As filed with the U.S. Securities and Exchange Commission on March 2, 2011

Registration No. 333-

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM S-4

REGISTRATION STATEMENT

UNDER THE SECURITIES ACT OF 1933

People s United Financial, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**6035**	**20-8447891**
(State or other jurisdiction of incorporation or organization)	**(Primary Standard Industrial Classification Code Number)**	**(I.R.S. Employer Identification Number)**

850 Main Street

Bridgeport, Connecticut 06604

(203) 338-7171

(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)

Robert E. Trautmann, Esq.

Senior Executive Vice President and General Counsel

People s United Financial, Inc.

850 Main Street

Bridgeport, Connecticut 06604

(203) 338-7171

(Name, address, including zip code, and telephone number, including area code, of agent for service)

With copies to:

Lee Meyerson, Esq.	**Michael W. McCurdy, Esq.**	**Richard Schaberg, Esq.**
Elizabeth Cooper, Esq.	**Executive Vice President, General Counsel and Secretary**	**Gregory F. Parisi, Esq.**
Simpson Thacher & Bartlett LLP 425 Lexington Avenue	**Danvers Bancorp, Inc.**	**Hogan Lovells US LLP**
		Columbia Square
New York, New York 10017	**One Conant Street**	
(212) 455-2000	**Danvers, Massachusetts 01923 (978) 739-4998**	**555 Thirteenth Street, NW Washington, District of Columbia 20004 (202) 637-5910**

Approximate date of commencement of the proposed sale of the securities to the public: As soon as practicable after this Registration Statement becomes effective and upon completion of the merger described in the enclosed proxy statement/prospectus.

If the securities being registered on this Form are being offered in connection with the formation of a holding company and there is compliance with General Instruction G, check the following box. ¨

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act of 1933, as amended, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

CALCULATION OF REGISTRATION FEE

Title of each class of securities to be registered	**Amount to be registered**	**Proposed maximum offering price per share**	**Proposed maximum aggregate offering price**	**Amount of registration fee**
Common Stock, par value $0.01 per share	21,186,313 (1)	N/A	$271,752,581.61 (2)	$31,550.47 (3)

(1) Represents the maximum number of shares of People s United Financial, Inc. common stock estimated to be issuable upon the completion of the merger described herein.

(2) Estimated solely for the purpose of calculating the registration fee required by Section 6(b) of the Securities Act and computed pursuant to Rule 457(f)(1) and (f)(3) and 457(c) of the Securities Act. The proposed maximum aggregate offering price of the registrant s common stock was calculated based upon the market value of shares of Danvers Bancorp, Inc. common stock (the securities to be canceled in the merger) in accordance with Rule 457(c) under the Securities Act as follows: (i) the product of (A) $21.74, the average of the high and low prices per share of Danvers Bancorp, Inc. common stock on the NASDAQ Global Select Market on February 25, 2011 and (B) 22,371,443, the maximum possible number of shares of Danvers Bancorp, Inc. common stock which may be canceled and exchanged in the merger (including shares of Danvers Bancorp, Inc. common stock issuable upon exercise of outstanding warrants to purchase Danvers Bancorp, Inc. common stock), less (ii) the estimated amount of cash that would be paid by People s United Financial, Inc. in exchange for such maximum possible number of shares of Danvers Bancorp, Inc. common stock which may be canceled and exchanged in the merger (which equals $214,490,732).

(3) Determined in accordance with Section 6(b) of the Securities Act at a rate equal to $116.10 per $1,000,000 of the proposed maximum aggregate offering price.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until the Registration Statement shall become effective on such dates as the Commission, acting pursuant to said Section 8(a), may determine.

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The information in this proxy statement/prospectus is not complete and may be changed. We may not sell the securities offered by this proxy statement/prospectus until the registration statement filed with the Securities and Exchange Commission is effective. This proxy statement/prospectus does not constitute an offer to sell or a solicitation of an offer to buy any securities in any jurisdiction where an offer or solicitation is not permitted.

PRELIMINARY SUBJECT TO COMPLETION DATED MARCH 2, 2011

MERGER PROPOSED YOUR VOTE IS VERY IMPORTANT

[ ], 2011

Dear Stockholder:

On January 20, 2011, Danvers Bancorp, Inc. (Danvers) and People s United Financial, Inc. (People s United) agreed to a strategic business combination in which Danvers will merge with and into People s United with People s United surviving the merger, which we refer to herein as the merger. Under the terms and conditions of the merger, the stockholders of Danvers, as of the record date, will be able to elect to receive either (i) $23.00 in cash or (ii) 1.624 shares of People s United common stock for each share of Danvers common stock, subject to proration provisions described in this proxy statement/prospectus, whereby approximately 55% of Danvers shares will be exchanged for stock and approximately 45% for cash. The value of the stock consideration will depend on the market price of People s United common stock on the effective date of the merger.

We are sending you this proxy statement/prospectus to notify you of and invite you to the special meeting of Danvers common stockholders being held to consider the Agreement and Plan of Merger, dated as of January 20, 2011, which we refer to herein as the merger agreement, that Danvers has entered into with People s United, and to ask you to vote at the special meeting in favor of the merger agreement and the transactions contemplated by the merger agreement, including the merger.

The special meeting of stockholders of Danvers will be held at [ ] on [ ], 2011 at [ ], local time.

At the special meeting, you will be asked to adopt the merger agreement and the transactions contemplated by the merger agreement. You will also be asked to approve the adjournment of the special meeting, if necessary, in order to solicit proxies in favor of the merger agreement and the transactions contemplated by the merger agreement, including the merger.

The merger cannot be completed unless, among other things, the holders of a majority of the outstanding shares of Danvers common stock adopt the merger agreement. The board of directors of Danvers unanimously approved the merger agreement and determined that the merger is fair and in the best interests of Danvers and its stockholders, and accordingly unanimously recommends that stockholders vote **FOR** adoption of the merger agreement and the transactions contemplated by the merger agreement, including the merger, and **FOR** the approval of the adjournment of the special meeting, if necessary, in order to solicit additional proxies in favor of the adoption of the merger agreement and the transactions contemplated thereby, including the merger.

The attached proxy statement/prospectus, which serves as the proxy statement for the special meeting of the stockholders of Danvers and the prospectus for the shares of People s United common stock to be issued in the merger, includes detailed information about the special meeting, the merger, and the documents related to the merger. **We urge you to read this entire document carefully, including the discussion of the risks related to the merger and owning People s United common stock after the merger in the section titled Risk Factors beginning on page 22. You can also obtain information about Danvers and People s United from documents that have been filed with the Securities and Exchange Commission that are incorporated in the proxy statement/prospectus by reference.**

Shares of People s United common stock are listed on the NASDAQ Global Select Market under the symbol PBCT. Shares of Danvers common stock are listed on the NASDAQ Global Select Market under the symbol DNBK. On [ ], 2011, the last practicable trading day prior to the printing of the attached proxy statement/prospectus, the last sales price of People s United common stock was $[ ] per share and the last sales

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price of Danvers common stock was $[ ] per share. A chart showing the value of cash and common stock merger consideration at various hypothetical closing sale prices of People s United common stock is provided on page 2 of this document. You should obtain current market quotations for both People s United common stock and Danvers common stock.

Your vote is important. Whether or not you plan to attend the special meeting, please take the time to vote by completing and mailing the enclosed proxy card or by submitting a proxy through the Internet or by telephone as described on the enclosed instructions as soon as possible to make sure your shares are represented at the special meeting. If you submit a properly signed proxy card without indicating how you want to vote, your proxy will be counted as a vote **FOR** adoption of the merger agreement and **FOR** the approval of the adjournment of the special meeting. The failure to vote by submitting your proxy or attending the special meeting and voting in person will have the same effect as a vote against adoption of the merger agreement.

Danvers board of directors unanimously recommends that stockholders vote FOR the adoption of the merger agreement and the transactions contemplated by the merger agreement, including the merger, and FOR the approval of the adjournment of the special meeting, if necessary, in order to solicit additional proxies in favor of the merger agreement and the transactions contemplated by the merger agreement, including the merger.

Sincerely,

Kevin T. Bottomley
Chairman of the Board,

President and Chief Executive Officer

Neither the Securities and Exchange Commission nor any state securities commission or bank regulatory agency has approved or disapproved of the securities to be issued in the merger or determined if the attached proxy statement/prospectus is accurate or adequate. Any representation to the contrary is a criminal offense.

The shares of People s United common stock to be issued in the merger are not savings accounts, deposits or other obligations of any bank or savings association and are not insured by any federal or state governmental agency.

This document is dated [ ], 2011, and is first being mailed to Danvers stockholders on or about [ ], 2011.

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One Conant Street Danvers, Massachusetts 01923 (978) 777-2200

NOTICE OF SPECIAL MEETING OF STOCKHOLDERS TO BE HELD ON [ ], 2011

A special meeting of stockholders of Danvers Bancorp, Inc. will be held at [ ], on [ ], 2011 at [ ], local time, for the following purposes:

1. to consider and vote upon a proposal to adopt the Agreement and Plan of Merger by and between Danvers Bancorp, Inc. and People s United Financial, Inc., dated as of January 20, 2011, a copy of which is attached as Annex A to the accompanying proxy statement/prospectus, and the transactions contemplated thereby; and

2. to consider and vote upon a proposal to approve one or more adjournments of the special meeting, if necessary, to permit further solicitation of proxies if there are not sufficient votes at the time of the special meeting, or at any adjournment or postponement of that meeting, to adopt the merger agreement.

The proposed merger of Danvers with and into People s United is more fully described in the attached document, which you should read carefully and in its entirety before voting.

The board of directors of Danvers has established the close of business on [ ], 2011 as the record date for the special meeting. Only record holders of Danvers common stock as of the close of business on that date will be entitled to notice of and vote at the special meeting or any adjournment or postponement of that meeting. The list of stockholders entitled to vote at the special meeting will be available for review by any Danvers stockholder entitled to vote at the special meeting at Danvers principal executive offices during regular business hours for the 10 days before the special meeting. The affirmative vote of holders of at least a majority of the shares of Danvers common stock outstanding and entitled to vote at the special meeting is required to adopt the merger agreement.

Your vote is important, regardless of the number of shares that you own. **Please complete, sign and return the enclosed proxy card promptly in the enclosed postage-paid envelope** or submit a proxy through the Internet or by telephone as described in the enclosed instructions. Voting by proxy will not prevent you from voting in person at the special meeting, but will assure that your vote is counted if you are unable to attend. You may revoke your proxy at any time before the meeting. If your shares are held in the name of a bank, broker or other nominee, please follow the instructions furnished to you by such record holder with these materials. If you do not vote in person or by proxy, the effect will be a vote against adoption of the merger agreement.

The Danvers board of directors unanimously recommends that you vote FOR adoption of the merger agreement and the transactions contemplated thereby. In addition, the Danvers board of directors recommends that you vote **FOR** the proposal to adjourn the meeting, if necessary, to permit further solicitation of proxies for the adoption of the merger agreement.

By Order of the Board of Directors,

Michael W. McCurdy
Executive Vice President, General Counsel and Secretary

Danvers, Massachusetts

[ ], 2011

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ADDITIONAL INFORMATION

The accompanying proxy statement/prospectus incorporates by reference important business and financial information about People s United and Danvers from documents that are not included in or delivered with the proxy statement/prospectus. This information is available to you without charge upon your written or oral request. You can obtain the documents incorporated by reference in the proxy statement/prospectus by requesting them in writing or by telephone from the appropriate company at the following addresses and telephone numbers:

People s United Financial, Inc.	**Danvers Bancorp, Inc.**
850 Main Street	One Conant Street
Bridgeport, Connecticut 06604	Danvers, Massachusetts 01923
Attention: Peter C. Goulding, Investor Relations	Attention: Michael W. McCurdy, Secretary
(203) 338-7171	(978) 777-2200
www.peoples.com (Investor Relations tab)	*www.danversbank.com (Investor Relations tab)*

If you would like to request documents, please do so by [ ], 2011, in order to receive them before the special meeting of Danvers stockholders.

For a more detailed description of the information incorporated by reference in the accompanying proxy statement/prospectus and how you may obtain it, see Where You Can Find More Information beginning on page 97 of the accompanying proxy statement/prospectus.

The accompanying proxy statement/prospectus provides a detailed description of the merger and the merger agreement. We urge you to read the accompanying proxy statement/prospectus, including any documents incorporated by reference into the accompanying proxy statement/prospectus, and its annexes carefully and in their entirety. If you have any questions concerning the merger, the other meeting matters or the accompanying proxy statement/prospectus or need assistance voting your shares, please contact Danvers proxy solicitor at the address or telephone number listed below:

Phoenix Advisory Partners, LLC

110 Wall Street

27th Floor

New York, NY 10005

Banks and brokers should call:	Stockholders should call:
(212) 493-3910	(800) 576-4314

Please do not send your stock certificates at this time. You will be sent separate instructions regarding the surrender of your stock certificates.

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SUMMARY

This summary highlights selected information from this proxy statement/prospectus. It does not contain all of the information that may be important to you. We urge you to read carefully the entire document and the other documents to which this proxy statement/prospectus refers in order to fully understand the merger and the related transactions. See Where You Can Find More Information beginning on page 97. Each item in this summary refers to the page of this proxy statement/prospectus on which that subject is discussed in more detail.

The Companies (Page 29)

People s United

People s United is the holding company of People s United Bank. People s United has assets of $25 billion, nearly 340 branches and more than 500 ATMs. A diversified financial services company founded in 1842, People s United provides consumer, commercial, insurance, retail investment and wealth management and trust services to personal and business banking customers. The address of People s United s principal executive offices is 850 Main Street, Bridgeport, Connecticut 06604, and its telephone number is (203) 338-7171.

Danvers

Danvers, a Delaware corporation organized in 2007, is a registered bank holding company under the Bank Holding Company Act of 1956 by virtue of its ownership of Danversbank, a Massachusetts-chartered stock savings bank headquartered in Danvers, Massachusetts. Originally founded in 1850 as a Massachusetts-chartered mutual savings bank, Danversbank s business consists primarily of taking deposits and making loans to its customers, including commercial and industrial loans, commercial real estate loans, owner-occupied residential mortgages and consumer loans, and investing in a variety of investment securities.

At December 31, 2010, Danvers had total consolidated assets of $2.9 billion, loans of $1.8 billion, deposits of $2.1 billion, and stockholders equity of $285 million.

Danvers principal executive offices are located at One Conant Street, Danvers, Massachusetts 01923, and its telephone number is (978) 777-2200.

The Merger (Page 35)

The proposed merger is of Danvers with and into People s United, with People s United as the surviving corporation in the merger. The merger agreement is attached to this proxy statement/prospectus as Annex A. Please carefully read the merger agreement as it is the legal document that governs the merger.

What Danvers Stockholders Will Receive in the Merger (Page 72)

Upon completion of the merger, each outstanding share of Danvers common stock (other than shares owned directly or indirectly by People s United or Danvers (which will be cancelled) and other than those shares with respect to which appraisal rights are properly exercised and not withdrawn, if any, which we collectively refer to as the excluded shares) will be converted into the right to receive, at the election of the holder of each such share, either $23.00 in cash or 1.624 shares of People s United common stock, subject to proration in the circumstances described below. In the event of proration, a Danvers stockholder may receive a portion of the merger consideration in a form other than that which such stockholder elected.

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The value of the stock consideration is dependent upon the value of People s United common stock and therefore will fluctuate with the market price of People s United common stock. Accordingly, any change in the price of People s United common stock prior to the merger will affect the market value of the stock consideration that Danvers stockholders will receive as a result of the merger, as follows:

Value of One Share of People s United Common Stock ($)	Value Received in Exchange for Each Share of Danvers Common Stock	
	Cash Consideration ($)	Stock Consideration ($)
16.00	23.00	25.98
15.50	23.00	25.17
15.00	23.00	24.36
14.50	23.00	23.55
14.159 *	23.00	22.99
14.00	23.00	22.74
13.50	23.00	21.92
13.00	23.00	21.11
12.50	23.00	20.30
12.00	23.00	19.49

* Average closing price of People s United stock for the 10 trading days immediately preceding the date of the merger agreement.

Based on the $[ ] closing price of People s United common stock on the NASDAQ Global Select Market on [ ], 2011, the last practicable trading day prior to the printing of this proxy statement/prospectus, a Danvers stockholder will receive shares of People s United common stock having a value of approximately $[ ] for each share of Danvers common stock that is exchanged for People s United common stock.

The examples above are illustrative only. The value of the stock consideration that a Danvers stockholder will receive for each Danvers share that is exchanged for stock will be based on the closing price of People s United common stock on the effective date of the merger. The actual closing price may be outside the range of the amounts set forth above, and as a result the actual value of the stock consideration may not be shown in the above table.

A Danvers stockholder may specify different elections with respect to different shares that such

stockholder holds. For example, a Danvers stockholder who owns 100 shares of Danvers common stock may make a cash election with respect to 50 shares and a stock election with respect to the other 50 shares.

Proration (Page 72)

The total number of shares of People s United common stock that will be issued in the merger is approximately [ ], based on the number of shares of Danvers common stock outstanding on [ ], 2011 and the aggregate amount of cash that will be paid in the merger is fixed at $214,490,732. The total amount of Danvers common stock that will be converted into cash in the merger is fixed at 9,325,684 shares. All other shares of Danvers common stock will be converted into shares of People s United common stock (other than shares to be cancelled). As a result, if the aggregate number of shares of Danvers common stock with respect to which cash elections are made plus the aggregate number of shares of Danvers common stock with respect to which appraisal rights are properly exercised and not withdrawn exceeds 9,325,684, Danvers stockholders electing cash will have the cash consideration proportionately reduced and will receive a portion of their consideration in shares of People s United common stock, despite their election. If the aggregate number of shares of Danvers common stock with respect to which cash elections are made plus the aggregate number of shares of Danvers common stock with respect to which appraisal rights are properly exercised and not withdrawn is less than 9,325,684, Danvers stockholders electing no preference or who do not make an effective election and/or Danvers stockholders electing shares of People s United common stock will receive all or a portion of their consideration in cash, despite their election.

What Holders of Danvers Stock Options and Other Equity-Based Awards Will Receive in the Merger (Page 75)

Each outstanding and unexercised option to purchase shares of Danvers common stock that is outstanding and unexercised immediately prior to the effective time will fully vest and be cancelled at the effective time of the merger, and each option holder

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will be entitled to receive an amount in cash equal to (1) the number of Danvers shares subject to that holder s option(s) multiplied by (2) the excess, if any, of $23.00 over the per-share exercise price of that holder s option(s).

At the effective time of the merger, all of the then outstanding Danvers restricted stock awards will fully vest, and all of the related shares will be converted in the merger into the right to receive the same merger consideration as all other outstanding shares of Danvers common stock are entitled to receive in the merger.

Accounting Treatment of the Merger (Page 63)

People s United will account for the merger as a purchase for financial reporting purposes.

Material U.S. Federal Income Tax Consequences of the Merger (Page 59)

The merger is intended to qualify for U.S. federal income tax purposes as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code of 1986, as amended, which we refer to as the Code. Therefore, for U.S. federal income tax purposes, as a result of the merger, a U.S. holder of shares of Danvers common stock generally will only recognize gain (but not loss) in an amount not to exceed the cash (if any) received as part of the merger consideration and will recognize gain or loss if such holder received the entirety of its consideration in cash or with respect to any cash received in lieu of fractional shares of People s United common stock.

Opinion of Sandler O Neill + Partners, L.P., Financial Advisor to Danvers (Page 41)

On January 20, 2011, Sandler O Neill & Partners, L.P., or Sandler O Neill, rendered to the Danvers board its oral opinion, subsequently confirmed in writing that, as of such date, the consideration to be received in the merger was fair to Danvers stockholders from a financial point of view. The full text of Sandler O Neill s written opinion, which sets forth the assumptions made, matters considered and qualifications and limitations on the review undertaken in connection with the opinion, is

attached to this document as Annex B. Danvers shareholders are urged to read the opinion in its entirety. Sandler O Neill s written opinion is addressed to the board of directors of Danvers and is directed only to the fairness of the merger consideration to Danvers stockholders from a financial point of view. The written opinion does not address the underlying business decision of Danvers to engage in the merger or any other aspect of the merger and is not a recommendation to any Danvers stockholder as to how such stockholder should vote at the special meeting with respect to the merger, the form of consideration a stockholder should elect in the merger or any other matter.

Recommendation of Danvers Board of Directors (Page 41)

Danvers board of directors has determined that the merger is fair and in the best interests of Danvers and its stockholders. The Danvers board of directors unanimously recommends that Danvers stockholders vote **FOR** adoption of the merger agreement and the transactions contemplated by the merger agreement, and **FOR** the approval of the adjournment of the special meeting.

Interests of Danvers Directors and Executive Officers in the Merger (Page 53)

Danvers executive officers and directors may have financial interests in the merger that are different from, or in addition to, the interests of Danvers stockholders. These interests include the vesting in full of outstanding equity compensation awards and rights to continued indemnification and insurance coverage by People s United after the merger for acts or omissions occurring before the merger. The Danvers board of directors was aware of these interests and considered them in its decision to approve the merger agreement.

People s United Board of Directors after the Merger (Page 59)

People s United has agreed that it will cause Kevin T. Bottomley, the current President and Chief Executive Officer of Danvers, to be appointed to the People s United board of directors to the class of directors with a term expiring in 2013 at the effective

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time of the merger. If Mr. Bottomley is not serving as President and Chief Executive Officer of Danvers at the effective time of the merger, People s United will instead cause such other director of Danvers designated by Danvers and reasonably acceptable to People s United to be appointed to the People s United board of directors.

