	–	1,402,598	–	1,402,598
Total fixed maturities	4,136,160	64,955,311	–	69,091,471
Equity securities – common stocks	4,547,103	–	–	4,547,103
Equity securities – perpetual preferred	–	1,311,420	–	1,311,420
Total equity securities	4,547,103	1,311,420	–	5,858,523
Short-term investments	–	5,625,451	–	5,625,451
Total	$8,683,263	71,892,182	–	80,575,445

There were no significant transfers between Level 1 and 2.

(4) Receivables

A summary of receivables at December 31, 2010 and 2009 follows:

	2010	2009
Insurance premiums due from agents	190,663	212,127
Receivables under construction contracts:	21,844	214,444
Other	621,841	196,410
Total receivables	834,348	622,981
Less allowances for doubtful accounts	(48,266)	(55,460)
Total receivables, net	$786,082	567,521

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.

(5) Property and Equipment

A summary of property and equipment at December 31, 2010 and 2009 follows:

	2010	2009
Building	$17,072,279	$17,041,203
Land	1,358,178	800,000
Equipment and vehicles	887,962	829,726
Furniture and fixtures	878,934	876,205
	20,197,353	19,547,134
Less accumulated depreciation	9,675,714	9,128,890
Less impairment allowance on building	6,886,172	6,484,548
	$3,635,467	3,933,696

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. The impairment loss was increased to $6,886,172 on December 31, 1010 as a result of the ultimate sale of the building in February 2011. Rental income earned in 2010 and 2009 was $675,850 and $734,818, respectively.

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 2010 and 2009 was $546,823 and $529,946, 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.

	2010	2009
Balance at January 1	$21,597,746	$23,064,539
Less reinsurance recoverable	3,642,683	3,530,878
Net balance at January 1	17,955,063	19,533,661
Incurred related to:		
Current year	2,418,000	3,200,000
Prior years	(2,051,116)	(2,033,981)
Total incurred	366,884	1,166,019
Payments related to:		
Current year	35,000	212,000
Prior years	1,847,328	2,532,617
Total payments	1,882,328	2,744,617
Net balance at December 31	16,439,619	17,955,063
Plus reinsurance recoverable	3,718,182	3,642,683
Balance at December 31	$20,157,801	21,597,746

The decrease in reserves for unpaid losses and loss adjustment expenses in 2010 from 2009 primarily resulted from recovery of several claims offset in part by a decrease in claim payments in 2010. The decrease in incurreds for 2010 represents normal loss development on general liability and surety exposures in 2010 compared to exceptionally favorable loss development in 2009. The decrease in reserves for unpaid losses and loss adjustment expenses in 2009 from 2008 primarily resulted from a increase in claim payments due to several large claim settlements in 2009 on 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, 2010, 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, 2010 and 2009. 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, 2010 and 2009 follows:

	2010	2009
Term Loan due 2016	$8,571,429	10,000,000

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 $8,571,429 at December 31, 2010. 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, 2010.

Principal payments on long-term debt are $1,428,571 for each of the years 2011 through 2016. Interest expense paid in 2010 and 2009 amounted to $304,253 and $248,181, respectively.

The fair value at December 31, 2010 of the term loan approximates carrying value.

(9) Income Taxes

The components of income tax expense (benefit) for the years ended December 31, 2010 and 2009 were as follows:

	2010	2009
Current Taxes:		
Federal	$ 293,199	594,964
State	94,593	50,475
	387,792	645,439
Deferred Taxes:		
Federal	(170,758)	(2,199,063)
State	–	–
	(170,758)	(2,199,063)
Total	$217,034	(1,553,624)

The effective income tax rate, as a percentage of earnings before income taxes for the years ended December 31, 2010 and 2009 was as follows:

	2010	2009
Federal statutory tax rate	34.0%	34.0%
State income tax (benefit)	5.4	(.8)
Tax exempt interest	(11.7)	2.7
Prior year effect	(6.9)	–
Other, net	(2.0)	.4
Effective income tax rate	18.8%	36.3%