No Solicitation of Alternative Transactions (Page 81)

Danvers has agreed not to initiate, solicit, encourage or knowingly facilitate the submission of any proposals from third parties regarding acquiring Danvers or its businesses. In addition, Danvers has agreed not to engage in discussions or negotiations with or provide confidential information to a third party regarding acquiring Danvers or its businesses. However, if Danvers receives an unsolicited acquisition proposal from a third party prior to the date of the special meeting of Danvers stockholders, Danvers may participate in discussions with, or provide confidential information to, such third party if, among other steps, the Danvers board of directors concludes in good faith that the proposal is or is reasonably likely to result in a financially superior proposal to the merger.

Regulatory Approvals Required for the Merger (Page 63)

Completion of the transactions contemplated by the merger agreement is subject to various regulatory approvals, including approval from the Office of Thrift Supervision, which we refer to as the OTS, and various state regulatory authorities. Prior to the date of this proxy statement, People s United and Danvers have filed with regulatory authorities all of the required applications and notices necessary to complete the merger. In addition, the completion of the merger is subject to the expiration of certain waiting periods and other requirements. Although we do not know of any reason why we would not be able to obtain the necessary regulatory approvals in a timely manner, we cannot be certain when or if we will receive them.

Conditions to Completion of the Merger (Page 84)

As more fully described in this proxy statement/prospectus and the merger agreement, the completion of the merger depends on a number of mutual conditions being satisfied or waived, including:

- the approval of Danvers stockholders;
- receipt of all regulatory approvals required to consummate the transactions contemplated by the merger agreement and the expiration or termination of all statutory waiting periods; and
- the absence of any law or order prohibiting or making illegal the consummation of the merger.

Each of People s United s and Danvers obligations to complete the merger is also separately subject to the satisfaction or waiver of a number of conditions, including:

- the other party s representations and warranties in the merger agreement being true and correct, subject to the materiality standards contained in the merger agreement;
- material compliance of the other party with its covenants; and
- receipt by each party of a legal opinion from its respective counsel that the merger will qualify as a reorganization for U.S. federal income tax purposes within the meaning of Section 368(a) of the Code.

Additionally, the obligation of People s United to complete the merger is subject to the satisfaction or waiver of the receipt of all regulatory approvals required to complete the merger of Danversbank with and into People s United Bank.

People s United and Danvers cannot be certain of when, or if, the conditions to the merger will be satisfied or waived or whether or not the merger will be completed.

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Danversbank Charitable Foundation (Page 84)

The parties have also agreed that the board of directors of the Danversbank Charitable Foundation shall remain unchanged for three years following the effective time of the merger (except as described in the following sentence) and that all proceeds disbursed by the Danversbank Charitable Foundation will be disbursed within the sole discretion of the foundation s board of directors. The parties further agreed that People s United will have the right to appoint two additional individuals to the board of directors of the Danversbank Charitable Foundation and that Kevin T. Bottomley will be Chairman of the board of directors of the foundation for three years following the effective time of the merger. People s United has also agreed to make certain charitable contributions in Danvers market area for a period of three years after the effective time of the merger.

Termination of the Merger Agreement (Page 84)

People s United and Danvers can agree at any time to terminate the merger agreement without completing the merger, even if Danvers stockholders have adopted the merger agreement. Also, either of People s United or Danvers can terminate the merger agreement if:

- a governmental entity which must grant a regulatory approval that is a condition to the merger denies such approval and such action has become final and non-appealable;
- a governmental entity issues a final non-appealable order enjoining or prohibiting the merger;
- the merger is not completed by September 30, 2011 (other than because of a breach of the merger agreement by the party seeking termination);
- the other party breaches the merger agreement in a manner that would entitle the party seeking to terminate the merger agreement the right not to consummate the merger, subject to the right of the breaching party to cure, if curable, the breach within 30 days of written notice of the breach, and the party seeking to terminate is not then in material breach of the merger agreement; or
- Danvers stockholders fail to adopt the merger agreement at the Danvers special meeting.

Additionally, People s United may terminate the merger agreement if:

- any governmental entity which must grant an approval for the merger of Danversbank with and into People s United Bank has denied approval of such merger and such denial has become final and nonappealable;
- any government entity issues a final non-appealable order enjoining or prohibiting the merger of Danversbank with and into People s United Bank;
- Danvers board of directors has failed to recommend the merger to Danvers stockholders or has withdrawn, modified or qualified in a manner adverse to People s United its recommendation of the merger;
- Danvers has failed to call and hold a special meeting of Danvers stockholders;
- Danvers has materially breached its non-solicitation obligations described under The Merger Agreement No Solicitation of Alternative Transactions, beginning on page 81, in any respect adverse to People s United;

Danvers negotiates or authorizes the conduct of negotiations (and 10 days have elapsed without such negotiations being discontinued) with a third party regarding an acquisition proposal other than the merger; or

a tender or exchange offer for 15% or more of the outstanding Danvers common stock is commenced and the Danvers board of directors recommends that Danvers stockholders tender their shares or otherwise fails to recommend that Danvers stockholders reject such tender offer or exchange offer within 10 business days of the commencement of the offer.

Danvers may also terminate the merger agreement if the average closing price of People s United common stock for a specified period prior to closing is less than $11.33 and People s United common stock underperforms a specified peer-group index by more than 20%, provided that People s United will have the option to increase the amount of People s United common stock to be provided to Danvers stockholders, in which case no termination will occur.

Termination Fee (Page 86)

Danvers has agreed to pay to People s United a termination fee of $19,725,000 if the merger agreement is terminated under the circumstances specified in The Merger Agreement Termination of the Merger Agreement Termination Fee beginning on page 86.

Amendment or Waiver of Merger Agreement Provisions (Page 87)

People s United and Danvers may jointly amend the merger agreement and each of People s United and Danvers may waive its right to require the other party to comply with particular provisions of the merger agreement. However, People s United and Danvers may not amend the merger agreement after Danvers stockholders adopt the merger agreement if the amendment would legally require further approval by Danvers stockholders without first obtaining such further approval.

People s United may also change the structure of the merger, as long as any such change does not alter or change the amount or kind of merger consideration to be provided under the merger agreement, materially impede or delay completion of the merger, or adversely affect the anticipated tax consequences to Danvers stockholders in the merger.

Special Meeting of Danvers Stockholders (Page 31)

Danvers will hold its special meeting of common stockholders on [ ], 2011, at [ ], local time, at [ ]. At the special meeting you will be asked to vote for the adoption of the merger agreement and

the transactions contemplated by the merger agreement and to approve adjournment of the special meeting, if necessary, to solicit additional proxies in favor of adoption of the merger agreement.

You can vote at the Danvers special meeting of common stockholders if you owned Danvers common stock at the close of business on [ ], 2011. As of that date, there were approximately [ ] shares of Danvers common stock outstanding and entitled to vote, approximately [ ] of which, or [ ]%, were owned beneficially or of record by directors and officers of Danvers. You can cast one vote for each share of Danvers common stock that you owned on that date.

Appraisal Rights (Page 66)

Under Delaware law, Danvers stockholders of record who do not vote in favor of the merger and properly make a demand for appraisal will be entitled to exercise appraisal rights and obtain payment in cash for the judicially determined fair value of their shares of Danvers common stock in connection with the merger if the merger is completed. The relevant provisions of the General Corporation Law of the State of Delaware, which we refer to in this proxy statement/prospectus as the DGCL, are included as Annex C to this proxy statement/prospectus.

Differences Between Rights of People s United and Danvers Stockholders (Page 90)

As a result of the merger, some or all of the holders of Danvers common stock will become holders of People s United common stock. Following the merger, Danvers stockholders will have different rights as stockholders of People s United than as stockholders of Danvers due to the different provisions of the governing documents of People s United and Danvers. For additional information regarding the different rights as stockholders of People s United than as stockholders of Danvers, see Comparison of Stockholder Rights beginning on page 90.

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QUESTIONS AND ANSWERS ABOUT THE MERGER AND THE SPECIAL MEETING

The following questions and answers are intended to address briefly some commonly asked questions regarding the merger and the special meeting. These questions and answers may not address all questions that may be important to you as a stockholder. To better understand these matters, and for a description of the legal terms governing the merger, you should carefully read this entire proxy statement/prospectus, including the annexes, as well as the documents that have been incorporated by reference in this proxy statement/prospectus.

Q: Why am I receiving this proxy statement/ prospectus?

A: People s United and Danvers have agreed to the acquisition of Danvers by People s United under the terms of an agreement and plan of merger that is described in this proxy statement/prospectus. A copy of the merger agreement is attached to this proxy statement/ prospectus as Annex A. In order to complete the merger, Danvers stockholders must vote to adopt the merger agreement. Danvers will hold a special meeting of its stockholders to obtain this approval. This proxy statement/prospectus contains important information about the merger, the merger agreement, the special meeting of Danvers stockholders, and other related matters, and you should read it carefully. The enclosed voting materials for the special meeting allow you to vote your shares of Danvers common stock without attending the special meeting in person.

We are delivering this proxy statement/ prospectus to you as both a proxy statement of Danvers and a prospectus of People s United. It is a proxy statement because the Danvers board of directors is soliciting proxies from its stockholders to vote on the approval of the merger agreement at a special meeting of stockholders, and your proxy will be used at the special meeting or at any adjournment or postponement of the special meeting. It is a prospectus because People s United will issue People s United common stock to the Danvers common stockholders who receive stock consideration in the merger and this prospectus contains information about that common stock.

Q: What am I being asked to vote on?

A: Danvers stockholders are being asked to vote on the following proposals:

- to adopt the merger agreement between People s United and Danvers; and
- to approve one or more adjournments of the special meeting, if necessary, to permit further solicitation of proxies if there are not sufficient votes to adopt the merger agreement at the time of the special meeting.

Q: What will happen in the merger?

A: In the proposed merger, Danvers will merge with and into People s United, with People s United being the surviving corporation. Simultaneously with the merger, Danversbank will be merged with and into People s United Bank, with People s United Bank as the surviving entity.

Q: What will I receive in the merger?

A: Danvers stockholders will be entitled to elect to receive merger consideration of either $23.00 in cash or 1.624 shares of People s United common stock for each outstanding share of Danvers common stock (other than excluded shares) held at the time of the merger. However, the form of merger consideration you actually receive may differ from the form of consideration you elect to receive. This is because the total amount of Danvers common stock that will be converted into cash in the merger is fixed at 9,325,684 shares. As a result, if the aggregate number of shares of Danvers common stock with respect to which cash elections are made plus the aggregate number of shares of Danvers common stock with respect to which appraisal rights are properly exercised and not withdrawn is more or less than

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9,325,684, Danvers stockholders may receive a portion of their consideration in a form other than what they elected, despite their election. The value of the stock consideration is dependent upon the value of People s United common stock and therefore will fluctuate with the market price of People United common

stock. Accordingly, any change in the price of People s United common stock prior to the merger will affect the market value of the stock consideration that Danvers stockholders will receive as a result of the merger.

Q: What are the material U.S. federal income tax consequences of the merger to U.S. holders of shares of Danvers common stock?

A: The merger is intended to qualify for U.S. federal income tax purposes as a reorganization within the meaning of Section 368(a) of the Code. Therefore, for U.S. federal income tax purposes, as a result of the merger, a U.S. holder of shares of Danvers common stock generally will only recognize gain (but not loss) in an amount not to exceed the cash received (if any) as part of the merger consideration but will recognize gain or loss (1) if such holder received the entirety of its consideration in cash and (2) with respect to any cash received in lieu of fractional shares of People s United common stock. See The Merger Material U.S. Federal Income Tax Consequences of the Merger beginning on page 59.

Q: Will I be able to trade the shares of People s United common stock that I receive in the merger?

A: You may freely trade the shares of People s United common stock issued in the merger, unless you are an affiliate of People s United as defined by Rule 144 under the Securities Act of 1933, as amended. Affiliates consist of individuals or entities that control, are controlled by, or under the common control with People s United and include the executive officers and directors and may include significant stockholders of People s United.

Q: What will happen to shares of People s United common stock in the merger?

A: Nothing. Each share of People s United common stock outstanding will remain outstanding as a share of People s United common stock.

Q: What are the conditions to completion of the merger?

A: The obligations of People s United and Danvers to complete the merger are subject to the satisfaction or waiver of certain closing conditions contained in the merger agreement, including the receipt of required regulatory approvals, tax opinions and adoption of the merger agreement by Danvers stockholders.

Q: When do you expect the merger to be completed?

A: We will complete the merger when all of the conditions to completion contained in the merger agreement are satisfied or waived, including obtaining customary regulatory approvals and the adoption of the merger agreement by Danvers stockholders at the special meeting. While we expect the merger to be completed in the second quarter of 2011, because fulfillment of some of the conditions to completion of the merger is not entirely within our control, we cannot assure you of the actual timing.

Q: When is this proxy statement/prospectus being mailed?

A: This proxy statement/prospectus and the proxy card are first being sent to Danvers stockholders on or about [ ], 2011.

Q: What stockholder approvals are required to complete the merger?

A: For Danvers, the affirmative vote of holders of a majority of the shares of Danvers common stock outstanding and entitled to vote at the special meeting is required to adopt the merger agreement. For People s United, no approval of stockholders is needed and no vote will be taken.

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Q: When and where is the special meeting?

A: The special meeting of stockholders of Danvers will be held at [ ] on [ ], 2011 at [ ], local time.

Q: What will happen at the special meeting?

A: At the special meeting, Danvers stockholders will consider and vote upon the proposal to adopt the merger agreement. If, at the time of the special meeting, there are not sufficient votes to adopt the merger agreement, we may ask you to consider and vote upon a proposal to adjourn the special meeting, so that we can solicit additional proxies.

Q: Who is entitled to vote at the special meeting?

A: All holders of Danvers common stock who held shares at the close of business on the record date ([ ], 2011) are entitled to receive notice of and to vote at the special meeting provided that such shares remain outstanding on the date of the special meeting.

Q: What constitutes a quorum for the special meeting?

A: The presence in person or by proxy of a majority of the total number of outstanding shares of Danvers common stock entitled to vote constitutes a quorum for the special meeting.

Q: Does the Danvers board of directors recommend voting in favor of the merger agreement?

A: Yes. After careful consideration, the Danvers board of directors unanimously recommends that Danvers stockholders vote **FOR** adoption of the merger agreement.

Q: Are there any risks that I should consider in deciding whether to vote for adoption of the merger agreement?

A: Yes. You should read and carefully consider the risk factors set forth in the section in this proxy statement/prospectus entitled Risk Factors beginning on page 22.

Q: What do I need to do now?

A: You should carefully read and consider the information contained in or incorporated by reference into this proxy statement/ prospectus, including its annexes. It contains important information about the merger, the merger agreement, People s United and Danvers. After you have read and considered this information, you should complete and sign your proxy card and return it in the enclosed postage-paid return envelope or submit a proxy through the Internet or by telephone as soon as possible so that your shares of Danvers common stock will be represented and voted at the special meeting.

Q: If my shares are held in street name by my broker, bank or other nominee, will my broker, bank or other nominee automatically vote my shares for me?

A: No. Your broker, bank or other nominee will not vote your shares of Danvers common stock unless you provide instructions to your broker, bank or other nominee on how to vote. You should instruct your broker, bank or other nominee to vote your shares by following the instructions provided by the broker, bank or nominee with this proxy statement/prospectus.

Q: How will my shares be represented at the special meeting?

A: At the special meeting, the officers named in your proxy card will vote your shares in the manner you requested if you properly signed and submitted your proxy. If you sign your proxy card and return it without indicating how you would like to vote your shares, your proxy will be voted as the Danvers board of directors recommends, which is (1) **FOR** the adoption of the merger agreement and (2) **FOR** the approval of the adjournment of the special meeting, if necessary, to solicit additional proxies if there are not sufficient votes to adopt the merger agreement at the time of the special meeting.

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Q: What if I fail to submit my proxy card or to instruct my broker, bank or other nominee?

A: If you fail to properly submit your proxy card or to instruct your broker, bank or other nominee to vote your shares of Danvers common stock and you do not attend the special meeting and vote your shares in person, your shares will not be voted. This will have the same effect as a vote against adoption of the merger agreement.

Q: Can I attend the special meeting and vote my shares in person?

A: Yes. Although the Danvers board of directors requests that you return the proxy card accompanying this proxy statement/prospectus, all Danvers stockholders are invited to attend the special meeting. Stockholders of record on [ ], 2011 can vote in person at the special meeting. If your shares are held in street name, you must obtain a proxy from the record holder to vote your shares in person at the special meeting.

Q: Can I change my vote after I have submitted my signed proxy card?

A: Yes. You can change your vote at any time after you have submitted your proxy card and before your proxy is voted at the special meeting.

You may deliver a written notice bearing a date later than the date of your proxy card to the secretary of Danvers, stating that you revoke your proxy.

You may sign and deliver to the secretary of Danvers a new proxy card relating to the same shares and bearing a later date.

You may properly cast a new vote through the Internet or by telephone at any time before the closure of the Internet and telephone voting facilities.

You may attend the special meeting and vote in person, although attendance at the special meeting will not, by itself, revoke a proxy.

You should send any notice of revocation or your completed new proxy card, as the case may be, to Danvers at the following address:

Danvers Bancorp, Inc.

One Conant Square

Danvers, Massachusetts 01923

Attn: Michael W. McCurdy, Secretary

If you have instructed a bank, broker or other nominee to vote your shares, you must follow the directions you receive from your bank, broker or other nominee to change your voting instructions.

Q: What happens if I sell my shares after the record date but before the special meeting?

A: The record date of the special meeting is earlier than the date of the special meeting and the date that the merger is expected to be completed. If you sell or otherwise transfer your Danvers shares after the record date but before the date of the special meeting, you will retain your right to vote at the special meeting (provided that such shares remain outstanding on the date of the special meeting), but you will not have the right to receive the merger consideration to be received by Danvers stockholders in the merger. In order to receive the merger consideration, you must hold your shares through completion of the merger.

Q: What do I do if I receive more than one proxy statement/prospectus or set of voting instructions?

A: If you hold shares directly as a record holder and also in street name or otherwise through a nominee, you may receive more than one proxy statement/prospectus and/or set of voting instructions relating to the special meeting. These should each be voted and/or returned separately in order to ensure that all of your shares are voted.

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Q: How do I make an election as to the form of merger consideration I wish to receive?

A: If you wish to elect the type of merger consideration you receive in the merger, you should carefully review and follow the instructions set forth in the form of election, which is being separately mailed to Danvers stockholders following the mailing of this proxy statement/prospectus. You will need to properly complete, sign and date the form of election and transmittal materials and return them to the exchange agent, Mellon Investor Services LLC, at the address given in the materials, prior to the election deadline. If your shares of Danvers common stock are represented by certificates, those certificates will need to be returned along with your completed election form. The election deadline will be the later of the date of the Danvers special meeting and the date that Danvers and People s United believe to be as near as practicable to five business days prior to the anticipated date for the completion of the merger, although this may change if agreed to by People s United and Danvers. People s United will issue a press release announcing the election deadline. If you do not submit a properly completed and signed form of election to the exchange agent by the election deadline, you will have no control over the type of merger consideration you may receive and, consequently, may receive only cash, only People s United common stock or a combination of cash and People s United common stock in the merger. If you hold shares in street name, you must follow your broker s instructions to make an election.

Q: Can I elect to receive cash consideration with respect to a portion of my Danvers shares and People s United common stock with respect to the rest of my Danvers shares?

A: Yes. A Danvers stockholder may specify different elections with respect to different shares that such stockholder holds. For example, a Danvers stockholder who owns 100 shares of Danvers common stock may make a cash election with respect to 50 shares and a stock election with respect to the other 50 shares.

Q: Are Danvers stockholders entitled to seek appraisal or dissenters rights if they do not vote in favor of the adoption of the merger agreement?

A: Yes. Under Delaware law, holders of shares of Danvers common stock that meet certain requirements will have the right to dissent from the merger and obtain payment in cash for the fair value of their shares of Danvers common stock, as determined by the Delaware Court of Chancery, rather than the merger consideration. To exercise appraisal rights, Danvers stockholders must strictly follow the procedures prescribed by Delaware law. These procedures are summarized under the section entitled The Merger Appraisal Rights beginning on page 66. In addition, the text of the applicable appraisal rights provisions of Delaware law is included as Annex C to this proxy statement/prospectus.

Q: Should I send in my stock certificates now?

A: No. You will receive a form on which you can elect the type of consideration you would prefer to receive as a result of the merger, which will include instructions for surrendering your stock certificates in order to make an effective election. If you do not surrender your stock certificates as part of the election process, then after the merger is complete you will receive separate written instructions for surrendering your shares of Danvers common stock in exchange for the merger consideration. In the meantime, you should retain your stock certificates because they are still valid. Please do not send in your stock certificates with your proxy card.

Q: Where can I find more information about the companies?

A: You can find more information about People s United and Danvers from the various sources described under Where You Can Find More Information beginning on page 97.

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Q: Will a proxy solicitor be used?

A: Yes. Danvers has engaged Phoenix Advisory Partners to assist in the solicitation of proxies for the special meeting and Danvers estimates it will pay Phoenix Advisory Partners a fee of approximately $7,500. Danvers has also agreed to reimburse Phoenix Advisory Partners for reasonable out-of-pocket expenses and disbursements incurred in connection with the proxy solicitation and to indemnify Phoenix Advisory Partners against certain losses, costs and expenses. In addition, Danvers officers and employees may request the return of proxies by telephone or in person, but no additional compensation will be paid to them.

Q: Whom should I call with questions?

A: You may contact People s United or Danvers at the telephone numbers listed under Where You Can Find More Information on page 97. In each case, please ask to speak with the persons identified in that section. You may also contact Phoenix Advisory Partners toll free at (800) 576-4314.

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SELECTED HISTORICAL FINANCIAL DATA OF PEOPLE S UNITED

People s United is providing the following information to aid you in your analysis of the financial aspects of the merger. People s United derived the financial information as of and for the fiscal years ended December 31, 2007 through December 31, 2010 from its historical audited financial statements for these fiscal years. People s United derived the financial information as of and for the fiscal year ended December 31, 2006 from the historical audited financial statements of People s United Bank for that fiscal year.

On November 30, 2010, People s United completed its acquisitions of LSB Corporation and of Smithtown Bancorp, Inc. LSB Corporation was the holding company for River Bank, a savings bank headquartered in North Andover, Massachusetts. Smithtown Bancorp, Inc. was the holding company for Bank of Smithtown, a commercial bank headquartered in Smithtown, New York. In connection with the acquisition of LSB Corporation, People s United acquired total assets of approximately $837 million and assumed total deposits of approximately $475 million. In connection with the acquisition of Smithtown Bancorp, Inc., People s United acquired total assets of approximately $2.3 billion and assumed total deposits of approximately $1.8 billion. The assets acquired and liabilities assumed in these transactions were recorded by People s United at their estimated fair values as of the closing date and People s United s results of operations for the year ended December 31, 2010 include the results of LSB Corporation and Smithtown Bancorp, Inc. beginning with the closing date.

On April 16, 2010, People s United Bank entered into a definitive purchase and assumption agreement with the Federal Deposit Insurance Corporation pursuant to which People s United Bank assumed all of the deposits, certain assets and the banking operations of Butler Bank, located in Lowell, Massachusetts. The transaction resulted in the acquisition of approximately $244 million in total assets and approximately $227 million in total deposits. The assets acquired and liabilities assumed were recorded by People s United at their estimated fair values as of the closing date and People s United s results of operations for the year ended December 31, 2010 include the results of Butler Bank beginning with the closing date.

On February 19, 2010, People s United completed its acquisition of Financial Federal Corporation, a financial services company providing collateralized lending, financing and leasing services nationwide to small and medium sized businesses. In connection with the acquisition of Financial Federal Corporation, People s United acquired total assets of $1.52 billion and assumed total liabilities of $825 million. The assets acquired and liabilities assumed were recorded by People s United at their estimated fair values as of the closing date and People s United s results of operations for the year ended December 31, 2010 include the results of Financial Federal Corporation beginning with the closing date.

This information is only a summary, and you should read it in conjunction with People s United s consolidated financial statements and the related notes contained in People s United s periodic reports filed with the Securities and Exchange Commission that have been incorporated by reference in this proxy statement/prospectus. See Where You Can Find More Information beginning on page 97.

	As of and for the Fiscal Year Ended December 31,				
	2010	2009	2008	2007	2006
(in millions, except per share data)					
Selected Financial Condition Data:					
Total assets	$ 25,037	$ 21,257	$ 20,168	$ 13,555	$ 10,687
Loans	17,518	14,234	14,566	8,950	9,372
Securities	3,033	902	1,902	61	77
Short-term investments(1)	1,120	3,492	1,139	3,516	225
Allowance for loan losses	173	173	158	73	74
Goodwill and other acquisition-related intangibles	1,962	1,515	1,536	104	105
Deposits	17,933	15,446	14,269	8,881	9,083
Borrowings	1,011	159	188		4
Subordinated notes and debentures	182	182	181	65	65
Stockholders equity	5,219	5,101	5,174	4,445	1,340
Non-performing assets(2)	303	206	94	26	23

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(in millions, except per share data)	As of and for the Fiscal Year Ended December 31, 2010	2009	2008	2007	2006
Financial Results:					
Net interest income FTE[3]	$ 702.3	$ 580.2	$ 640.3	$ 486.6	$ 382.4
Provision for loan losses	60.0	57.0	26.2	8.0	3.4
Net security gains (losses)	(1.0)	22.0	8.3	5.5	(27.2)
All other non-interest income	300.2	287.1	295.3	179.9	174.6
Non-interest expense[4]	811.2	684.6	709.0	439.3	346.9
Income from continuing operations	85.7	101.2	137.8	149.2	121.7
Net income	85.7	101.2	137.8	150.7	124.0
Selected Financial Ratios And Other Data:					
Performance Ratios:					
Return on average assets[5]	0.39%	0.49%	0.68%	1.18	
Diluted net income (loss) per share (1)	$ 0.18	$ 0.02	$ (0.07)	$ (0.42)	$ (0.11)
Shares used in diluted net income (loss) per share calculation (1)	63,269	65,202	60,766	60,141	59,299

	December 31, 2005	2004	2003	2002	2001
			(in thousands)		
Consolidated Balance Sheet Data:					
Cash, cash equivalents and short-term investments	$ 54,397	$ 47,273	$ 45,439	$ 44,867	$ 39,807
Working capital	38,889	30,362	27,085	29,874	28,143
Total assets	111,581	105,455	101,406	108,436	117,391
Long-term liabilities, less current portion	10,996	14,325	15,453	17,754	2,080
Stockholders equity	55,368	46,945	45,181	48,423	71,077

(1) See Note 1 of Notes to the Consolidated Financial Statements for an explanation of the method used to determine the number of shares used in computing net income (loss) per share.

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Management s Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the other sections of this annual report on Form 10-K, including Business , Selected Financial Data , and Financial Statements and Supplementary Data. This MD&A contains a number of forward-looking statements, all of which are based on our current expectations, beliefs and strategies and could be affected by the uncertainties and risk factors described throughout this filing and particularly in the Risk Factors section

Our actual results may differ materially from those indicated in such forward-looking statements. See Risk Factors and Special Note Regarding Forward-Looking Statements in this Report on Form 10-K and the risks discussed in other reports filed by us from time to time with the Securities and Exchange Commission.

Overview

We are a leading provider of an Enterprise Reporting Application Platform, a unified software platform that enables large organizations and packaged application software vendors to develop and deploy self-service, customer and employee-facing Enterprise Reporting Applications. Enterprise Reporting Applications are intuitive, Web portal-like reporting applications that empower 100% of users with decision-making information. Our Actuate 8 product line provides a platform upon which Global 9000 organizations (companies with annual revenues greater than $1 billion) and packaged application software vendors develop and deploy mission-critical Enterprise Reporting Applications. These applications retrieve business information from corporate databases and deliver it as interactive Web pages, Excel spreadsheets, and analytic cubes to customers, partners and employees around the globe. Our products and services are used by our customers to develop and deploy Enterprise Reporting Applications across a range of business functions including financial management, sales management, account management, and customer self-service.

We began shipping our first product in January 1996. We sell software products through two primary means: (i) directly to end-user customers through our direct sales force and (ii) through indirect channel partners such as OEMs, resellers and system integrators. OEMs generally integrate our products with their applications and either provide hosting services or resell them with their products. Our other indirect channel partners resell our software products to end-user customers. Our revenues are derived from license fees for software products and fees for services relating to such products, including software maintenance and support, consulting and training.

Our total revenues for fiscal year 2005 were $106.4 million, which were slightly higher than our prior fiscal year revenues of $104.7 million. License revenues decreased by 13% from $42.7 million in fiscal 2004 to $36.9 million in fiscal year 2005. The decrease in license revenues was more than offset by growth in services revenues, which grew approximately 12% from $62.0 million in fiscal 2004 to $69.5 million in fiscal year 2005. This growth was primarily due to increases in maintenance pricing and the installed base of customers receiving ongoing maintenance and support.

For fiscal year 2005, net income was $11.6 million or $0.18 per diluted share compared with net income of $1.3 million or $0.02 per share in fiscal year 2004. The improvement in profitability was primarily due to lower expenses in fiscal year 2005 compared to fiscal year 2004. From fiscal year 2004 to fiscal year 2005, total costs and expenses decreased by $9.4 million. The main factor contributing to this decrease was our restructuring in the fourth quarter of 2004. This restructuring resulted in higher charges in fiscal year 2004, and lower expenses in 2005 as a result of lower headcount. In fiscal year 2004, provision for income taxes was $0.9 million compared to $2.4 million in fiscal year 2005.

North American total revenues decreased by approximately 1%, from $82.3 million in fiscal year 2004 to $81.2 million in fiscal year 2005, while revenues from our international regions increased 12% from $22.4

million in fiscal year 2004 to $25.2 million in fiscal year 2005. To date, we have sold our products internationally primarily through our subsidiaries in Europe and Asia/Pacific. During fiscal year 2005, we derived 24% of our total revenues from sales outside of North America while 21% of our total revenues were derived from sales outside North America in fiscal year 2004.

During fiscal year 2005, three trends continued to have significant impact on results of our operations. First, as an enterprise software vendor, we experienced a weak corporate spending environment for Enterprise Reporting Applications. We currently believe that corporate IT budgets will grow only modestly in 2006. Second, we continued to witness corporations consolidating their business intelligence and Enterprise Reporting Software purchases into fewer suppliers. Corporations were reluctant to buy software from new vendors. This impacted our ability to acquire as many new Global 9000 customers as planned. Finally, we continued to experience vigorous competition in the Enterprise Reporting market. The existence of this competitive environment required additional sales and marketing efforts to differentiate our products, which resulted in extended sales cycles. We believe that competition in the Enterprise Reporting market will continue to be vigorous in 2006.

During 2004, we announced four strategic initiatives to help improve the sale of our software products in the future. These initiatives are as follows:

Selling to IT Management We intend to re-focus our sales efforts on selling our products to IT managers who we believe generally recognize the technical advantages of our products. We hope this initiative will result in increased license revenue in the short term.

Solution Selling to Line-of-Business Management We are creating software solutions to market to line-of-business managers. These solutions are in the areas of financial management and customer self service reporting. We hope this initiative will result in increased license revenue over the medium-to-long term.

Investing in the Business Intelligence Reporting Tool (BIRT) We are continuing to make a significant investment in creating a new open source code reporting tool, known as BIRT. We hope that BIRT will eventually become widely adopted by Java developers and will create demand for our other commercially available products. The BIRT project is a long-term initiative.

Selling to Global 9000 Corporations in the Financial Services Sector We intend to continue focusing on selling our products to Global 9000 financial services companies in an effort to increase our substantive market share in this sector.

During 2005 we continued to pursue these initiatives started in 2004 and we will continue to do so in 2006. We have added the following strategic initiative resulting from our acquisition of performancesoft:

Delivering a highly differentiated Performance Management offering We intend to combine performancesoft s leading Performance Management applications and Actuate s Enterprise Reporting Application platform to provide capabilities for distributing accountability throughout the enterprise. We hope this initiative will result in increased license revenue in the short-to-medium term.

As of December 31, 2005, we had 491 full-time employees, a net increase of 11 employees, or 2%, in our workforce reported as of December 31, 2004. We expect our headcount to grow considerably in 2006 with the inclusion of the personnel from performancesoft, which was acquired in January 2006.

In the first quarter of 2004 we recognized $586,000 in severance, benefit and related legal costs when we initiated a restructuring of our international sales operation to size the operation to meet the expected business and economic environment for our products in overseas markets. This restructuring resulted in a workforce reduction of five people. In the fourth quarter of 2004, we implemented a second restructuring program. This was to further align our cost structure with future revenue expectations. The restructuring plan reduced our operating

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expenses considerably in 2005. Statement of Financial Accounting Standards (SFAS) No. 146, Accounting for Costs Associated with Exit or Disposal Activities requires the recognition of costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. Therefore, only a portion of the costs associated with this restructuring were reflected in our results of operations for the fourth quarter of 2004. The total amount of these costs expensed during the fourth quarter of 2004 was approximately $1.4 million. Under this restructuring program, we recognized additional restructuring expenses of approximately $665,000 in fiscal year 2005. These costs were related to the restructuring of our international sales operation and primarily consisted of charges related to employee matters, estimated settlement costs stemming from employee litigation and idle facilities. According to SFAS 146, in order to record the costs related to an idle facility, we must first cease use of the facility. We ceased use of this facility in the first quarter of fiscal year 2005.

We have a limited ability to forecast future revenues and expenses, thus the prediction of future operating results is difficult and unreliable. In addition, historical growth rates in our revenues and earnings should not be considered indicative of future revenue or earnings growth rates or operating results. There can be no assurance that any of our business strategies will be successful or that we will be able to achieve and maintain profitability on a quarterly or annual basis. It is likely that in some future quarter our operating results will be below the expectations of public market analysts and investors, and in such event the price of our common stock could decline.

Critical Accounting Policies and Estimates

General. Discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent liabilities. On a regular basis, we evaluate estimates, including those related to bad debts, income taxes, restructuring, and litigation. Estimates are based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue Recognition. We generate revenues from sales of software licenses and related services. We receive software license revenues from licensing our products directly to end-users and indirectly through resellers, system integrators and original equipment manufacturers (OEMs). We receive service revenues from maintenance contracts, consulting services and training that we perform for customers.

We recognize revenues in accordance with AICPA Statement of Position (SOP) 97-2 (SOP 97-2), *Software Revenue Recognition,* as amended and modified by SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions.* For sales to end-user customers, we recognize license revenues when a license agreement has been signed by both parties or a definitive purchase order has been received from the customer, the product has been shipped, there are no unusual uncertainties surrounding the product acceptance, the fees are fixed or determinable, collectibility is probable and vendor-specific objective evidence of fair value exists to allocate the fee to the undelivered elements of the arrangement. Vendor-specific objective evidence is based on the price charged when an element is sold separately. We have not established vendor specific objective evidence of fair value for license fees. Therefore, we recognize revenues from arrangements with multiple elements involving software licenses under the residual method. If the license agreement contains payment terms that would indicate that the fee is not fixed or determinable, such as extended payments due beyond the Company s normal practice, revenues are recognized as the payments become due and payable, assuming that all other revenue recognition criteria are met.

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We enter into reseller and distributor arrangements that typically give such distributors and resellers the right to distribute our products to end-users headquartered in specified territories. We recognize license revenues from arrangements with U.S. resellers and distributors when there is persuasive evidence of an arrangement with the reseller or distributor, the product has been shipped, the fees are fixed or determinable and collectiblity is probable. We recognize license fee revenues from arrangements with international resellers and distributors upon receipt of evidence of sell-through and when all other revenue recognition criteria have been met. If it is not practical to obtain evidence of sell-through, we defer revenues until the end-user has been identified and cash has been received. In some instances there is a timing difference between when our reseller completes its sale to the end-user and the period in which we receive the documentation required for revenue recognition. Because we delay revenue recognition until the required documentation is obtained, we may recognize revenue in a period subsequent to the period in which the reseller completes the sale to its end-user.

We also enter into OEM arrangements that provide for license fees based on the bundling or embedding of our products with the OEMs products. These arrangements generally provide for fixed, irrevocable royalty payments. We recognize license fee revenues from U.S. OEM arrangements when a license agreement has been signed by both parties, the product has been shipped, there are no unusual uncertainties surrounding the product acceptance, the fees are fixed or determinable, collectibility is probable and vendor-specific objective evidence of fair value exists to allocate the fee to the undelivered elements of the arrangement. For sales through international OEMs, we defer revenue until we receive a royalty report or other evidence of sell-through from such OEM assuming all other revenue recognition criteria have been met. As discussed above, there may be a timing difference between the period in which our OEM completes the sale to its end-user, and the period in which we recognize the revenue.

Credit-worthiness and collectibility for end-users are assessed based on payment history and current credit profile. When a customer is not deemed credit-worthy, revenues are deferred and recognized upon cash receipt.

We recognize maintenance revenues, which consist of fees for ongoing support and unspecified product updates, ratably over the term of the contract, which is typically one year. Consulting revenues are primarily related to implementation and configuration and are typically charged on a time and materials basis. Training revenues are generated from classes offered at our headquarters and customer locations. Revenues from consulting and training services are recognized as the services are performed. When a contract includes both license and service elements, the license fee is recognized on delivery of the software and when all other revenue recognition criteria are met, provided services do not include significant customization or modification of the product and are not otherwise essential to the functionality of the software.

Allowance for Doubtful Accounts. Our accounts receivable is subject to collection risks. Our gross accounts receivable is reserved against this risk through an allowance for doubtful accounts. This allowance is for estimated losses resulting from the inability of our customers to make required payments. It is a significant estimate and is regularly evaluated by us for adequacy by taking into consideration a combination of factors. We look at factors such as past experience, credit quality of the customer, age of the receivable balance, and current economic conditions. These factors are reviewed to determine whether a specific reserve for bad debt should be recorded to reduce the related receivable to the amount believed to be collectible. We also specifically reserve for all outstanding domestic consulting, training, and maintenance renewal invoices which are older than a specified number of months past due.

We also record unspecified reserves for bad debt for all other customers based on a variety of factors, including length of time the receivables are past due and historical experience. A reserve percentage is applied to various aged categories of receivables based on historical experience to determine how much of an unspecified reserve is needed. The use of different estimates or assumptions could produce different allowance balances. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances might be required.

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Income Taxes. We make certain estimates and judgments in the calculation of tax liabilities and the determination of net deferred tax assets, which arise from temporary differences between tax and financial statement recognition methods. Significant changes to these estimates may result in an increase or decrease to our tax provision in a subsequent period.

Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (SFAS 109), also requires that the deferred tax assets be reduced by a valuation allowance, if based on the weight of available evidence, it is more likely than not that some portion or all of the recorded deferred tax assets will not be realized in future periods. In evaluating our ability to recover our deferred tax assets, in full or in part, we consider all available positive and negative evidence, including our past operating results, the existence of cumulative losses in the most recent fiscal years and our forecast of future taxable income on a jurisdiction by jurisdiction basis. In determining future taxable income, we are responsible for assumptions utilized including the amount of state, federal and international pre-tax operating income, the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require significant judgment about the forecasts of future taxable income and are consistent with the plans and estimates we are using to manage the underlying businesses. Based on all the available evidence we believe that the deferred tax assets recorded on our balance sheet may not be realized. As a result a valuation allowance is recorded to reduce deferred tax assets to the amount that is more likely than not to be realized.

While we have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for and amount of the valuation allowance, in the event we were to determine that we would be able to realize our deferred tax assets in the future in excess of our net recorded amount, an adjustment to the deferred tax asset would increase income or reduce loss, reduce goodwill or intangibles or increase shareholder s equity in the period such determination was made. Likewise, if we were to determine that we would not be able to realize all or part of our net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made. Due to the current economic environment, increased competition, a history of net losses, and our uncertainty in projecting future taxable income, we have determined that we can no longer rely on projections of future taxable income to support the realization of our deferred tax assets. A valuation allowance has, therefore, been recorded in fiscal year 2005 to reduce deferred tax assets to zero, except for $129,000 of deferred tax assets recorded in the United Kingdom.

Contingencies. We are or have been engaged in legal actions arising in the ordinary course of business. We are required to assess the likelihood of any adverse judgments or outcomes to these matters as well as potential ranges of probable losses. A determination of the amount of reserves required, if any, for these contingencies are made after careful analysis of each individual matter. The required reserves may change in the future due to new developments in each matter or changes in approach, such as a change in litigation or settlement strategy for a particular matter.

Accrual for Restructuring Charges. During the fiscal years ended December 31, 2004 and 2002, we implemented certain restructuring plans that were a combination of reductions in workforce, exits of idle facilities and write-offs of fixed assets. The restructuring charges were based on actual and estimated costs incurred in connection with these restructuring plans. These estimates were impacted by the rules governing the termination of employees, especially those in foreign countries. In fiscal year 2002, we recorded a facility restructuring charge, which consisted of estimated future obligations for the non-cancelable lease payments and estimated costs associated with subleasing the property. We reduced the amount of the facility restructuring charge by the estimated amount of sublease income. The assumptions we made, which we periodically re-evaluate and adjust as appropriate, are based on estimates of such factors as future vacancy rates, the time required to sublease the property and sublease rates. These market conditions can fluctuate greatly due to such factors as changes in property occupancy rates and the rental prices charged for comparable properties. These changes could materially affect our accrual. If, in future periods, it is determined that we have over-accrued for restructuring charges for exiting the idle facilities, the reversal of such over-accrual would have a favorable impact on our financial statements in the period this was determined and would be recorded as a credit to

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restructuring charges. Conversely, if it is determined that our accrual is insufficient, an additional restructuring charge would be recorded and would have an unfavorable impact on our financial statements in the period this was determined.

Valuation of Goodwill and Other Purchased Intangible Assets. We evaluate our intangible assets for indications of impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Intangible assets consist of purchased technology, customer lists, non-compete agreements, experienced workforce, and trademarks. Factors that could trigger an impairment review include significant under-performance relative to expected historical or projected future operating results, significant changes in the manner of our use of the acquired assets, or the strategy for our overall business or significant negative industry or economic trends. If this evaluation indicates that the value of the intangible asset may be impaired, we make an assessment of the recoverability of the net carrying value of the asset over its remaining useful life. If the assessment indicates that the intangible asset is not recoverable, we will reduce the net carrying value of the related intangible asset to fair value and may adjust the remaining amortization period. Any such impairment charge could be significant and could have a material adverse effect on our reported financial statements. As of December 31, 2005 the net carrying amount of our intangible assets was $1.2 million.

We evaluate goodwill at least annually for indications of impairment based on our fair value as determined by our market capitalization in accordance with Statement of Financial Standards No. 142 (SFAS 142), Goodwill and Other Intangible Assets . If this evaluation indicates that the value of the goodwill may be impaired, we make an assessment of the impairment of the goodwill using the two-step method prescribed by SFAS 142. Any such impairment charge could be significant and could have a material adverse effect on our reported financial statements.