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2010 and 2009 are presented below:

	2010	2009
Deferred Tax Assets:		
Reserves for losses and loss adjustment expenses	$ 369,747	449,215
Unearned premiums	76,156	97,678
Allowance for doubtful accounts	16,410	18,856
Impairment allowance on building and lease	2,440,707	2,204,746
State net operating loss carryforward	1,300,840	1,201,150
Stock based compensation	146,523	140,778
Other	19,834	–
Total gross deferred tax assets	4,370,217	4,112,423
Less valuation allowance	(1,300,840)	(1,201,150)
Net deferred tax assets	$3,069,377	2,911,273
Deferred Tax Liabilities:		
Plant and equipment	$ 712,085	686,352
Deferred policy acquisition costs	173,009	200,414
Discount on investments	49,170	60,150
Unrealized gains on investments	326,602	132,847
Other	179	179
Total gross deferred tax liabilities	1,261,045	1,079,942
Net deferred tax assets (liabilities)	$1,808,332	1,831,331

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, 2010 and 2009.

The most significant component of the state gross deferred asset is the net operating loss carryforward for the State of Connecticut which amounted to $26,016,790 as of December 31, 2010 which expires in 2020 through 2029. In 2010 and 2009, 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. The change of $99,690 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 paid in 2010 were $396,701 and taxes received in 2009 were $223,139.

(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 to the ACMAT 401(k) Plan in both 2010 and 2009. Costs associated with operating the Plan are borne by the Company and were insignificant for each of the years ended December 31, 2010 and 2009.

(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, ACMAT repurchased and retired, in the open market and in privately negotiated transactions, 3,060 shares of its Common Stock at an average price of $22.63 per share. The Company also repurchased and retired during 2009, in the open market and in privately negotiated transactions, 197,538 shares of its Class A Stock at an average price of $25.49 per share.

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 $3,016,582 in 2011.

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 $30,165,816 and $30,404,590 at December 31, 2010 and 2009 respectively, and their statutory net income for the years ended December 31, 2010 and 2009 was $2,733,246 and $3,683,040, 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.

(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, 2010 and 2009:

	Earnings (Loss)	Weighted Average Shares Outstanding	Per Share Amount
2010:			
Basic EPS:			
Earnings (Loss) available to stockholders	$940,693	1,367,200	$.69
Effect of Dilutive Securities:			
Stock options	–	103,050	
Diluted EPS:			
Earnings (Loss) available to stockholders	$ 940,693	1,470,250	$.64
2009:			
Basic EPS:			
Earnings available to stockholders	$(2,723,747)	1,373,741	($1.98)
Effect of Dilutive Securities:			
Stock options	–	116,918	
Diluted EPS:			
Earnings available to stockholders	$(2,723,747)	1,490,659	($1.83)

(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 $10.97 for the year ended December 31, 2010. Total stock-based compensation expense totaled $16,898 and $37,286 for the year ended December 31, 2010 and 2009, respectively. The tax benefit recognized on stock-based compensation totaled $5,745 and $12,677 for the year ended December 31, 2010 and 2009, respectively.

As of December 31, 2010 there were 290,500 stock options outstanding of which 14,000 were not yet vested. The compensation costs related to non-vested share compensation arrangements granted but not yet recognized was approximately $3,800 as of December 31, 2010. The Company expects to recognize that cost over a weighted average period of less than one year.

The following table shows the stock option activity for the Company during 2010 and 2009.

	Option Shares	Weighted average exercise price	Weighted average remaining contractual term (in years)	Aggregate intrinsic value
Outstanding at December 31, 2008	339,500	$10.71		
2009 activity:				
Granted	–			
Exercised	(7,000)	$ 9.00		
Canceled	–			
Outstanding at December 31, 2009	332,500	$10.75		
2009 activity:				
Granted	–			
Exercised	–	$ –		
Canceled	(42,000)			
Outstanding at December 31, 2010	290,500	$10.97	2.76	$1,425,484
Exercisable at December 31, 2010	276,500	$11.07	2.83	$1,356,786
Expected to Vest	14,000	$9.00	1.47	$68,698

Of the 332,500 outstanding options at December 31, 2009, 294,165 were exercisable. During 2010 and 2009, officers and directors exercised 0 and 7,000 stock options, respectively. Proceeds from stock options exercised in 2010 and 2009 were $0 and $63,000, respectively. Tax benefits related to stock options exercised in 2010 and 2009 were $0 and $34,201, respectively.