Valuation of Minority Interest in Actuate Japan. The minority shareholders of Actuate Japan have the option to put their equity interest (Minority Interest) in Actuate Japan and we have the option to call the Minority Interest for approximately $756,000 as of December 31, 2005. Our policy is to record a loss, if any, at the time that the put or call is probable of being exercised. Should an indicator arise that the Minority Interest has declined in value below the exercise price of the put and call option, we would conclude that exercise is probable at that point in time and recognize a liability for the intrinsic value of the option. We periodically perform a valuation analysis of the Minority Interest. This valuation analysis includes assumptions regarding projected future cash flows and discount rates. Variances in these assumptions could have a significant impact on our conclusion as to whether a loss is probable and the amount of the loss. As of December 31, 2005, we concluded that a loss was not probable. We consolidate 100% of the operating results and all investments in the subsidiary are eliminated in consolidation.

Recovery of Long-Lived Assets. The Company evaluates the recovery of its long-lived assets periodically by analyzing its operating results and considering significant events or changes in the business environment.

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Results of Operations

The following table sets forth certain consolidated statement of operations data as a percentage of total revenues for the periods indicated:

	Year Ended December 31,		
	2005	2004	2003
Revenues:			
License fees	35%	41%	46%
Services	65	59	54
Total revenues	100	100	100
Costs and expenses:			
Cost of license fees	2	3	3
Cost of services	22	24	22
Sales and marketing	35	40	44
Research and development	16	19	18
General and administrative	12	10	12
Amortization of other intangibles		1	2
Purchased in-process research and development			1
Restructuring charges	1	2	
Total costs and expenses	88	99	102
Income (loss) from operations	12	1	(2)
Interest and other income, net	1	1	1
Income (loss) before income taxes	13	2	(1)
Provision for income taxes	2	1	3
Net income (loss)	11%	1%	(4)%

Revenues

Year Ended December 31,			$ Change	% Change	$ Change	% Change
2005	2004	2003	2004 to 2005		2003 to 2004	
(dollars in thousands)						
$106,401	$104,657	$104,455	$1,744	2%	$202	0%

Our revenues are derived from license fees and services, which include software maintenance and support, consulting, and training. The increase in total revenue for fiscal 2005 compared to fiscal 2004 was due primarily to a 16% or approximately $7.3 million increase in our maintenance revenue due to the impact of an aggressive support renewal pricing structure implemented in fiscal year 2004 and a continued increase in the worldwide installed base of customers receiving ongoing support. These increases were offset by a decrease of approximately 13% or $5.8 million in our license and 2% or $256,000 in our consulting services revenues. We believe these decreases were primarily due to increased competition from other vendors in our market as well as several unusually large license deals signed in fiscal year 2004. The slight increase in total revenues for fiscal 2004 compared to fiscal 2003 was due to an increase of approximately 15% in support and maintenance revenue due to continued increase in worldwide installed base of customers receiving ongoing maintenance and support, offset by decreases of approximately 10% or $4.9 million in license and 4% or $742,000 in consulting services revenues. We believe these decreases were due primarily to increased competition from other vendors in our market.

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License Fees

Year Ended December 31,			$ Change	% Change	$ Change	% Change
2005	2004	2003	2004 to 2005		2003 to 2004	
(dollars in thousands)						
$ 36,939	$42,703	$47,598	$(5,764)	(13)%	$(4,895)	(10)%

The decrease in license revenue, in both percentage and absolute dollar terms for fiscal 2005 compared to fiscal 2004 and for fiscal year 2004 as compared to fiscal year 2003 was primarily seen in our North American region and was primarily due to several interrelated factors, including (i) a continued depressed information technology spending environment for enterprise reporting solutions, (ii) difficulty in securing new customer accounts, (iii) continued competitive pressures, and (iv) fewer significant transactions, each individually in excess of $1.0 million, in fiscal year 2005 compared to fiscal year 2004. The following table represents the changes in license revenue by region:

(dollars in thousands)	Year Ended December 31,			2004 to 2005		2003 to 2004	
	2005	2004	2003	$ Change	% Change	$ Change	% Change
Software License							
North America	$ 26,942	$ 33,552	$ 39,228	$ (6,610)	(20)%	$ (5,676)	(14)%
International	9,997	9,151	8,370	846	9%	781	9%
Total license revenue	**$ 36,939**	**$ 42,703**	**$ 47,598**	**$ (5,764)**	**(13)%**	**$ (4,895)**	**(10)%**
Percentage of total revenue:	35%	41%	46%				

The European region marked the highest growth in license revenue during fiscal year 2005. This was due mainly to a significant agreement with a financial institution during the fourth quarter of fiscal year 2005. The decreases in license revenues in North America over fiscal 2004 were primarily due to less large deals in excess of $1.0 million in fiscal year 2005. In addition, the competitive environment in our market niche continues to contribute to the decrease in domestic license revenues in fiscal 2005 over 2004 year. License revenues derived from our indirect channel partners, including OEMs, systems integrators and resellers, accounted for 37%, 32% and 30% of total revenues from license fees for fiscal years 2005, 2004 and 2003, respectively.

We expect license fees to increase in absolute dollars in fiscal year 2006 primarily as a result of our recent acquisition of performancesoft, inc., which occurred in January 2006.

Maintenance and Service Revenue

Maintenance and services revenue comprised of maintenance and support, professional services, and training. The steady increase in maintenance revenue from fiscal year 2004 to 2005 was mainly attributed to the impact of the Company s change in pricing structure of maintenance renewals introduced in fiscal year 2004, as well as a larger installed base of customers receiving ongoing maintenance and support. Also in fiscal year 2005, the Company benefited from a concerted effort to increase maintenance renewals. In contrast to prior years, in order to increase maintenance renewals, the Company hired additional employees to head the effort of ensuring customers renew their maintenance agreements once the original maintenance contracts expire. This effort was undertaken during the second quarter of fiscal 2004 and resulted in continued increase of maintenance and support revenue in both fiscal years 2004 and 2005. In fiscal 2005 our professional services revenues remained relatively consistent in all geographical regions with the levels experienced in fiscal 2004. We expect maintenance and services revenue to increase in fiscal year 2006 in absolute dollars as our installed base of customers under maintenance continues to grow and as a result of our acquisition of performancesoft, inc. in January 2006.

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Costs and Expenses

Cost of License Fees

Year Ended December 31,			$ Change	% Change	$ Change	% Change
2005	2004	2003	2004 to 2005		2003 to 2004	
(dollars in thousands)						
$ 2,294	$3,417	$3,140	$(1,123)	(33)%	$277	9%

Cost of license fees consists primarily of production costs including printing and packaging, amortization of purchased technologies, third party royalty fees and localization costs. The decrease in cost of license fees in fiscal year 2005 was primarily due to a 13% decrease in software license revenues resulting in approximately $400,000 reductions in third party royalties and $200,000 in production costs. Third party royalties further decreased due to the fact that we are no longer obligated to pay royalties to one of our main vendors as we acquired the rights to the underlying technology outright in the fourth quarter of fiscal year 2005. There was also a reduction of approximately $620,000 in the amortization of purchased technologies. Purchased technologies related to the Tidestone acquisition became fully amortized in the second quarter of fiscal 2005 and accounted for approximately $530,000 of the decrease. The increase in cost of license fees in fiscal year 2004 as compared to fiscal year 2003 was primarily due to a full year amortization of purchased technology as a result of our acquisition of Nimble Technology in fiscal year 2003 resulting in a net increase of $370,000, increased third party royalties of $430,000 offset by a $360,000 decrease in localization costs. We expect our cost of license fees as a percentage of revenues from license fees to gradually increase in future periods primarily as a result of the straight line amortization of purchased technology associated with the acquisition of performancesoft, inc. in January of 2006.

Cost of Services

Year Ended December 31,			$ Change	% Change	$ Change	% Change
2005	2004	2003	2004 to 2005		2003 to 2004	
(dollars in thousands)						
$ 23,723	$24,763	$23,648	$(1,040)	(4)%	$1,115	5%

Cost of services consists primarily of personnel and related costs, facilities costs incurred in providing software maintenance and support, training and consulting services, as well as third-party costs incurred in providing training and consulting services. The decrease in cost of services in absolute dollars in fiscal year 2005 compared to fiscal year 2004 is primarily a result of the decrease in employee compensation and related costs of $1.6 million due to an 8% reduction to our services headcount or approximately 9 heads and reduced facilities cost of approximately $400,000. These decreases were offset by increased third party consulting costs of approximately $1.0 million. Our increase in maintenance and support revenues, combined with a 4% reduction to the overall cost of services, resulted in improved services margins of approximately 6% over fiscal year 2004. The increase in cost of services in absolute dollars in fiscal year 2004 compared to fiscal year 2003 is primarily a result of the increase in service revenue during the year. Although service revenue in absolute dollars increased by $5.1 million over fiscal year 2003, cost of services as a percentage of services revenues decreased from 42% in fiscal year 2003 to 40% in fiscal year 2004. This decrease is due to the fact that the primary driver in the service revenue increase was derived from maintenance and support, which have considerably lower costs associated with them than consulting services. We expect cost of services to increase in fiscal year 2006 in line with the anticipated increase in service revenues associated with our acquisition of performancesoft, inc. in January 2006.

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Sales and Marketing

Year Ended December 31,			$ Change	% Change	$ Change	% Change
2005	2004	2003	2004 to 2005		2003 to 2004	
(dollars in thousands)						
$ 37,070	$41,296	$45,769	$(4,226)	(10)%	$(4,473)	(10)%

Sales and marketing expenses consist primarily of salaries, commissions and bonuses earned by sales and marketing personnel, promotional expenses, travel, entertainment and facility costs. Sales and marketing expenses decreased in fiscal year 2005 as compared to fiscal year 2004 due primarily to a $3.1 million reduction in compensation and associated expenses and a $1.0 million reduction of facilities and equipment charges. This decrease was mainly the result of our restructuring plan that was implemented in the fourth quarter of fiscal year 2004 which resulted in a significant reduction to our international sales operations. Sales and marketing expenses decreased in fiscal year 2004 as compared to fiscal year 2003 due primarily to a reduction of $3.5 million in marketing program expenses and a reduction of $1.1 million in professional and outside consulting services, both as a result of the Company s efforts in fiscal year 2004 to focus on reducing overall marketing expenditures. Sales and marketing expenses also decreased in fiscal year 2004 partially as a result of the restructuring in the fourth quarter of 2005, which resulted in a 24% decrease in headcount as compared to 2003. At the end of fiscal year 2005, we had 156 employees in sales and marketing, compared with 151 and 199 employees at the end of fiscal years 2004 and 2003, respectively. We currently expect our sales and marketing expenses to increase in absolute dollars in fiscal year 2006 primarily due to our recent acquisition of performancesoft, inc. in January of 2006.

Research and Development

Year Ended December 31,			$ Change	% Change	$ Change	% Change
2005	2004	2003	2004 to 2005		2003 to 2004	
(dollars in thousands)						
$ 16,533	$19,847	$18,732	$(3,314)	(17)%	$1,115	6%

Research and development costs are expensed as incurred and consist primarily of personnel and related costs associated with the development of new products, the enhancement of existing products, quality assurance and testing. The decrease in fiscal year 2005 as compared to fiscal year 2004 was primarily attributed to the consolidation of our research and development facilities which resulted in the closure of our office in Seattle, Washington. This closure occurred during the fourth quarter of fiscal year 2004 and resulted in compensation, travel and facilities related savings of approximately $3.2 million in 2005. The increase in fiscal year 2004 was primarily due to costs associated with the opening of our Shanghai research facility totaling approximately $510,000. At the end of fiscal year 2005, we had 130 employees in research and development compared to 126 and 130 employees at the end of fiscal years 2004 and 2003, respectively. We believe that continued investments in technology and product development are essential for us to remain competitive in the markets we serve. We expect research and development expenses to increase in absolute dollars in fiscal year 2006 due to our recent acquisition of performancesoft, inc. in January of 2006.

General and Administrative

Year Ended December 31,	$ Change	% Change	$ Change	% Change

2005	2004	2003	2004 to 2005		2003 to 2004	
(dollars in thousands)						
$ 13,115	$10,856	$12,220	$2,259	21%	$(1,364)	(11)%

General and administrative expenses consist primarily of personnel and related costs in finance, human resources, legal and tax functions, as well as audit and legal fees and bad debt expense. The increase in expenses

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in fiscal year 2005 in absolute dollars was primarily due to a continued increase in professional consulting fees of approximately $1.3 million. This increase was primarily due to costs incurred in early 2005 related to the Company s compliance with the requirements of Section 404 of the Sarbanes-Oxley Act for fiscal year 2004. We also experienced an increase of approximately $500,000 due primarily to a full year of depreciation and capitalized costs related to the implementation of our new accounting system, which was activated in August of fiscal year 2004. Employee compensation and related costs also increased by approximately $400,000 due to the addition of 11 heads or a 13% increase in headcount. The $1.4 million decrease in general and administrative expenses from fiscal year 2003 to fiscal year 2004 was primarily due to a decrease of $2.0 million in legal costs associated with the MicroStrategy litigation, which ended favorably in fiscal year 2004. We also recorded a reversal of sales taxes of $365,000 in the second quarter of fiscal year 2004 due to a favorable outcome on our Board of Equalization audit. In addition, we negotiated a more favorable property and liability insurance premium, which lowered the expense by approximately $260,000 in fiscal year 2004. These decreases were offset by increases in professional consulting fees and internal personnel costs of approximately $1.2 million in fiscal year 2004 as a result of the Company s compliance with the requirements of Section 404 of the Sarbanes-Oxley Act. We expect our general and administrative expenses to increase in absolute dollars for fiscal year 2006. This overall increase will be primarily due to the addition of performancesoft, inc. in the first quarter of 2006. This overall increase will partially be offset by a decrease in professional fees associated with maintaining compliance under the Sarbanes-Oxley Act.

Amortization of Other Intangibles

Year Ended December 31,			**$ Change**	**% Change**	**$ Change**	**% Change**
2005	**2004**	**2003**	**2004 to 2005**		**2003 to 2004**	
			(dollars in thousands)			
$ 487	$1,110	$2,021	$(623)	(56)%	$(911)	(45)%

In accordance with Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (SAFS 142), we discontinued the amortization of goodwill effective January 1, 2002. The provisions of SFAS 142 require an impairment test at least annually, which we completed on October 1, 2003, October 1, 2004 and October 1, 2005. None of these annual impairment tests resulted in an impairment of recorded goodwill.

The decreases in amortization of other purchased intangibles in both absolute dollars and as a percentage of total revenues for fiscal year 2005 as compared to fiscal year 2004 was due to the fact that we fully amortized the other intangibles associated with our acquisitions of Tidestone and Nimble Technology by the second and third quarter of fiscal year 2005, respectively. In addition, during the second quarter of fiscal year 2005, we offset approximately $527,000 of accrued liabilities from our purchase of Nimble Technology against purchased technologies as the contingencies that gave rise to the original accrued liability amounts were settled for an amount lower than originally estimated. As there was no goodwill associated with the Nimble acquisition, the reduction of accrued liabilities resulted in a decrease to unamortized purchased technologies during the second quarter of fiscal year 2005. The net decrease in amortization of other purchased intangible assets in fiscal year 2004 as compared to fiscal year 2003 was primarily due to the customer base related to prior acquisitions in Europe that were fully amortized by the middle of fiscal year 2003. This resulted in a decrease of approximately $1.0 million offset by an increase in the amortization of purchased technology and workforce of $488,000 related to the acquisition of Nimble Technology. We expect the estimated amortization expense of our existing other purchased intangible assets to increase in future periods due to our acquisition of performancesoft, inc. in January of fiscal year 2006.

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Restructuring Charges

Year Ended December 31,			$ Change	% Change	$ Change	% Change
2005	2004	2003	2004 to 2005		2003 to 2004	
(dollars in thousands)						
$ 665	$2,006	$	$(1,341)	(66.8)%	$2,006	N/A

The following discussion should be read in conjunction with the Notes to the Consolidated Financial Statements, which are included in this Form 10-K.

During fiscal year 2002, we recorded a restructuring charge of $27.1 million. This charge consisted of a $24.8 million facility exit charge and $2.3 million in costs related to the reduction of our worldwide workforce.

The facility exit charge was the result of a long-term non-cancelable lease agreement that we entered into during the fourth quarter of fiscal year 2000, in anticipation of a projected business expansion. During the third quarter of fiscal year 2002, we decided to exit this facility. We review our assumptions underlying the idle facilities reserve on a regular basis. During the third quarter of fiscal year 2005, the sublease was extended with the existing tenant. As a result of this extension, some of the assumptions that were previously asserted changed and, accordingly, we revised and lowered the estimated exit costs by approximately $404,000.

During fiscal year 2004, the Company underwent two restructurings. The first occurred in the first quarter of fiscal year 2004 when we initiated a restructuring of our international sales operation. We undertook this restructuring in order to size the operation to meet the expected business and economic environment for our products in international markets and to shift our sales strategy from one based primarily on direct sales to a strategy more focused on indirect sales channels. This restructuring consisted primarily of a workforce reduction and associated legal expenses, which resulted in a headcount reduction of five people and associated severance, benefit and related legal costs of $586,000 during the first quarter of 2004.

In the fourth quarter of 2004, we implemented a second restructuring program. This was to further align our cost structure with future revenue expectations. Under this restructuring program, we recognized restructuring expenses of approximately $1.4 million in the fourth quarter of 2004 and approximately $665,000 in fiscal year 2005. These costs were entirely related to the restructuring of our international sales operation and primarily consisted of charges related to employee matters, estimated settlement costs stemming from employee litigation and idle facilities charges. These costs were partially offset by reductions in an office lease loss accrual due to an early termination of the facility lease. According to Financial Accounting Standards statement No. 146 (SFAS 146) Accounting for Costs Associated with Exit or Disposal Activities , in order to record the costs related to an idle facility, we must first cease use of the facility. We ceased use of this facility in the first quarter of fiscal year 2005.

We are currently in the process of evaluating whether to consolidate any of our facilities as a result of the performancesoft acquisition. If we were to consolidate any of our facilities in fiscal year 2006 it could result in a facility-related restructuring charge.

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The following table summarizes the analysis of the restructuring accrual activity for the fiscal years ended December 31, 2003, 2004 and 2005 (in thousands):

	Severance & Benefits	Facility Related	Total
Balance at December 31, 2002	$ 668	$ 20,195	$ 20,863
Cash payments	(480)	(3,767)	(4,247)
Changes in estimate	(188)	188	
Rents collected on the sublease		646	646
Balance at December 31, 2003		17,262	17,262
Restructuring charges	2,006		2,006
Cash payments	(612)	(3,649)	(4,261)
Changes in estimate	(125)		(125)
Rents collected on the sublease		1,352	1,352
Balance at December 31, 2004	1,269	14,965	16,234
Restructuring charges	744	(79)	665
Cash payments	(1,106)	(4,062)	(5,168)
Changes in estimate	(442)	278	(164)
Rents collected on the sublease		1,266	1,266
	465	12,368	12,833
Less: Current portion	(465)	(2,483)	(2,948)
Balance at December 31, 2005	$	$ 9,885	$ 9,885

Interest and Other Income, Net

Year Ended December 31,			$ Change	% Change	$ Change	% Change
2005	2004	2003	2004 to 2005		2003 to 2004	
(dollars in thousands)						
$ 1,436	$822	$720	$614	75%	$102	14%

Interest and other income, net, are comprised primarily of interest income earned by us on our cash and short-term investments. The increase for fiscal year 2005 compared to fiscal year 2004 was primarily due to improved returns on our cash and investments of $820,000 and currency exchange gains totaling $300,000. These increases were offset by a realized investment loss of $301,000 which we incurred in the second and third quarters of fiscal year 2005, a one-time grant of $138,000 received in the prior year and adjustments of approximately $70,000 in personnel and social taxes by our international subsidiaries. The realized investment loss was associated with our investment in a company that we evaluated during the second quarter of fiscal year 2005. We determined the value to be other than temporarily impaired and, accordingly, reduced the book value from $500,000 to approximately $199,000. In the fourth quarter of fiscal 2005, this company was acquired and we received approximately $170,000 in cash. The remaining balance of approximately $30,000 has not yet been received by Actuate, as it is pending final settlement. The increase in interest and other income, net, in fiscal year 2004 from 2003 was primarily due to improved returns on our cash and investments totaling approximately $650,000 and other gains totaling $175,000 related to currency exchange transactions with our international subsidiaries. We expect interest and other income to decrease slightly in fiscal year 2006 due to the fact that a significant cash outlay was required to close our acquisition of performancesoft, inc. in January 2006.

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Provision for Income Taxes

Year Ended December 31,			$ Change	% Change	$ Change	% Change
2005	2004	2003	2004 to 2005		2003 to 2004	
(dollars in thousands)						
$ 2,359	$886	$3,542	$1,473	166%	$(2,656)	(75)%

The provision for income taxes of $2.4 million, $886,000 and $3.5 million is based on pretax income of $13.9 million, $2.2 million, and pretax losses of $1.0 million in fiscal years 2005, 2004 and 2003, respectively. The provision for income taxes in fiscal years 2005 and 2004 represents primarily federal, state and foreign taxes as adjusted for the impact of operating losses utilized, income tax credits and the reversal of reserves no longer required. The provision for income taxes in fiscal year 2003 represents primarily federal, state and foreign taxes as adjusted for the impact of operating losses not currently utilized, income tax credits, and the write off of deferred tax assets recognized in 2002. The increase in the provision for income taxes in fiscal year 2005 compared to fiscal year 2004 was primarily due to higher pre-tax book income. The higher pre-tax book income along with the utilization of net operating loss carry forwards reduced the effective tax rate from 40.5% to 16.9%. The decrease in the provision for income taxes in fiscal year 2004 compared to fiscal year 2003 was primarily due to a $3.0 million increase in 2003 in the valuation allowance for deferred tax assets that did not occur in 2004.