The following table summarizes information about stock options outstanding at December 31, 2010:

Range of exercise price	Number Outstanding	Weighted average remaining contractual life	Weighted average exercise price	Grant Year	Number exercisable
$ 9.00	134,000	1.47	$9.00	2002	120,000
$12.22	54,500	3.20	$12.22	2004	54,500
$11.40	20,000	3.20	$11.40	2004	20,000
$13.25	82,000	4.48	$13.25	2005	82,000
$9.00-13.25	290,500	2.76	$10.97		276,500

(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.

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.

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:

	2010	2009
Revenues:		
ACSTAR Bonding	$ 6,661,657	9,473,765
ACMAT Contracting	2,159,599	3,260,582
	$8,821,256	12,734,347
Operating Earnings (Loss):		
ACSTAR Bonding	$3,726,965	4,904,557
ACMAT Contracting	(1,863,361)	(2,449,199)
	$1,863,604	2,455,358
Depreciation and Amortization:		
ACSTAR Bonding	$847,453	333,806
ACMAT Contracting	477,884	487,551
	$1,325,337	821,357
Identifiable Assets:		
ACSTAR Bonding	$ 84,918,179	90,236,704
ACMAT Contracting	16,945,318	15,707,895
	$101,863,497	105,944,599
Capital Expenditures:		
ACSTAR Bonding	$7,405	57,273
ACMAT Contracting	642,814	246,071
	$650,219	303,344

The components of revenue for each segment are as follows:

	2010	2009
ACSTAR Bonding:		
Premiums	$3,222,050	5,230,093
Investment income, net	2,449,207	2,953,886
Capital gains	983,260	1,260,346
Other income	7,140	29,440
	$6,661,657	9,473,765
ACMAT Contracting:		
Contract revenues	$20,787	1,134,730
Investment income, net	133,276	77,829
Capital gains	169,155	1,493
Inter-segment revenue:		
Rental income	316,598	384,713
Underwriting services and agency commissions	816,238	920,964
Other income	703,545	740,853
	$2,159,599	3,260,582

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

	2010	2009
Revenue:		
Total revenue for reportable segments	$8,821,256	12,734,347
Inter-segment eliminations	(758,171)	(835,419)
	$8,063,085	11,898,928
Operating Earnings:		
Total operating earnings for reportable segments	$1,863,604	2,455,358
Impairment loss on building	(401,624)	(6,484,548)
Interest expense	(304,253)	(248,181)
	$1,157,727	(4,277,371)

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.

(17) Subsequent Event

On February 23, 2011, the Company sold its corporate headquarters for $2,800,000. In 2009, the Company recognized an impairment loss of $6,484,548 and increased the impairment loss by $401,624 in 2010. Although the Company has signed a two-year lease for its current space, the Company expects to move to a new headquarters by June 2012.

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.

	2010		2009	
	High	Low	High	Low
Common Stock				
1st Quarter	25.00	24.25	26.00	26.00
2nd Quarter	24.70	24.35	26.00	26.00
3rd Quarter	24.75	24.55	26.00	21.75
4th Quarter	25.00	24.60	25.00	23.05
Class A Stock				
1st Quarter	24.60	22.71	28.00	18.25
2nd Quarter	28.00	22.00	25.00	18.05
3rd Quarter	27.75	22.50	27.00	21.00
4th Quarter	26.00	23.00	25.00	23.00

Annual Meeting

The annual meeting of stockholders will be held on June 22, 2011 at 12:00 PM 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 15, 2011 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

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, 2010 and 2009, 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, 2010 and 2009, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

KPMG LLP

Hartford, Connecticut
May 5, 2011

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