We have determined that, based on a number of factors discussed below, as of December 31, 2005, no deferred tax assets should be recognized. A valuation allowance has, therefore, been recorded to reduce deferred tax assets to zero except for $129,000 of deferred tax assets recorded in the United Kingdom. We have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for and amount of the valuation allowance. In the event we were to determine that we would be able to realize our deferred tax assets in the future in excess of our net recorded amount, an adjustment to the deferred tax assets would increase income or reduce loss, reduce goodwill or intangibles or increase shareholder s equity in the period such determination was made. Likewise, should we determine that we would not be able to realize all or part of our net deferred tax assets in the future, an adjustment to the deferred tax assets would be charged to income in the period such determination was made. Due to the current economic environment, increased competition, a history of net losses, and our uncertainty in projecting future taxable income, we have determined that we can no longer rely on projections of future taxable income to support the realization of our deferred tax assets. During the year ended December 31, 2005, we recorded a $1.9 million decrease to the valuation allowance related to the deferred tax benefit utilized in the current year. We will continue to assess our ability to realize the tax benefits available to us based on actual and forecasted results.

On October 22, 2004, the American Jobs Creation Act of 2004 (Jobs Act) was enacted. Among other provisions, the Jobs Act provides for a deduction for income from qualified domestic production activities phased in from 2005 to 2010, and a temporary incentive for U.S. corporations to repatriate accumulated income earned abroad. We have not and do not plan to repatriate foreign earnings under the Jobs Act and have determined the impact of the deduction for domestic production activities. Such deduction was first available to the Company in 2005. The deduction does not have an impact on our provision for income taxes due to the net operating losses utilized.

Liquidity and Capital Resources

Our sources of cash, cash equivalents and short-term investments are funds generated from our business operations and funds that may be drawn down under our credit facility.

As of December 31, 2005, cash, cash equivalents and short-term investments were $54.4 million, compared to $47.3 million as of December 31, 2004.

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Cash generated by operations was $13.3 million for the year ended December 31, 2005 compared to $4.9 million for the same period in fiscal 2004. This increase largely resulted from (i) an increase in net income primarily due to lowered operating expenses derived from our restructuring plan implemented in the fourth quarter of fiscal year 2004; (ii) increased deferred revenue balances; and (iii) a smaller increase in the accounts receivable balance when compared to fiscal year 2004. Accounts receivable, net of allowances, increased $2.0 million, or 8%, to $26.8 million as of December 31, 2005 from $24.8 million as of December 31, 2004. Days sales outstanding (DSO), calculated based on revenue for the most recent quarter and accounts receivable as of the balance sheet date, increased to 85 days as of December 31, 2005 from 83 days as of December 31, 2004. The slight increase in DSO and accounts receivable is attributable to several factors, including unusually high billings in the last month of the quarter as a percentage of total billings for the quarter. These increases were offset by a decrease of $3.4 million in restructuring related liabilities, and decreases of $1.9 million to satisfy other accrued liabilities in fiscal 2005.

Net cash provided by operations was $4.9 million during fiscal year 2004, compared to $4.3 million in fiscal year 2003, an increase of $600,000. Net cash provided by operating activities increased primarily due to (i) generation of net income of $1.3 million in fiscal year 2004 as compared to a net loss of $4.5 million in 2003; and (ii) reduced payments related to restructuring. This was mostly due to an increase in sublease income that directly off-set the restructuring liability reserves during fiscal year 2004. This increase was offset by a higher accounts receivable balance at December 31, 2004.

Accounts receivable, net of allowances, increased by $4.6 million or 23% to $24.8 million as of December 31, 2004 from $20.2 million as of December 31, 2003. Days sales outstanding (DSO), calculated based on revenue for the most recent quarter and accounts receivable as of the balance sheet date increased from 68 days at December 31, 2003 to 83 days at December 31, 2004. This high DSO number was the result of several factors, including unusually high billings in the last month of the quarter as a percentage of total billings for the quarter.

Cash used in investing activities was $2.9 million for the year ended December 31, 2005 compared to $3.1 million used for the same period in fiscal 2004. Cash used in investing activities remained relatively constant as purchases of property and equipment were unusually high in fiscal year 2004 due to the implementation of a new enterprise-wide accounting software application. This was offset by an increase in purchases of short-term investments and a payment to a minority shareholder as a result of their exercise of a put option in fiscal year 2005.

Cash used in investing activities was $3.1 million in fiscal 2004 compared to $6.4 million used in fiscal 2003. This decrease in fiscal year 2004 was primarily due to the acquisition of Nimble Technology in July of fiscal year 2003 offset by increase in payments associated with purchase of property and equipment in fiscal year 2004 which were due to the implementation of our new enterprise-wide accounting software application.

Cash used in financing activities was $5.1 million for the year ended December 31, 2005 compared to $318,000 used in fiscal 2004, a change of $4.8 million. This increase in cash used was primarily the result of lower proceeds from the issuance of common stock in fiscal year 2005, offset by increased level of stock repurchases. In fiscal year 2005, we spent approximately $7.1 million in cash to repurchase approximately 3.0 million shares of common stock in the open market.

Net cash used in financing activities was $318,000 in fiscal year 2004 compared to net cash provided by financing activities of $1.1 million in fiscal year 2003, a change of $1.4 million. This decrease was primarily the result of lower proceeds from the issuance of common stock in 2004, offset by a lower level of stock repurchases in 2004. For fiscal year 2004, we spent $2.7 million in cash to repurchase approximately 824,000 shares of our common stock in the open market. This was partially offset by proceeds derived from the issuance of common stock under our employee stock purchase and stock option plans which totaled approximately $2.4 million in fiscal year 2004. In fiscal year 2003, net cash provided by financing activities were primarily due from proceeds

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derived from the issuance of common stock under our employee stock purchase and stock option plans totaling $4.1 million, partially offset by the repurchase of shares of our common stock. In fiscal year 2003, we spent approximately $3.0 million in cash to repurchase approximately 1.0 million shares of common stock in the open market.

	Year ended December 31,		
	2005	2004	2003
	(In thousands, except share data)		
Number of shares repurchased	3,002,731	824,300	1,040,817
Cost of shares repurchased	$ 7,078	$ 2,690	$ 2,964

We believe that our current cash balances and cash generated from operations will be sufficient to meet our working capital and capital expenditures requirements for at least the next twelve months. Thereafter, if cash generated from operations is insufficient to satisfy our liquidity requirements, we may find it necessary to sell additional equity, draw down under our existing credit facility or obtain additional credit facilities. The sale of additional equity could result in additional dilution to our current stockholders. A portion of our cash may be used to acquire or invest in complementary businesses, including the acquisition of the minority interest in our 78% owned subsidiary in Japan, or complementary products or to obtain the right to use complementary technologies.

In February 2006, a minority shareholder of Actuate Japan notified us that it wishes to exercise its rights to put its equity interest in Actuate Japan. We anticipate that we will pay approximately $350,000 for this interest during the first quarter of 2006.

In January 2006 we paid approximately $16.5 million in cash to acquire all of the outstanding equity of performancesoft. Under the performancesoft acquisition agreement, we are obligated to pay up to $13.5 million in additional consideration to the shareholders of performancesoft based on the gross revenue of performancesoft (determined in accordance with U.S. GAAP) during the period beginning on January 5, 2006 and ending on December 31, 2006. No additional consideration is payable if performancesoft does not meet specific minimum gross revenue thresholds or if a specific operating margin target is not satisfied. The exact amount of any such additional consideration is dependent on the amount of gross revenue for performancesoft reflected in our consolidated financial statements for 2006, and is subject to adjustment if specified operating expense targets are exceeded. Any such additional consideration is required to be paid by Actuate on or prior to February 28, 2007.

Under the Company s stock repurchase program, the Company is authorized to repurchase Actuate common stock in an amount not to exceed cash flow from operations during the prior quarter, with the actual amount to be approved in advance by the Board. From the end of the fiscal year through February 14, 2006, the Company has repurchased a total of 289,000 shares for a total of approximately $989,000 in the open market under this stock repurchase plan.

Contractual Obligations and Commercial Commitments.

The following table summarizes our contractual obligations as of December 31, 2005 (in thousands):

	Total	Less than 1 year	1 3 years	3 5 years	Thereafter
Lease obligations:					
Operating lease (1)	$ 20,855	$ 5,255	$ 8,056	$ 6,064	$ 1,480
Purchase obligations (2)	2,426	2,426			
Total commitments	23,281	7,681	8,056	6,064	1,480
Other liabilities (3)	1,000	1,000			
Total	**$ 24,281**	**$ 8,681**	**$ 8,056**	**$ 6,064**	**$ 1,480**

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(1) Our future contractual obligations include minimum lease payments under operating leases at December 31, 2005, net of contractual sublease proceeds.

(2) Purchase obligations represent an estimate of all open purchase orders and contractual obligations in the ordinary course of business for which we have not received the goods or services as of December 31, 2005. Although open purchase orders are considered enforceable and legally binding, the terms generally allow us the option to cancel, reschedule and adjust our requirements based on our business needs prior to the delivery of goods or performance of services.

(3) Includes $1.0 million for the purchase of source code from a third party. See section below entitled Third Party Source Code for further discussion.

Of the remaining net future minimum lease payments, approximately $9.5 million is included in restructuring liabilities on the Company s consolidated balance sheet as of December 31, 2005.

In connection with the office building leases in South San Francisco, California, we initially provided the landlord with letters of credit in the amount of $3.9 million as a security deposit. We have provided a security interest in all of our assets as collateral for the letter of credit. These letters of credit have been reduced at pre-determined intervals. As of December 31, 2005 the amounts remaining under these letters of credit total $1.8 million.

Investment in Actuate Japan. The minority shareholders of Actuate Japan have the option to put their 22% equity interest (Minority Interest) in Actuate Japan and we have the option to call the Minority Interest for approximately $756,000 as of December 31, 2005. In April 2005, a minority shareholder of Actuate Japan notified us that it wished to exercise its right to put its equity interest in Actuate Japan. This minority shareholder exercised its right on October 24, 2005 resulting in a payment of $366,000 by Actuate. As a result of this exercise, the minority shareholders of Actuate Japan have the option to put their remaining 22% equity interest (Minority Interest) in Actuate Japan and we have the option to call the Minority Interest for approximately $756,000 as of December 31, 2005.

Acquisition of performancesoft inc. In January 2006 the Company acquired all of the outstanding shares of capital stock of performancesoft inc. The acquisition principally consisted of an initial cash purchase price of $16.5 million and additional contingent cash consideration of up to $13.5 million based on the achievement of certain revenue and operating margin targets for 2006. This contingent consideration would be payable in 2007.

Third Party Source Code. In December of 2005 Actuate agreed to purchase source code from a third-party technology vendor for $1,150,000 in cash. Prior to this purchase Actuate had been paying royalties to this vendor for the right to use and sell this underlying technology in its products. As of December 31, 2005 we have made the first payment of $150,000 due under this agreement. The remaining balance of $1.0 million would be due upon acceptance of the source code, which is expected to occur in the first quarter of 2006. Under this agreement, royalties are no longer required to be paid. The source code fee is being capitalized and will be amortized to cost of license on a straight-line basis over the expected three year life of the software.

Indemnifications. In the normal course of business, we provide indemnifications of varying scope to customers against claims of intellectual property infringement made by third parties arising from the use of our products. Historically, costs related to these indemnification provisions have not been significant and we are unable to estimate the maximum potential impact of these indemnification provisions on our future results of operations.

Recently Issued Accounting Pronouncements

In November 2005, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) Nos. FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to*

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Certain Investments. This FSP addresses the determination as to when an investment is considered impaired, whether that impairment is other than temporary, and the measurement of an impairment loss. This FSP also includes accounting considerations subsequent to the recognition of other-than-temporary impairments. The adoption of this FSP is not expected to have a material effect on the Company s consolidated financial position, results of operations or cash flows. The guidance in this FSP will be applied to reporting periods beginning after December 15, 2005.

In June 2005, the FASB issued Statement of Financial Accounting Standards No. 154, *Accounting Changes and Error Corrections* (SFAS 154), which changes the requirements for the accounting for and reporting of a change in accounting principle. Previously, most voluntary changes in accounting principles required recognition via a cumulative effect adjustment within net income of the period of the change. SFAS 154 requires retrospective application to prior periods financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005; however, SFAS 154 does not change the transition provisions of any existing accounting pronouncements.

In June 2005, the Emerging Issues Task Force (EITF) issued No. 05-06 *Determining the Amortization Period for Leasehold Improvements* (EITF 05-6). The pronouncement requires that leasehold improvements acquired in a business combination or purchase, significantly after the inception of the lease, be amortized over the lesser of the useful life of the asset or the lease term that includes reasonably assured lease renewals as determined on the date of the acquisition of the leasehold improvement. This pronouncement should be applied prospectively effective beginning on January 1, 2006. We do not expect the adoption of EITF 05-6 to have a material effect on the Company s consolidated financial position, results of operations or cash flows.

On December 16, 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payment (SFAS No. 123R). SFAS No. 123R eliminates the alternative of applying the intrinsic value measurement provisions of APB Opinion No. 25 (APB 25) to stock compensation awards issued to employees. Rather, the new standard requires enterprises to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide services in exchange for the award, known as the requisite service period (usually the vesting period).

SFAS No. 123R will be effective for our fiscal quarter beginning January 1, 2006, and requires the use of the Modified Prospective Application Method. Under this method, SFAS No. 123R is applied to new awards and to awards modified, repurchased, or cancelled after the effective date. Additionally, compensation cost for the portion of awards for which the requisite service has not been rendered (such as unvested options) that is outstanding as of the date of adoption shall be recognized as the remaining requisite services are rendered. We are in the process of evaluating the approximate impact of SFAS No. 123R for fiscal 2006, however, we expect the impact to be material. The actual effects of adopting SFAS No. 123R will depend on numerous factors including, but not limited to, the assumed award forfeiture rate and the accounting policies adopted concerning the method of recognizing the fair value of awards over the requisite service period.

On March 29, 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB 107) regarding the Staff s interpretation of Share-Based Payments. This interpretation expresses the views of the staff regarding the interaction between SFAS 123(R) and certain SEC rules and regulations and provides the staff s views regarding the valuation of share-based payment arrangements for public companies. In particular, this SAB provides guidance related to share-based payment transactions with non-employees, the transition from nonpublic to public entity status, valuation methods, the accounting for certain redeemable financial instruments issued under share-based payment arrangements, the classification of compensation expense, non-GAAP financial measures, first-time adoption of SFAS 123(R) in an interim period, capitalization of compensation cost related to share-based payment arrangements, the accounting for income tax effects of share-based payment arrangements upon adoption of SFAS 123(R), the modification of employee share options prior to adoption of Statement 123(R) and

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disclosures in Management s Discussion and Analysis, or MD&A, subsequent to adoption of SFAS 123(R). The Company will adopt SAB 107 in connection with its adoption of SFAS 123(R) in the first quarter of fiscal 2006, which is likely to have a material impact on our consolidated financial position, results of operations and cash flows.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 153, *Exchanges of Nonmonetary Assets* (SFAS 153), an amendment of Accounting Principles Board Opinion No. 29. SFAS 153 addresses the measurement of exchanges of nonmonetary assets and redefines the scope of transactions that should be measured based on the fair value of the assets exchanged. SFAS 153 is effective for the Company for nonmonetary asset exchanges beginning in the first quarter of fiscal 2006. The adoption of SFAS 153 is not expected to have a material effect on the Company s consolidated financial position, results of operations or cash flows.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risk. Market risk represents the risk of loss that may impact our financial position due to adverse changes in financial market prices and rates. Our market risk exposure is primarily a result of credit risk, fluctuations in interest rates and foreign exchange rates.

Foreign Currency Exchange Risk. During the fiscal years 2005 and 2004 we derived 24% and 22%, respectively, of our total revenues from sales outside of North America. We face exposure to market risk on these receivables with respect to fluctuations in the relative value of currencies. Our international revenues and expenses are denominated in foreign currencies, principally the Euro and the British Pound Sterling. The functional currency of each of our foreign subsidiaries is the local currency. We are also exposed to foreign exchange rate fluctuations as the financial results of foreign subsidiaries are translated into U.S. dollars in consolidation. As exchange rates vary, transaction gains and losses may vary from expectations and adversely impact overall expected profitability. Our gains due to foreign exchange rate fluctuations were approximately $89,000 in fiscal year 2005 compared to losses of approximately $210,000 during fiscal year 2004.

Interest Rate Risk. The primary objective of our investment activities is to preserve principal while at the same time maximizing yields without significantly increasing risk. To achieve this objective, we invest in highly liquid and high quality debt securities. To minimize the exposure due to adverse shift in the general level of U.S. interest rates we invest in short-term securities that have an average maturity of one year or less. Due to the short-term nature of our investments, we believe that there is no material risk exposure.

Credit Risk. Financial instruments that potentially subject us to concentrations of credit risk consist primarily of cash and cash equivalents, investments in marketable securities, trade accounts receivable. We have policies that limit investments in investment grade securities and the amount of credit exposure to any one issuer. We perform ongoing credit evaluations of our customers and maintain an allowance for potential credit losses. We do not require collateral or other security to support client receivables. Our credit risk is also mitigated because our customer base is diversified by geography and no single customer has accounted for more than 10% of our consolidated revenue on an annual basis. We generally do not use foreign exchange contracts to hedge the risk in receivables denominated in foreign currencies. We do not hold or issue derivative financial instruments for trading or speculative purposes.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements and supplementary data required by this Item 8 are listed in Item 14(a)(1) and begin at page F-1 of this Report.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

On June 9, 2004, the Audit Committee of the Company decided to dismiss Ernst & Young LLP as the independent accountants of Actuate Corporation. On June 13, 2004, Ernst & Young LLP was notified of such dismissal. The report of Ernst & Young LLP on the financial statements of the Company for 2003 did not contain an adverse opinion or disclaimer of opinion and was not qualified or modified as to uncertainty, audit scope or accounting principles. The decision to change accountants was approved by the Audit Committee of Actuate Corporation.

In connection with its audit for the fiscal year 2003 and through June 13, 2004, there were no disagreements with Ernst & Young LLP on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements if not resolved to the satisfaction of Ernst & Young LLP would have caused them to make reference thereto in their report on the financial statements for such years. Other than as described below, during fiscal year 2003 and through June 13, 2004, there have been no reportable events (as defined in Regulation S-K, Item 304(a)(1)(v)).

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On May 29, 2003 Ernst & Young LLP provided the Audit Committee of Actuate Corporation with a report that identified material weaknesses with certain internal controls related to the detection of side letters and the process of investigating customer assertions regarding terms not specified in the contractual agreements with the Company. Ernst & Young LLP discussed these material weaknesses with the Audit Committee and management of Actuate Corporation. Actuate Corporation implemented a remedial action plan, which included implementing certain new processes and procedures to address the identified material weaknesses. Such action plan was based in large part on recommendations made by Ernst & Young LLP.

On June 9, 2004, the Audit Committee of the Company appointed KPMG LLP as its new independent accountants.

In 2005 management identified a material weakness while assessing the effectiveness of the Company s internal control over financial reporting as of December 31, 2004. See Item 9A Controls and Procedures for a description of the material weakness.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Actuate maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company s reports under the Securities and Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this Annual Report on Form 10-K. Based on the foregoing, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15(d)-15(e) under the Securities and Exchange Act of 1934, as amended) were sufficiently effective to ensure that the information required to be disclosed by us in the reports we file or submit was recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms.

In 2005, management assessed the effectiveness of the Company s internal control over financial reporting as of December 31, 2004, and this assessment identified the following material weakness: The Company s policies and procedures did not require review and approval by the relevant senior accounting personnel at the parent company level of journal entries for material nonrecurring transactions originating at the foreign subsidiary level. The absence of this control resulted in a failure in the Company s year-end financial statement close process to ensure that original assumptions made in determining the amount of a restructuring charge had not changed as of year-end. As a result of this deficiency, a material error in accounting for the amount recorded for a restructuring charge originating at a foreign subsidiary level occurred. This material error in accounting was corrected by reducing the restructuring charge and the related accrued liability prior to issuance of the Company s 2004 consolidated financial statements.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal controls over financial reporting during the quarter ended December 31, 2005 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

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Management s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended). Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2005. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Our management has concluded that, as of December 31, 2005, our internal control over financial reporting is effective based on these criteria. Our independent registered public accounting firm, KPMG LLP, has issued their report on our assessment of our internal control over financial reporting, which is included herein.

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all error and all fraud. There are inherent limitations to the effectiveness of any controls system. A controls system, no matter how well designed and operated, cannot provide absolute assurance that its objectives are met, and no evaluation of controls can provide absolute assurance that all control issues and any instances of fraud, within a company will be detected.

ITEM 9B. OTHER INFORMATION

None.

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PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required by this Item regarding our directors and compliance with Section 16(a) of the Securities and Exchange Act of 1934 is incorporated herein by reference from the sections entitled Election of Directors and Compliance with Section 16(a) of the Exchange Act, respectively, contained in our proxy statement for our 2006 Annual Meeting of Stockholders to be held on May 24, 2006 (the Proxy Statement). The information required by this Item with respect to our executive officers is contained in Item 1 of Part I of this Annual Report under the heading Actuate Executive Officers.

Adoption of Code of Ethics

Actuate has adopted a Code of Ethics and Business Conduct (the Code) applicable to all of its Board members, employees and executive officers, including its Chief Executive Officer (Principal Executive Officer), Chief Financial Officer (Principal Financial and Accounting Officer) and Controller. We have made the Code available under the investors/corporate governance section of our website at www.actuate.com.

We intend to satisfy the disclosure requirement under Item 10 of Form 8-K regarding (i) any amendments to the Code, or (ii) any waivers under the Code relating to our Chief Executive Officer or Chief Financial Officer, by posting such information under the investors/corporate governance section of our website at www.actuate.com.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item regarding executive compensation is incorporated herein by reference from the section entitled Executive Compensation and Related Information of the Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this Item regarding security ownership of certain beneficial owners and management is incorporated herein by reference from the section entitled Security Ownership of Certain Beneficial Owners and Management of the Proxy Statement.

Equity Compensation Plan Information

Information about our equity compensation plans at December 31, 2005, that were either approved or not approved by stockholders was as follows:

Plan Category	Number of securities to be issued upon exercise of outstanding options	Weighted average exercise price of outstanding options	Number of available securities remaining for future issuance
Equity compensation plans approved by stockholders (1)	18,054,739	$ 2.88	11,786,773
Equity compensation plans not approved by stockholders (2)	1,237,665	$ 2.00	647,271
Total	19,292,404	$ 2.83	12,434,044

(1) Consists of five plans: our Amended and Restated 1998 Equity Incentive Plan, Tidestone 1998 Incentive Stock Option Plan, Tidestone Non-Qualified Stock Option Plan of 1999, 1998 Non-Employee Directors Option Plan, and the Amended and Restated 1998 Employee Stock Purchase Plan. As of January 1 of each year, the number of shares reserved for issuance under the Amended and Restated 1998 Equity Incentive

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Plan automatically increases by the lesser of (i) 5% of the total number of shares of common stock outstanding and (ii) 2,800,000 shares.

(2) Consists of one plan: our 2001 Supplemental Stock Option Plan. See Note 9 of the Notes to Consolidated Financial Statements.

On January 5th 2006 we acquired all of the outstanding shares of capital stock of performancesoft, inc., a privately-held entity headquartered in Toronto, Canada. Actuate s Board of Directors duly authorized the issuance of stock options to eligible employees from the Company s 1998 Equity Incentive Plan with the grant price effective as of the close of the acquisition. A total of 530,200 non-statutory stock options were issued on January 5th, 2006 with the price of $3.36. Each option shall have a maximum term of ten years measured from the date of grant. Each grant shall fully vest in four years with 25% cliff vesting at end of year one and the remaining balance to vest in thirty-six successive monthly installments.

Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Maximum Number of Shares That May Yet Be Purchased Under the Program
October 1, 2005 October 30, 2005	300,000	$ 2.92	300,000	
November 1, 2005 November 30, 2005				
December 1, 2005 December 31, 2005				
Total	**300,000**		**300,000**	

On September 19, 2001, the Company s board of directors authorized a stock repurchase program of up to $6.0 million of our common stock. On October 24, 2002 and April 28, 2004 Actuate s board of directors extended the stock repurchase program by authorizing the management to repurchase up to an additional $3.0 million and $1.5 million worth of Company s common stock, respectively. On July 28, 2004, the Company s board of directors authorized management to repurchase, on an on-going basis, up to $1.5 million Actuate common stock each calendar quarter. During the fourth quarter of 2004, the board of directors suspended the repurchase program.

In January 2005, pursuant to the stock repurchase program announced in September 2001, and extended from time to time by the Company s Board of Directors, the Board of Directors approved an on-going extension of the Company s stock repurchase program. This was further confirmed in April 2005, July 2005 and October 2005 when the Board of Directors authorized management to proceed with the repurchases. The Company is authorized to repurchase Actuate common stock in an amount not to exceed cash flow from operations during the prior quarter, with the actual amount to be approved in advance by the Board. During the fiscal year 2005, the Company repurchased a total of 3.0 million shares of the Company s common stock, totaling approximately $7.1 million. From the end of the fiscal year through February 14, 2006, the Company has repurchased a total of 289,000 shares in the open market under this stock repurchase plan.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this Item regarding certain relationships and related transactions is incorporated herein by reference from the section entitled Certain Relationships and Related Transactions of the Proxy Statement.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this Item regarding principal accountant fees and services is incorporated herein by reference from the section entitled Principal Accountant Fees and Services of the Proxy Statement.

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PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a)(1) Financial Statements

See Index on Page F-1.

(a)(2) Financial Statement Schedules

Schedule II Valuation and Qualifying Accounts.

Other schedules have been omitted because the information required to be set forth therein is not applicable or is readily available in the financial statements or notes thereto.

(a)(3) Exhibits

Exhibit No.	Description
2.1(7)	Share Purchase Agreement, dated as of January 5, 2006, by and among Actuate Corporation, performancesoft, inc., the shareholders of performancesoft, inc. and Michael Tipping, as shareholder s representative.
3.1(3)	Form of Third Amended and Restated Certificate of Incorporation.
3.2(1)	Form of Bylaws of the Registrant.
4.1(1)	Reference is made to Exhibits 3.1 and 3.2.
4.2(1)	Specimen Common Stock Certificate.
10.1(1)	Form of Indemnification Agreement.
10.2(1)+	1994 Stock Option Plan, as amended.
10.3(1)+	Amended and Restated 1998 Equity Incentive Plan.
10.4(1)+	Amended and Restated 1998 Employee Stock Purchase Plan.
10.5(1)+	1998 Non-Employee Directors Option Plan.
10.6(4)+	2001 Supplemental Stock Option Plan.
10.7(1)+	Offer Letter between the Company and Daniel A. Gaudreau dated May 7, 1997.
10.8(2)	Office Building Lease between the Actuate and HMS Gateway Office, L.P. dated August 18, 1999.
10.9(2)	First Amendment to Office Building Lease between the Actuate and HMS Gateway Office, L.P. dated September 30, 1999.

10.10(4)	Office Building Lease between the Actuate and HMS Gateway Office, L.P. dated December 21, 2000.
10.11(6)	Form of Severance Agreement (Messrs. Cittadini and Gaudreau)
10.12(6)	Form of Severance Agreement (Messrs. Ryan and Akiha and Ms. Vogt)
10.13(6)	Form of Severance Agreement (Messrs Coggins and Strauss)
16.1(5)	Letter Regarding Change in Certifying Accountant
21.1	Subsidiaries of Actuate Corporation.
23.1	Consent of Independent Registered Public Accounting Firms.
24.1	Power of Attorney. (See the signature page to this Form 10-K).
31.1	Rule 13a-14(a)/15d-14(a) Certification of the Chief Executive Officer
31.2	Rule 13a-14(a)/15d-14(a) Certification of the Chief Financial Officer
32.1	Section 1350 Certifications

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(1) Incorporated by reference to our Registration Statement on Form S-1 (File No. 333-55741).
(2) Incorporated by reference to our Quarterly Report on Form 10-Q for the period ended September 30, 1999.
(3) Incorporated by reference to our Annual Report on Form 10-K for the period ended December 31, 1999.
(4) Incorporated by reference to our Annual Report on Form 10-K for the period ended December 31, 2000.
(5) Incorporated by reference to our Form 8-K filed on June 16, 2004.
(6) Incorporated by reference to our Form 8-K filed on November 1, 2005
(7) Incorporated by reference to our Form 8-K filed on January 10, 2006.
\+ Indicates management or compensatory plan or arrangement.

(b) Exhibits

See (a)(3) above.

(c) Financial Statement Schedule

See (a)(2) above.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, we have duly caused this report to be signed on our behalf by the undersigned thereunto duly authorized.

ACTUATE CORPORATION

(Registrant)

By: /s/ Daniel A. Gaudreau

Daniel A. Gaudreau

Senior Vice President, Finance and Administration and Chief Financial Officer

Date: March 10, 2006

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each individual whose signature appears below constitutes and appoints Peter I. Cittadini and Daniel A. Gaudreau, and each of them, his or her true and lawful attorneys-in-fact and agents with full power of substitution, for him or her and in his or her name, place and stead, in any and all capacities, to sign any and all amendments (including post-effective amendments) to this Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his or her substitute or substitutes may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Nicolas C. Nierenberg **Nicolas C. Nierenberg**	Chairman of the Board and Chief Architect	March 10, 2006
/s/ Peter I. Cittadini **Peter I. Cittadini**	Director, President and Chief Executive Officer (Principal Executive Officer)	March 10, 2006
/s/ Daniel A. Gaudreau	Senior Vice President, Finance and Administration and Chief Financial Officer (Principal Financial and Accounting Officer)	March 10, 2006

Daniel A. Gaudreau		
/s/ GEORGE B. BEITZEL	Director	March 10, 2006
George B. Beitzel		
/s/ KENNETH E. MARSHALL	Director	March 10, 2006
Kenneth E. Marshall		
/s/ ARTHUR C. PATTERSON	Director	March 10, 2006
Arthur C. Patterson		
/s/ STEVEN D. WHITEMAN	Director	March 10, 2006
Steven D. Whiteman		

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ACTUATE CORPORATION

INDEX TO FINANCIAL STATEMENTS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders

Actuate Corporation:

We have audited the accompanying consolidated balance sheets of Actuate Corporation and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of operations, stockholders equity and comprehensive income (loss), and cash flows for the years then ended. In connection with our audit of the consolidated financial statements, we have also audited the financial statement schedule listed in Item 15(a)2. These consolidated financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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 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 Actuate Corporation and subsidiaries as of December 31, 2005 and 2004, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Actuate Corporation s internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 13, 2006, expressed an unqualified opinion on management s assessment of, and the effective operation of, internal control over financial reporting.

/s/ KPMG LLP

Mountain View, California

March 13, 2006

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders

Actuate Corporation:

We have audited management s assessment, included in the accompanying Management s Report on Internal Control Over Financial Reporting appearing under Item 9A, that Actuate Corporation maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Actuate Corporation s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of the inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management s assessment that Actuate Corporation maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on criteria established in *Internal Control Integrated Framework* issued by COSO. Also, in our opinion, Actuate Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Actuate Corporation and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of operations, stockholders equity and comprehensive income (loss), and cash flows for the years then ended, and our report dated March 13, 2006 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Mountain View, California

March 13, 2006

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Report of Ernst & Young LLP, Independent Registered Public Accounting Firm

Board of Directors and Stockholders

Actuate Corporation

We have audited the accompanying consolidated statement of operations, shareholders equity and comprehensive income (loss), and cash flows for the year ended December 31, 2003. Our audit also included the financial statement schedule listed in the Index at Item 15(a)(2). These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated results of operations and cash flows of Actuate Corporation for the year ended December 31, 2003, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set forth therein.

/s/ Ernst and Young LLP

San Francisco, California

January 26, 2004

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ACTUATE CORPORATION

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

	December 31,	
	2005	**2004**
ASSETS		
Current assets:		
Cash and cash equivalents	$ 12,490	$ 7,341
Short-term investments	41,907	39,932
Accounts receivable, net of allowances of $1,318, and $1,489 at December 31, 2005 and 2004	26,798	24,776
Other current assets	2,911	2,498
Total current assets	84,106	74,547
Property and equipment, net	4,716	6,158
Goodwill	20,990	20,766
Purchased intangibles, net	1,139	3,117
Other assets	630	867
	$ 111,581	$ 105,455
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 2,101	$ 2,414
Current portion of restructuring liabilities	2,948	3,669
Accrued compensation	5,306	5,244
Other accrued liabilities	3,108	4,996
Income taxes payable	279	539
Deferred revenue	31,475	27,323
Total current liabilities	45,217	44,185
Long-term liabilities:		
Deferred rent	198	320
Long-term deferred revenue	913	1,440
Restructuring liabilities, net of current portion	9,885	12,565
Total long-term liabilities	10,996	14,325
Commitments and contingencies (Notes 8 and 13)		
Stockholders equity:		
Preferred stock, $0.001 par value, issuable in series; 5,000,000 shares authorized; none issued or outstanding		
Common stock, $0.001 par value, 100,000,000 shares authorized; issued 67,536,651 and 66,235,200 shares, respectively; outstanding 60,170,503 and 61,871,783 shares, respectively	60	62
Additional paid-in capital	108,904	104,829
Treasury stock, at cost; 7,366,148 and 4,363,417 shares, respectively	(18,691)	(11,616)

Accumulated other comprehensive loss	(555)	(389)
Accumulated deficit	(34,350)	(45,941)
Total stockholders equity	55,368	46,945
	$ 111,581	$ 105,455

See accompanying notes to Consolidated Financial Statements.

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ACTUATE CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Year ended December 31,		
	2005	**2004**	**2003**
Revenues:			
License fees	$ 36,939	$ 42,703	$ 47,598
Services	69,462	61,954	56,857
Total revenues	106,401	104,657	104,455
Costs and expenses:			
Cost of license fees	2,294	3,417	3,140
Cost of services	23,723	24,763	23,648
Sales and marketing	37,070	41,296	45,769
Research and development	16,533	19,847	18,732
General and administrative	13,115	10,856	12,220
Amortization of purchased intangibles	487	1,110	2,021
Purchased in-process research and development			600
Restructuring charges	665	2,006	
Total costs and expenses	93,887	103,295	106,130
Income (loss) from operations	12,514	1,362	(1,675)
Interest and other income, net	1,436	822	720
Income (loss) before provision for income taxes	13,950	2,184	(955)
Provision for income taxes	2,359	886	3,542
Net income (loss)	$ 11,591	$ 1,298	$ (4,497)
Basic net income (loss) per share	$ 0.19	$ 0.02	$ (0.07)
Shares used in basic net income (loss) per share calculation	61,057	61,577	60,766
Diluted net income (loss) per share	$ 0.18	$ 0.02	$ (0.07)
Shares used in diluted net income (loss) per share calculation	63,269	65,202	60,766

See accompanying notes to Consolidated Financial Statements.

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ACTUATE CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY AND

COMPREHENSIVE INCOME (LOSS)

(in thousands, except share data)

	Common Stock			Treasury Stock			Accumulated Other		
	Shares	Amount	Additional Paid-in Capital	Number of shares	Amount	Deferred Stock Compensation	Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders Equity
Balance at January 1, 2003	**62,203,542**	**$ 60**	**$ 97,309**	**(2,498,300)**	**$ (5,963)**	**$ (41)**	**$ (200)**	**$ (42,742)**	**$ 48,423**
Comprehensive income									
Net loss								(4,497)	(4,497)
Net unrealized gains on available-for- sale securities							8		8
Currency translation							(101)		(101)
Total comprehensive loss									(4,590)
Issuance of common stock upon exercise of stock options, net of repurchases	1,050,527		1,528						1,528
Issuance of common stock under Employee Stock Purchase Plan	1,492,742	2	2,578						2,580
Amortization of deferred compensation, net						41			41
Stock repurchase		(1)		(1,040,817)	(2,963)				(2,964)
Tax benefits from employee stock options			163						163
Balance at December 31, 2003	**64,746,811**	**$ 61**	**$ 101,578**	**(3,539,117)**	**$ (8,926)**	**$**	**$ (293)**	**$ (47,239)**	**$ 45,181**
Comprehensive income									
Net income								1,298	1,298
Net unrealized losses on available-for- sale securities							(68)		(68)
Currency translation							(28)		(28)
Total comprehensive income									1,202
Issuance of common stock upon exercise of stock options	1,362,476	1	2,065						2,066
Issuance of common stock under Employee Stock Purchase Plan	125,913		306						306
Stock repurchase				(824,300)	(2,690)				(2,690)
Tax benefits from employee stock options			880						880
Balance at December 31, 2004	**66,235,200**	**$ 62**	**$ 104,829**	**(4,363,417)**	**$ (11,616)**	**$**	**$ (389)**	**$ (45,941)**	**$ 46,945**
Comprehensive income									
Net income								11,591	11,591
Net unrealized losses on available-for- sale securities							(56)		(56)
Currency translation							(110)		(110)

Total comprehensive income									11,425
Issuance of common stock upon exercise of stock options	1,077,366	1	1,529						1,530
Correction of shares outstanding	10,416								
Issuance of common stock under Employee Stock Purchase Plan	213,669		429						429
Stock repurchase		(3)		(3,002,731)	(7,075)				(7,078)
Tax benefits from employee stock options			2,117						2,117
Balance at December 31, 2005	**67,536,651**	**$ 60**	**$ 108,904**	**(7,366,148)**	**$ (18,691)**	**$**	**$ (555)**	**$ (34,350)**	**$ 55,368**

See accompanying notes to Consolidated Financial Statements.

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ACTUATE CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Year ended December 31,		
	2005	**2004**	**2003**
Operating activities			
Net income (loss)	$ 11,591	$ 1,298	$ (4,497)
Adjustments to reconcile net income (loss) to net cash from operating activities:			
Amortization of deferred compensation		96	41
Amortization of purchased intangibles	1,400	2,642	3,186
Depreciation	1,892	2,293	3,020
Purchased in-process research and development			600
Loss on investment	301		
Tax benefits from exercise of stock options	2,117	880	163
Change in operating assets and liabilities, net of effects of acquisition:			
Accounts receivable	(2,022)	(4,568)	3,776
Other current assets	(431)	5	1,308
Deferred tax assets			2,140
Accounts payable	214	(344)	(1,319)
Accrued compensation	62	842	(1,197)
Other accrued liabilities	(1,888)	613	(2,154)
Income taxes payable	(67)	(702)	291
Deferred rent liabilities	(122)	(69)	17
Deferred revenue	3,625	2,973	2,517
Restructuring liabilities	(3,402)	(1,028)	(3,601)
Net cash generated by operating activities	13,270	4,931	4,291
Investing activities			
Purchase of property and equipment	(450)	(3,354)	(1,658)
Proceeds from maturities of short-term investments	71,783	75,038	99,516
Purchase of short-term investments	(73,812)	(75,450)	(101,098)
Acquisition of Nimble Technology, net of cash assumed			(3,016)
Purchase of minority shares of Actuate Japan	(366)		
Net change in other assets	(46)	671	(97)
Net cash used in investing activities	(2,891)	(3,095)	(6,353)
Financing activities			
Proceeds from issuance of common stock	1,959	2,372	4,108
Stock repurchases	(7,078)	(2,690)	(2,964)
Net cash generated by (used in) financing activities	(5,119)	(318)	1,144

Net increase (decrease) in cash and cash equivalents	5,260	1,518	(918)
Effect of exchange rate on cash and cash equivalents	(111)	(27)	(77)
Cash and cash equivalents at the beginning of the year	7,341	5,850	6,845
Cash and cash equivalents at the end of the year	$ 12,490	$ 7,341	$ 5,850
Supplemental disclosure of cash flow information			
Cash paid for income taxes	$ 325	$ 320	$ 45

See accompanying notes to Consolidated Financial Statements.

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ACTUATE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Actuate Corporation (We , Actuate or the Company) provides an Enterprise Reporting Application Platform, a unified software platform that enables large organizations and packaged application software vendors to develop and deploy self-service customer and employee-facing Enterprise Reporting Applications. The Company s Actuate 8 product line provides a platform upon which Global 9000 organizations (companies with annual revenues greater than $1 billion) and packaged application software vendors develop and deploy mission-critical Enterprise Reporting Applications. Such Applications retrieve business information from corporate databases and deliver it as interactive Web pages, Excel spreadsheets, and analytic cubes to customers, partners and employees around the globe. Actuate s products and services are used by its customers to develop and deploy Enterprise Reporting Applications across a range of business functions including financial management, sales management, account management, and customer self-service.

Actuate was incorporated in November 1993 in the State of California and re-incorporated in the State of Delaware in July 1998. Actuate s principal executive offices are located at 701 Gateway Boulevard, South San Francisco, California. Actuate s telephone number is 650-837-2000. Actuate maintains a Web site at www.actuate.com.

Basis of Presentation

The consolidated financial statements include the accounts of Actuate and its wholly-owned and majority-owned subsidiaries. Actuate has offices throughout North America, Europe and Asia including offices in Switzerland, United Kingdom, France, Germany, Singapore, Japan and China. All intercompany balances and transactions have been eliminated.

As of December 31, 2005, Actuate has approximately 78% of the outstanding voting stock of Actuate Japan Company Ltd. (Actuate Japan). The Company has consolidated the results of Actuate Japan from the date that it became the majority shareholder, which occurred in fiscal year 2000. Accumulated losses applicable to the minority shareholders exceed their equity capital in Actuate Japan and, as a result, there is no minority interest presented on the accompanying consolidated balance sheets. This excess loss applicable to the minority shareholders has been charged to Actuate, as the minority shareholders are not obligated to contribute their share of losses exceeding their equity capital.

On July 25, 2003, the Company acquired 100% of the outstanding stock of Nimble Technology, Inc. (Nimble), a privately held Enterprise Information Integration (EII) software company. The Consolidated Statements of Operations include Nimble s operating results from the date of acquisition.

The results of operations for fiscal year 2003 include two out-of-period adjustments. During the preparation of the Form 10-Q for the three months ended March 31, 2003, Actuate discovered several unauthorized side agreements, customer allegations of unauthorized side arrangements and other matters relating to revenue recognition. In the period ended March 31, 2003, Actuate recorded a reduction of $398,000 in revenues and an increase in the benefit for income taxes of $170,000 to correct the accounting for these identified transactions. In conjunction with the review of the Company s accrued liability balances during the quarter ended September 30, 2003, Actuate recorded a reversal of accrued commissions as a reduction in operating expenses, approximately $430,000 of which related to prior fiscal years. The Company does not believe that these amounts are material to the annual periods in which they should have been recorded, nor does the Company believe that these amounts are material to its consolidated operating results for the year ended December 31, 2003.

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ACTUATE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. On a regular basis, Actuate evaluates estimates, including those related to bad debts, intangible assets, income taxes and restructuring charges. Actual results could differ materially from those estimates.

Revenues

Actuate generates revenues from sales of software licenses and related services. The Company receives software license revenues from licensing its products directly to end-users and indirectly through resellers, system integrators and original equipment manufacturers (OEMs). The Company receives service revenues from maintenance contracts, consulting services and training that Actuate performs for customers.

Actuate recognizes revenues in accordance with AICPA Statement of Position (SOP) 97-2 (SOP 97-2), *Software Revenue Recognition,* as amended and modified by SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions.* For sales to end-user customers, Actuate recognizes license revenues when a license agreement has been signed by both parties or a definitive purchase order has been received from the customer, the product has been shipped, there are no unusual uncertainties surrounding the product acceptance, the fees are fixed or determinable, collectibility is probable and vendor-specific objective evidence of fair value exists to allocate the fee to the undelivered elements of the arrangement. Vendor-specific objective evidence is based on the price charged when an element is sold separately. Actuate has not established vendor-specific objective evidence of fair value for license fees. Therefore, the Company recognizes revenues from arrangements with multiple elements involving software licenses under the residual method. If the license agreement contains payment terms that would indicate that the fee is not fixed or determinable, revenues are recognized as the payments become due and payable, assuming that all other revenue recognition criteria are met.

Actuate enters into reseller and distributor arrangements that typically give such distributors and resellers the right to distribute its products to end-users headquartered in specified territories. Actuate recognizes license revenues from arrangements with U.S. resellers and distributors when there is persuasive evidence of an arrangement with the reseller or distributor, the product has been shipped, the fees are fixed or determinable and collectibility is probable. Actuate recognizes license revenues from arrangements with international resellers and distributors upon receipt of evidence of sell-through and when all other revenue recognition criteria have been met. If it is not practical to obtain evidence of sell-through, the Company defers revenues until the end-user has been identified and cash has been received. In some instances there is a timing difference between when a reseller completes its sale to the end-user and the period in which Actuate receives the documentation required for revenue recognition. Because Actuate delays revenue recognition until the required documentation is obtained, it may recognize revenue in a period subsequent to the period in which the reseller completes the sale to its end-user.

Actuate also enters into OEM arrangements that provide for license fees based on the bundling or embedding of its products with the OEMs products. These arrangements generally provide for fixed, irrevocable royalty payments. Actuate recognizes license fee revenues from U.S.

OEM arrangements when a license agreement has been executed by both parties, the product has been shipped, there are no unusual uncertainties surrounding the product acceptance, the fees are fixed or determinable, collectibility is probable and vendor-specific objective evidence of fair value exists to allocate the fee to the undelivered elements of the arrangement. For sales through international OEMs, the Company defers revenue until it receives a royalty report from such

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ACTUATE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

OEM assuming all other revenue recognition criteria have been met. As discussed above, there may be a timing difference between the period in which the Company s OEM completes the sale to its end-user, and the period in which the Company recognizes the revenue.

Credit-worthiness and collectibility for end-users are assessed based on payment history and current credit profile. When a customer is not deemed credit-worthy, revenues are deferred and recognized upon cash receipt.

Actuate recognizes maintenance revenues, which consist of fees for ongoing support and unspecified product updates, ratably over the term of the contract, typically one year. Consulting revenues are primarily related to standard implementation and configuration. Training revenues are generated from classes offered at the Company s headquarters and customer locations. Revenues from consulting and training services are recognized as the services are performed. When a contract includes both license and service elements, the license fee is typically recognized on delivery of the software and when all other revenue recognition criteria are met, provided services do not include significant customization or modification of the product and are not otherwise essential to the functionality of the software.

Cash, Cash Equivalents and Short-Term Investments

Cash and cash equivalents consist of cash deposited with banks and highly liquid, high-quality instruments with maturities at the date of purchase of 90 days or less. Such instruments typically include money market securities, commercial paper, and other high quality debt instruments. In accordance with FASB Statement Number 115, Accounting for Certain Investments in Debt and Equity Securities , and based on our intentions regarding these instruments, we classify all of our short-term investments as available-for-sale, and account for these investments at fair value. Short-term investments consist primarily of high quality debt securities with original maturities over 90 days, and may include corporate notes, United States government agency notes, municipal notes, and auction rate securities. The cost of securities sold is based on the specific identification method.

Actuate views its available-for-sale portfolio securities with maturity beyond 90 days to be available for use in current operations. Accordingly, Actuate has classified all such marketable investments as short-term investments, even though the stated maturity dates may be one year or more beyond the current balance sheet date, as they are highly liquid instruments. In addition, all auction rate notes, including auction preferred and short-term municipals are classified as short-term investments regardless of the underlying reset date.

Fair Values of Financial Instruments

The fair value of the Company s cash, short-term investments, accounts receivable, and accounts payable, approximates the carrying amount, which is the amount for which the instrument could be exchanged in a current transaction between willing parties.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to credit risk consist principally of marketable investments and accounts receivable. Actuate places its investments with high-credit-quality multiple issuers. The Company sells to a diverse customer base, predominantly to customers in the United States. No single customer has accounted for more than 10% of sales in any period presented. Actuate does not require collateral on sales with credit terms.

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ACTUATE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company s accounts receivable is subject to collection risks. The Company s gross accounts receivable is reserved against this risk through an allowance for doubtful accounts. This allowance is for estimated losses resulting from the inability of Actuate s customers to make required payments. It can be a significant estimate and is regularly evaluated for adequacy by taking into consideration a combination of factors. The Company looks at factors such as past experience, credit quality of the customer, age of the receivable balance, and current economic conditions. These are reviewed to determine whether a specific reserve for bad debt should be recorded to reduce the related receivable to the amount believed to be collectible. The Company also specifically reserves for all outstanding domestic consulting, training, and maintenance renewal invoices which are older than a specified number of months past due.

The Company also records unspecified reserves for bad debt for all other customers based on a variety of factors, including length of time the receivables are past due and historical experience. A reserve percentage is applied to various aged categories of receivables based on historical experience to determine how much of an unspecified reserve is needed. The use of different estimates or assumptions could produce different allowance balances. If the financial condition of Actuate s customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances might be required.

Software Development Costs

Software development costs associated with new products and enhancements to existing software products are expensed as incurred until technological feasibility in the form of a working model has been established. To date, the time period between the establishment of technological feasibility and completion of software development has been short, and no significant development costs have been incurred during that period. Accordingly, Actuate has not capitalized any software development costs to date.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is provided using the straight-line method over the estimated useful lives of the respective assets, which range from two to eight years. Leasehold improvements are amortized over the shorter of the lease term or estimated useful life. The Company only capitalizes fixed assets with an initial value in excess of a specific threshold. Purchased items below that initial threshold value are immediately expensed.

Goodwill and Other Purchased Intangible Assets

Effective January 1, 2002, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 141 (SFAS 141), Business Combinations , and No. 142, Goodwill and Other Intangible Assets (SFAS 142). Under SFAS 142, goodwill and acquired workforce are no longer amortized, and instead, are tested for impairment annually, or more frequently, if impairment indicators arise. Other intangible assets consist of customer lists, purchased technologies, non-compete agreements, and trademark acquired from various acquisitions. Intangible assets acquired in business acquisitions are recorded at their fair values using the income approach or cost approach. These other intangible assets are being amortized over the expected useful life not exceeding four years using the straight-line method. See Note 6 for further discussion.

Impairment of Long-Lived Assets

The Company evaluates its long-lived assets for impairment annually or whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of any asset to future net undiscounted

ACTUATE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less the costs to sell.

Advertising Costs

Advertising costs are expensed as incurred. Advertising costs are included in sales and marketing expense and amounted to $365,000, $480,000 and $712,000 in fiscal years 2005, 2004 and 2003, respectively.

Income Taxes

The Company accounts for income taxes using the asset and liability method as prescribed by Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (SFAS 109). Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. 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. If it is more likely than not that the deferred tax assets will not be realized, a valuation allowance is recorded to reduce the carrying value of the deferred tax assets.

Foreign Currency Translation

The functional currency of each of the Company s foreign subsidiaries is the foreign subsidiary s local currency except for the Company s Cayman subsidiary, whose functional currency is the U.S. dollar. Actuate translates the assets and liabilities of its international non-U.S. functional currency subsidiaries into U.S. dollars at the rates of exchange in effect at the end of the period. Revenues and expenses are translated using rates that approximate those in effect during the period. Gains and losses from currency translation are included in stockholders equity in the consolidated balance sheet. Currency transaction gains or losses, which have not been significant to Actuate s operating results in any period, are recorded in interest and other income, net in the accompanying consolidated financial statements. Accumulated translation adjustments are reported in stockholder s equity as a component of accumulated other comprehensive income (loss).

Stock-Based Compensation

Actuate has several stock-based compensations plans, which are described more fully in Note 9. Actuate grants stock options for a fixed number of shares to employees with an exercise price equal to the fair value of the shares at the date of grant. Recently, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure an amendment of SFAS No. 123 (SFAS 148). This statement amends SFAS No. 123, Accounting for Stock-Based Compensation, (SFAS 123) to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. Actuate has not adopted the recognition provisions of SFAS 123, as amended by SFAS 148, and continues to account for stock-based compensation under the intrinsic value method of Accounting Principles Board Opinion 25, Accounting for Stock Issued to Employees, (APB 25) and related Interpretations.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table illustrates the effect on net income (loss) and net income (loss) per share if the Company had applied the fair value recognition provisions of SFAS 123, as amended by SFAS 148, to stock-based employee compensation (in thousands, except per share data):

	Year ended December 31,		
	2005	**2004**	**2003**
Net income (loss) as reported	$ 11,591	$ 1,298	$ (4,497)
Less: Stock-based employee compensation expense determined under the fair value method for all awards, net of tax effect	(5,705)	(8,832)	(21,274)
Net income (loss) pro forma	$ 5,886	$ (7,534)	$ (25,771)
Net income (loss) per share as reported:			
Basic	$ 0.19	$ .02	$ (0.07)
Diluted	$ 0.18	$ .02	$ (0.07)
Net income (loss) per share pro forma:			
Basic	$ 0.10	$ (.12)	$ (0.42)
Diluted	$ 0.09	$ (.12)	$ (0.42)

See Note 9 for discussion of the assumptions used in the option pricing model and estimated fair value of employee stock options.

Actuate accounts for stock awards issued to non-employees in accordance with the provisions of SFAS 123 and Emerging Issues Task Force No. 96-18, (EITF 96-18), Accounting for Equity Instruments That Are Issues To Others Than Employees for Acquiring, or In Conjunction With Selling Goods or Services. Under SFAS 123 and EITF 96-18, stock awards to non-employees are accounted for at their fair value using the Black-Scholes method.

Net Income (loss) Per Share

Earnings Per Share. The Company computes basic earnings per share using the weighted-average number of common shares outstanding during the period, less weighted average shares subject to repurchase. The Company computes diluted earnings per share using the weighted-average number of common shares and dilutive stock options outstanding during the period using the treasury stock method. Due to the net loss incurred for fiscal year 2003, the effect of employee stock options is anti-dilutive in that period.

The table below reconciles the weighted-average common shares used to calculate basic net income (loss) per share with the weighted-average common shares used to calculate diluted net income (loss) per share (in thousands).

	Year ended December 31,		
	2005	**2004**	**2003**
Weighted-average shares of common stock outstanding	61,057	61,577	60,766
Weighted-average dilutive stock options outstanding under the treasury stock method	2,212	3,625	
Weighted-average common shares used in computing diluted net income (loss) per share	63,269	65,202	60,766

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The weighted-average number of common shares excluded from the calculation of diluted net loss per share was 17,810,000 in fiscal year 2003. Such stock options, had they been dilutive, would have been included in the computation of diluted net loss per share using the treasury stock method. In fiscal year 2005 and 2004, the Company excluded 10,948,000 and 7,911,000 stock options respectively, from Actuate s calculation of weighted-average common shares used in computing dilutive net income per share as they were anti-dilutive for the net income per share calculation. These anti-dilutive options could be dilutive in the future.

The weighted average exercise price of excluded stock options was $3.91, $4.68 and $2.95 for the years ended December 31, 2005, 2004 and 2003, respectively.

Other Comprehensive Income (Loss)

Other comprehensive income (loss) includes currency translation adjustments and unrealized gains and (losses) on short-term investments that are not included in net income (loss), but rather are recorded directly in stockholders equity. Comprehensive income (loss) includes net income (loss) and other comprehensive income (loss), and has been disclosed in the Consolidated Statements of Stockholders Equity. The components of accumulated other comprehensive loss are as follows (in thousands):

	December 31,	
	2005	2004
Foreign currency translation adjustments	$ (431)	$ (321)
Net unrealized losses on securities	(124)	(68)
	$ (555)	$ (389)

Segment Information

Actuate is principally engaged in the design, development, marketing and support of Actuate Enterprise Reporting Application Platform. Actuate s chief operating decision maker (the Chief Executive Officer) reviews financial information presented on a consolidated basis, accompanied by disaggregated information about revenues by geographic region for purposes of making operating decisions and assessing financial performance. Accordingly, Actuate considers itself to be in a single reportable segment, specifically the license, implementation and support of its software products.

Actuate evaluates the performance of its geographic regions based primarily on revenues. Actuate does not regularly assess the performance of its geographic regions on other measures of income or expense, such as operating income or net income. In addition, as Actuate s assets are primarily located in its corporate office in the United States and not allocated to any specific region, Actuate does not produce reports for, or measure the performance of, its geographic regions based on any asset-based metrics. Therefore, geographic information is presented only for revenues in Note 12.

Recent Accounting Pronouncements

In November 2005, FASB issued FASB Staff Position (FSP) Nos. FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. This FSP addresses the determination as to when an investment is considered impaired, whether that impairment is other than temporary, and the measurement of an impairment loss. This FSP also includes accounting considerations subsequent to the recognition of other-than-temporary impairments. The adoption of this FSP is not expected to have a material effect on the Company s consolidated financial position, results of operations or cash flows. The guidance in this FSP will be applied to reporting periods beginning after December 15, 2005.

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In June 2005, the FASB issued Statement of Financial Accounting Standards No. 154, *Accounting Changes and Error Corrections* (SFAS 154), which changes the requirements for the accounting for and reporting of a change in accounting principle. Previously, most voluntary changes in accounting principles required recognition via a cumulative effect adjustment within net income of the period of the change. SFAS 154 requires retrospective application to prior periods financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005; however, SFAS 154 does not change the transition provisions of any existing accounting pronouncements.

In June 2005, the Emerging Issues Task Force (EITF) issued No. 05-06 *Determining the Amortization Period for Leasehold Improvements* (EITF 05-6). The pronouncement requires that leasehold improvements acquired in a business combination or purchase, significantly after the inception of the lease, be amortized over the lesser of the useful life of the asset or the lease term that includes reasonably assured lease renewals as determined on the date of the acquisition of the leasehold improvement. This pronouncement should be applied prospectively effective beginning on January 1, 2006. The Company does not expect the adoption of EITF 05-6 will have a material impact on its consolidated financial position, results of operations or cash flows.

On December 16, 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payment (SFAS No. 123R). SFAS No. 123R eliminates the alternative of applying the intrinsic value measurement provisions of APB Opinion No. 25 (APB 25) to stock compensation awards issued to employees. Rather, the new standard requires enterprises to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide services in exchange for the award, known as the requisite service period (usually the vesting period).

SFAS No. 123R will be effective for our fiscal quarter beginning January 1, 2006, and requires the use of the Modified Prospective Application Method. Under this method, SFAS No. 123R is applied to new awards and to awards modified, repurchased, or cancelled after the effective date. Additionally, compensation cost for the portion of awards for which the requisite service has not been rendered (such as unvested options) that is outstanding as of the date of adoption shall be recognized as the remaining requisite services are rendered. We are in the process of evaluating the approximate impact of SFAS No. 123R for the remainder of fiscal 2006, however, we expect the impact to be material. The actual effects of adopting SFAS No. 123R will depend on numerous factors including, but not limited to, the assumed award forfeiture rate and the accounting policies adopted concerning the method of recognizing the fair value of awards over the requisite service period.

On March 29, 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB 107) regarding the Staff s interpretation of Share-Based Payments. This interpretation expresses the views of the staff regarding the interaction between SFAS 123(R) and certain SEC rules and regulations and provides the staff s views regarding the valuation of share-based payment arrangements for public companies. In particular, this SAB provides guidance related to share-based payment transactions with non-employees, the transition from nonpublic to public entity status, valuation methods, the accounting for certain redeemable financial instruments issued under share-based payment arrangements, the classification of compensation expense, non-GAAP financial measures, first-time adoption of SFAS 123(R) in an interim period, capitalization of compensation cost related to share-based payment arrangements, the accounting for income tax effects of share-based payment arrangements upon adoption of SFAS 123(R), the modification of employee share options prior to adoption of Statement 123(R) and disclosures in Management s Discussion and Analysis, or MD&A, subsequent to adoption of SFAS 123(R). The Company will adopt SAB 107 in connection with its adoption of SFAS 123(R) in the first quarter of fiscal 2006, which is likely to have a material impact on our consolidated financial position and results of operations. The Company will adopt these new pronouncements using the Modified Prospective Application method as defined in SFAS 123 (R).

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In December 2004, the FASB issued Statement of Financial Accounting Standards No.153, *Exchanges of Nonmonetary Assets* (SFAS 153), an amendment of Accounting Principles Board Opinion No. 29. SFAS 153 addresses the measurement of exchanges of nonmonetary assets and redefines the scope of transactions that should be measured based on the fair value of the assets exchanged. SFAS 153 is effective for the Company for nonmonetary asset exchanges beginning in the first quarter of fiscal 2006. The adoption of SFAS 153 is not expected to have a material effect on the Company s consolidated financial position, results of operations or cash flows.

Reclassifications

Certain prior year amounts have been reclassified to conform with the current year presentation, including a reclassification of a portion of our deferred revenue and deferred rent as of December 31, 2004 to long term liabilities to conform with the current period presentation. Such reclassifications had no impact on the results of operations, stockholders equity, or net cash generated by operating activities for the years presented.

2. Investment in Actuate Japan

On October 24, 2005 a minority shareholder of Actuate Japan exercised its right to put its equity interest in Actuate Japan. As a result, Actuate paid the minority shareholder $366,000 to purchase their 11.7% equity interest. As of December 31, 2005, the Company now owns 78% of the outstanding shares of Actuate Japan. The minority shareholders of Actuate Japan have the option to put their remaining 22% equity interest (Minority Interest) in Actuate Japan and the Company has the option to call the Minority Interest for approximately $756,000. The price increases each year by 2% over the then prevailing long-term prime rate. Actuate s policy is to record a loss, if any, at the time that the put or call is probable of being exercised. Should an indicator arise that the Minority Interest has declined in value below the exercise price of the put option, the Company would conclude that exercise is probable at that point in time and recognize a liability for the intrinsic value of the option. Actuate has not recorded any losses on the put/call option to date.

3. Acquisitions

Nimble

On July 25, 2003, Actuate acquired 100% of the outstanding stock of Nimble Technology, Inc. (Nimble), a privately held Enterprise Information Integration (EII) software company. The results of operations of Nimble are included in Actuate s consolidated financial statements from the date of acquisition. Nimble s EII product enables organizations to intelligently harness business information and to simplify the task of data integration when building web services and applications. Actuate intends to enhance and improve its product capabilities by incorporating Nimble s EII technology into its existing products.

Nimble was considered to be a development stage enterprise and did not meet the definition of a business under SFAS 141, *Business Combinations* , for business combination purposes. In accordance with SFAS 141, the acquisition of Nimble was accounted for as an acquisition of assets. The total purchase price was $4.8 million, consisting of a net cash payment of $3.1 million, net assumed liabilities of $1.6 million and acquisition-related expenses of $101,000. The total purchase price was allocated to various tangible and identifiable intangible assets, which consisted of $172,000 of cash, accounts receivable of $5,000, fixed assets of $255,000, acquired workforce of $408,000, purchased in-process research and development of $600,000, core technology of $3.1 million, and $248,000 of deferred compensation. The identifiable intangible assets of acquired workforce and core technology are being amortized on a straight-line basis over two years and five years, respectively. Purchased in-process research and development was expensed in the quarter ended

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2003 because the purchased in-process research and development had not reached technological feasibility and had no alternative uses. The value of the purchased in-process research and development was computed using the cost approach, which estimated the value by determining the current cost of replacing an asset with one of equivalent economic utility. The value of the core technology was computed using a discounted cash flow analysis based on management s estimates of future revenues and operating costs and expenses related to the technologies acquired from Nimble.

4. Cash Equivalents and Short-Term Investments

All cash equivalents and short-term investments have been classified as available for-sale securities and are detailed as follows (in thousands):

	Cost	Net Unrealized Gains	Net Unrealized Losses	Estimated Fair Value
Balance at December 31, 2005				
Classified as cash and cash equivalents:				
Cash	$ 12,376	$	$	$ 12,376
Money market funds	114			114
	12,490			12,490
Classified as short-term investments:				
Auction preferred	24,150			24,150
Corporate bonds	12,881		(78)	12,803
Federal and municipal obligations	5,000		(46)	4,954
	42,031		(124)	41,907
Total	$ 54,521	$	$ (124)	$ 54,397

	Cost	Net Unrealized Gains	Net Unrealized Losses	Estimated Fair Value
Balance at December 31, 2004				
Classified as cash and cash equivalents:				
Cash	$ 6,313	$	$	$ 6,313
Money market funds	1,028			1,028
	7,341			7,341

Classified as short-term investments:				
Auction preferred	8,747	3		8,750
Corporate bonds	3,108		(14)	3,094
Federal and municipal obligations	28,146		(58)	28,088
	40,001	3	(72)	39,932
Total	$ 47,342	$ 3	$ (72)	$ 47,273

Any individual security in the above tables with an unrealized loss has been in a continuous unrealized loss position for less than twelve months. At this time, the Company believes that, due to the nature of the Company s investments, the financial condition of the issuer and the Company s ability to hold these investments through these short-term loss positions, factors would not indicate that these unrealized losses should be viewed as other-than-temporary.

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As of December 31, 2005, the stated maturities of the Company s short-term investments are $25.2 million within one year and $16.8 million beyond one year. As of December 31, 2004, the stated maturities of the Company s short-term investments are $20.9 million within one year and $19.0 million beyond one year. These investments are generally classified as available-for-sale and are recorded on the balance sheet at fair market value with unrealized gains or losses reported as a separate component of accumulated other comprehensive income, net of tax. Actuate views all of its marketable securities as highly liquid and available for use in current operations. Accordingly, Actuate has classified all of its marketable securities as short-term investments, even though the stated maturity dates may be one year or more beyond the current balance sheet date.

In addition, all auction rate securities, including auction preferred and short-term municipals, are classified as short-term investments regardless of the underlying reset date.

5. Property and Equipment

Property and equipment consist of the following (in thousands):

	December 31,	
	2005	**2004**
Furniture and fixtures	$ 3,535	$ 3,983
Computers and purchased software	7,411	7,537
Leasehold improvements	3,904	3,843
Total	14,850	15,363
Less: accumulated depreciation and amortization	(10,134)	(9,205)
Property and equipment, net	$ 4,716	$ 6,158

In the first quarter of fiscal year 2004, the Company began the implementation of a new enterprise accounting system. In accordance with Statement of Position (SOP) No. 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, all appropriate implementation costs were capitalized from the beginning of the implementation of the project until the date in which the implementation was substantially complete. Capitalizable costs include all internal and external costs incurred to develop the internal use software during the application development stage. Such costs include the cost of external consultants and payroll and payroll related costs for personnel directly associated with the project. As of December 31, 2005 and 2004, a total of $2.8 million and $2.7 million had been capitalized under this project. The total capitalized implementation costs are being amortized over an estimated useful life of seven years. Amortization began upon activation of the new system in August of fiscal year 2004.

6. Goodwill and Purchased Intangible Assets

In accordance with SFAS 142, the Company performs its annual impairment test of goodwill on October 1 of each year. For fiscal years 2005, 2004 and 2003, the annual impairment tests did not result in an impairment of recorded goodwill.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Purchased intangible assets consist of the following (in thousands):

	December 31, 2005				December 31, 2004		
	Gross Carrying Amount	Accumulated Amortization	Adjustment to Purchase Price Allocation	Net Balance	Gross Carrying Amount	Accumulated Amortization	Net Balance
Customer lists	$ 10,600	$ (10,600)	$	$	$ 10,600	$ (10,396)	$ 204
Workforce	408	(408)			408	(289)	119
Purchased technologies	6,767	(5,050)	(578)	1,139	6,767	(4,136)	2,631
Non-compete agreements	1,030	(1,030)			1,030	(938)	92
Trademark	700	(700)			700	(629)	71
	$ 19,505	$ (17,788)	$ (578)	$ 1,139	$ 19,505	$ (16,388)	$ 3,117

Amortization expense of purchased intangible assets was $1.4 million, $2.6 million and $3.2 million for the years ended December 31, 2005, 2004 and 2003, respectively, which is included in cost of license fees and amortization of purchased intangibles in the accompanying consolidated statement of operations. The expected remaining annual amortization expense is summarized as follows (in thousands):

Fiscal Year	Amortization Amount
2006	$ 441
2007	441
2008	257
	$ 1,139

In April 2005, a minority shareholder of Actuate Japan notified us that it wished to exercise its right to put its equity interest in Actuate Japan. This minority shareholder exercised its right on October 24, 2005 resulting in a payment of $366,000 by Actuate. As a result of this payment we adjusted our investment in Actuate Japan and increased goodwill by the amount equal to the payment made on October 24, 2005. We also made adjustments to goodwill and purchased technology by the tax affected portion of the net operating losses (NOLs) utilized with respect to the Tidestone and Nimble acquisitions, respectively. These adjustments resulted in reductions of approximately $142,000 and $51,000 to our goodwill and purchased intangibles balances, respectively. As of December 31, 2005, the carrying amount of our goodwill was $20.9 million.

7. Deferred Revenue

Deferred revenue consists of the following (in thousands):

	December 31,	
	2005	**2004**
Maintenance and support	$ 24,948	$ 25,168
Other	7,440	3,595
	$ 32,388	$ 28,763

Maintenance and support consists of first year maintenance and support services associated with the initial purchase of Actuate s software, and the renewal of annual maintenance and support services from customers who purchased Actuate s software in prior periods. The maintenance and support period is generally 12 months and revenues are typically recognized on a straight-line basis over the term of the maintenance and support period.

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Other deferred revenue consisted of deferred license, training and consulting fees generated from arrangements, which did not meet some or all of the revenue recognition criteria of SOP No. 97-2 and are, therefore, deferred until all revenue recognition criteria have been met.

8. Contractual Obligations and Commercial Commitments

Operating Lease Commitments

Actuate leases its headquarter facilities under non-cancelable operating leases expiring in April 2011. For leases with escalating rent payments, rent expense is amortized on a straight-line basis over the life of the lease. The Company has deferred rent of approximately $198,000 and $320,000 as of December 31, 2005 and 2004, respectively.

In December 2000, the Company entered into a ten-year building lease agreement for additional office space in a building adjacent to Actuate s headquarters in South San Francisco, California. Actuate has not occupied any space in this facility. However, Actuate does sublease some of the space in this adjacent facility to a third party. The Company recorded a charge of $24.8 million related to the exit of this idle facility during fiscal year 2002. See Note 10 (Restructuring Charges) for further discussion. In conjunction with the signing of these two building leases, Actuate provided the landlord with a letter of credit in the amount of $3.9 million as a security deposit. The value of the letter of credit has decreased over time. As of December 31, 2005, $1.8 million in letters of credit remain securing these leases. Actuate has granted a security interest in all of its assets as a security for the letter of credit.

In addition to the Company s operating leases related to its headquarters, Actuate also has operating leases for various smaller facilities which house its foreign offices. Rent expense for all facilities under operating leases was approximately $4.3 million, $5.0 million and $5.0 million in fiscal years 2005, 2004, and 2003, respectively. Aggregate minimum lease commitments under all operating leases are as follows (in thousands):

Fiscal Year	Future minimum lease payment	Future contractual sublease proceeds	Net future minimum lease payments
2006	$ 7,029	(1,296)	$ 5,733
2007	6,668	(1,397)	5,271
2008	4,038	(1,522)	2,516
2009	3,704	(1,215)	2,489
Thereafter	4,846		4,846
	$ 26,285	$ (5,430)	$ 20,855

9. Stockholders Equity

Preferred Stock

Under the terms of the certificate of incorporation, the board of directors is authorized, subject to any limitations prescribed by law, to issue the preferred stock in one or more series. Each series shall have the rights, preferences, privileges and restrictions, such as dividend rights, dividend rates, conversion rights, voting rights, terms of redemption, redemption prices, liquidation preferences and the right to increase or decrease the number of shares of any series, as the board of directors shall determine. The board of directors may issue preferred stock with voting or conversion rights that may have the effect of delaying, deferring or preventing a change in control of Actuate and could adversely affect the market price of the common stock and the voting and other rights of the holders of common stock. The Company currently has no plans to issue any of the preferred stock.

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ACTUATE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Stock Option Plans

Amended and Restated 1998 Equity Incentive Plan. In May 1998, the Amended and Restated 1998 Equity Incentive Plan (the 1998 Plan) was adopted by the board of directors and approved by the stockholders in July 1998. Employees, consultants and directors are eligible for awards under the 1998 Plan. Initially, a total of 5,200,000 shares of common stock were reserved for issuance under the 1998 Plan. As of January 1 of each year, the number of shares reserved for issuance under the 1998 Plan will be increased automatically by the lesser of (i) 5% of the total number of shares of common stock then outstanding or (ii) 2,800,000 shares. The 1998 Plan has been amended and restated to account for stock splits.

Under the 1998 Plan, eligible participants may be awarded options to purchase shares of common stock, stock appreciation rights (SARs), restricted shares or stock units (collectively, the Awards). Options under the 1998 Plan may be incentive stock options designed to satisfy Section 422 of the Internal Revenue Code of 1986, as amended (the Code) or non-statutory stock options not designed to meet such requirements. If restricted shares or shares issued upon the exercise of options granted under the 1998 Plan are forfeited, then such shares will again become available for awards under the 1998 Plan. If stock units, options or SARs granted under the 1998 Plan are forfeited or terminated for any other reason before being exercised, then the corresponding shares will again become available for awards under the 1998 Plan. The exercise price for non-statutory and incentive stock options granted under the 1998 Plan may not be less than 85% or 100%, respectively, of the fair market value of the common stock on the option grant date. The Board may amend or terminate the 1998 Plan at any time. Amendments may be subject to stockholder approval to the extent required by applicable laws.

Options granted under the 1998 Plan are exercisable when vested. Shares generally vest at the rate of 20% or 25% after one year from the date of grant and the remaining balance vesting monthly over the next four or three years. Upon a change in control, an Award under the 1998 Plan will become fully vested as to all shares subject to such Award if such Award is not assumed by the surviving corporation or its parent and the surviving corporation or its parent does not substitute such Award with another award of substantially the same terms. In the event of an involuntary termination of a participant within 12 months following a change in control, the vesting of an Award under the 1998 Plan will accelerate in full. All outstanding repurchase rights under the 1998 Plan shall terminate automatically upon the occurrence of any merger, consolidation, or disposition of all or substantially all of the Company s assets, except to the extent the repurchase rights are expressly assigned to the successor corporation. As of December 31, 2005, 10,522,158 shares of common stock were reserved and available for future grants under the 1998 Option Plan.

2001 Supplemental Stock Plan. In January 2001, the board of directors adopted the 2001 Supplemental Stock Plan (the 2001 Plan). A total of 2,700,000 shares of common stock were reserved for issuance under the 2001 Plan. Employees and consultants are eligible for awards under the 2001 Plan. Members of the board of directors and officers of Actuate are not eligible to receive awards under the 2001 Plan.

Under the 2001 Plan, eligible participants may be awarded options to purchase shares of common stock and restricted shares only. All options granted under the 2001 Plan are non-statutory stock options. If restricted shares or shares issued upon the exercise of options granted under the 2001 Plan are forfeited, then such shares will again become available for awards under the 2001 Plan. The exercise price for non-statutory and incentive stock options granted under the 2001 Plan may not be less than 85% or 100%, respectively, of the fair market value of the common stock on the option grant date. The Board may amend or terminate the 2001 Plan at any time. Amendments may be subject to stockholder approval to the extent required by applicable laws.

Options granted under the 2001 Plan are exercisable when vested. Shares generally vest at the rate of 25% after one year from the date of grant and the remaining balance vesting monthly over the next four years. Upon a

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

change in control, an Award under the 2001 Plan will become fully vested as to all shares subject to such Award if such Award is not assumed by the surviving corporation or its parent and the surviving corporation or its parent does not substitute such Award with another award of substantially the same terms. In the event of an involuntary termination of a participant within 12 months following a change in control, the vesting of an Award under the 2001 Plan will accelerate in full. All outstanding repurchase rights under the 2001 Plan shall terminate automatically upon the occurrence of any merger, consolidation, or disposition of all or substantially all of the Company s assets, except to the extent the repurchase rights are expressly assigned to the successor corporation. As of December 31, 2005, 647,271 shares of common stock were reserved and available for future grants under the 2001 Option Plan.

Tidestone Technologies Stock Option Plans. Tidestone Technologies, Inc. s 1998 Incentive Stock Option Plan (T-98 Option Plan) and Non-qualified Stock Option Plan of 1999 (T-99 Option Plan) were assumed by the Company on May 30, 2001, in connection with the acquisition of Tidestone. The T-98 Option Plan and the T-99 Option Plan are collectively known as the Tidestone Option Plans . Each option under the Tidestone Option Plans was converted into a right to receive an option to purchase shares of Actuate s common stock. A total of 77,968 and 70,509 shares of common stock have been authorized for issuance under the T-98 Option Plan and T-99 Option Plan, respectively.

All options granted under the T-98 Option Plan are incentive stock options qualified under Section 422 of the Code, with a vesting term of five years while the options granted under the T-99 Option Plan are non-statutory stock options with a vesting term of three years. Options granted under the Tidestone Option Plans are generally exercisable upon grant, subject to repurchase rights by us until vested. Under the T-99 Option Plan, shares generally vest at the rate 33% annually. Under the T-98 Option Plan, shares generally vest at the rate of 20% annually. Upon a change in control, an Award under the Tidestone Option Plans will become fully vested as to all shares subject to such Award if such Award is not assumed by the surviving corporation or its parent and the surviving corporation or its parent does not substitute such Award with another award of substantially the same terms. As of December 31, 2005, 31,987 and 2,055 shares of common stock were reserved and available for future grants under the T-98 Option and T-99 Option Plan, respectively.

1998 Non-Employee Director Option Plan. The 1998 Non-Employee Directors Option Plan (the Directors Option Plan) was adopted by the board of directors in May 1998, and approved by the stockholders in July 1998. The Director Option Plan provides for non-employee members of the Board of Directors to be eligible for automatic option grants. 800,000 shares of common stock have been authorized for issuance under the Directors Option Plan. Each individual who first joins the board as a non-employee director, whether through election or appointment, will receive at that time an automatic option grant for 80,000 shares of common stock. With respect to the initial automatic option grant, the option will become exercisable as to 25% of the shares after one year of board service, with the balance of the shares becoming exercisable ratably in 36 monthly installments over the remaining period of optionee s board service. At each annual stockholders meeting beginning in fiscal year 1999, each current non-employee director will automatically be granted a stock option to purchase 10,000 shares of common stock, whether or not he or she is standing for re-election at that particular meeting, which will become fully vested and exercisable on the first anniversary of such meeting. Each option will have an exercise price equal to the fair market value of the common stock on the automatic grant date and a maximum term of ten years, subject to earlier termination following the optionee s cessation of Board service.

The Board may amend or modify the Directors Option Plan at any time. The Directors Option Plan will terminate on May 27, 2008, unless terminated sooner by the board. However, vesting will automatically accelerate in full upon (i) an acquisition of Actuate by merger, consolidation or asset sale, (ii) a tender offer for more than 50% of the outstanding voting stock or proxy contest for Board membership or (iii) the death or disability of the optionee while serving as a Board member. As of December 31, 2005, 370,000 shares of common stock were reserved and available for future grants under the Directors Option Plan.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Stock Option Exchange Program

2002 Option Exchange Program

On July 25, 2002, Actuate s board of directors approved a voluntary stock option exchange program whereby employees were given the opportunity, if they so chose, to cancel outstanding stock options previously granted to them that were priced at $5.00 and above in exchange for an equal number of new options. Employees choosing to participate in this exchange were required to cancel all options granted in the past six months, even if such options were granted at below $5.00 per share. The new options were granted six months and one day following the date of cancellation of the original options with the exercise price equaling the fair market value at the date of the new grant. The new options had the same vesting schedule as the cancelled options. The exchange program has been organized to comply with FASB Interpretation No. 44 Accounting for Certain Transactions Involving Stock Compensation and did not result in any additional compensation charges or variable plan accounting. All employees of the Company were eligible to participate in this program.

The total number of shares cancelled on August 30, 2002 under this 2002 Option Exchange Program was 10,053,821. The average price per share of the options cancelled was $13.82 and the new option price for options granted on March 3, 2003 under the 2002 Option Exchange Program was $1.49 per share. The new options have the same vesting schedule as the cancelled options.

Activity under all option plans was as follows:

	Shares Available For Grant	Outstanding Options		Weighted-
		Number of Shares	Price Per Share	Average Exercise Price
Balance at December 31, 2002	15,992,804	9,928,211	$ 0.06-$35.25	$ 4.95
Additional authorization	2,800,000			
Options granted	(11,773,183)	11,773,183	$ 1.27-$4.16	$ 1.67
Options exercised		(1,050,527)	$ 0.06-$3.75	$ 1.48
Options forfeited	1,408,668	(1,408,668)	$ 1.04-$35.25	$ 8.81
Balance at December 31, 2003	8,428,289	19,242,199	$ 0.06-$31.19	$ 2.85
Additional authorization	2,800,000			
Options granted	(3,220,800)	3,220,800	$ 2.40-$4.28	$ 2.92
Options exercised		(1,362,476)	$ 0.06-$3.75	$ 1.54
Options forfeited	2,056,619	(2,021,390)	$ 0.79-$6.90	$ 3.43

Balance at December 31, 2004	10,064,108	19,079,133	$	0.06-$31.19	$	2.90
Additional authorization	2,800,000					
Options granted	(3,014,030)	3,014,030	$	1.80-$3.47	$	2.43
Options exercised		(1,077,366)	$	0.06-$2.90	$	1.44
Options forfeited	1,723,393	(1,723,393)	$	0.82-$7.59	$	3.73
Balance at December 31, 2005	11,573,471	19,292,404	$	0.16-$31.19	$	2.83

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	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number of Shares	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price
$0.016-$1.49	7,520,504	6.57 years	$ 1.44	7,250,601	$ 1.44
$1.56-$2.48	2,885,790	8.79 years	$ 2.34	249,834	$ 1.95
$2.49-$3.53	4,155,661	6.61 years	$ 3.07	2,376,043	$ 3.23
$3.56-$4.41	3,240,201	6.22 years	$ 3.87	2,972,262	$ 3.89
$4.44-$31.19	1,490,248	5.52 years	$ 7.84	1,424,003	$ 7.98
$0.16-$31.19	19,292,404	6.77 years	$ 2.83	14,272,743	$ 2.91

At December 31, 2005 and 2004, 14,272,743 and 14,310,487 options were vested and exercisable, respectively.

Amended and Restated 1998 Employee Stock Purchase Plan

The 1998 Amended and Restated Employee Stock Purchase Plan (the Purchase Plan) was adopted by the board of directors in May 1998, and approved by the stockholders in July 1998. A total of 1,000,000 shares of common stock were initially reserved for issuance under the Purchase Plan. On January 1 of each year, the number of shares reserved for issuance under the Purchase Plan is automatically increased by 600,000 shares. The Purchase Plan is intended to qualify under Section 423 of the Code. Each calendar year, two overlapping 24-month offering periods will commence on February 1 and August 1. Each offering period contains four six-month accumulation periods, with purchases occurring at the end of each six-month accumulation period. If the market price of Actuate s stock at the end of any six-month purchase period is lower than the stock price at the original grant date, the plan is cancelled immediately after that purchase date. A new 24-month offering period is established using the then-current stock price as the base purchase price. The Purchase Plan permits each eligible employee to purchase common stock through payroll deductions, which may not exceed 15% of an employee s cash compensation. No more than 500 shares may be purchased by any individual on any accumulation date. The price of each share of common stock purchased under the Purchase Plan will be 85% of the lower of (i) the fair market value per share of common stock on the date immediately prior to the first date of the applicable offering period or (ii) the date at the end of the applicable accumulation period. Employees may end their participation in the Purchase Plan at any time during the accumulation period, and participation ends automatically upon termination of employment with us. The Purchase Plan has been amended and restated to account for stock splits. As of December 31, 2005, 4,339,427 shares had been purchased under the Purchase Plan and 860,573 shares of common stock were reserved and available for future issuance.

As of December 31, 2005, shares of common stock reserved for future issuance consisted of 12,434,044 securities available for future issuance and 19,292,404 of options outstanding.

Pro Forma Information

Until the Company s required adoption of SFAS 123R in the first quarter of fiscal year 2006, Actuate has elected to follow APB 25 and related interpretations in accounting for its employee stock options. Under APB 25, because the exercise price of Actuate s employee stock options equals the market price of the underlying stock on the date of the grant, no compensation expense is recognized.

Pro forma information regarding net income (loss) is required by SFAS 123, which requires that the information be determined as if the Company has accounted for its employee stock-based awards under the fair

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value method of SFAS 123. The fair value of the options granted in all periods was estimated using the Black-Scholes method, with the following weighted-average assumptions:

	Year ended December 31,		
	2005	2004	2003
Dividends	0%	0%	0%
Risk-free interest rate	3.50%	2.67%	3.38%
Expected life (in years)	3.0	3.0	3.0
Expected volatility	95%	113%	93%

The pro forma amounts disclosed in Note 1 may not be representative of the effects on pro forma net income (loss) for future years as options vest over several years, additional awards may be granted and awards may be cancelled in subsequent years.

The weighted-average grant date fair value of stock options granted was $1.82 in fiscal year 2005, $2.39 in fiscal year 2004 and $1.23 in fiscal year 2003.

During fiscal years 2005, 2004 and 2003, Actuate issued 213,669 shares, 125,913 shares and 1,492,742 shares, respectively, under the Purchase Plan. The weighted-average deemed fair value of employees stock purchase rights under the Purchase Plan during fiscal years 2005, 2004 and 2003 was $0.77, $1.54 and $1.28, respectively. The fair value of the purchase rights granted in fiscal years 2005, 2004 and 2003 was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions: risk-free interest rate of 3.87%, 3.38% and 1.31% for fiscal years 2005, 2004 and 2003, respectively; expected dividend yield of zero percent and expected life of six months for fiscal years 2005, 2004 and 2003; and expected volatility of 45%, 93% and 93% for fiscal years 2005, 2004 and 2003, respectively.

Stock Repurchase Program

On September 19, 2001, the Company s Board of Directors authorized a stock repurchase program of up to $6.0 million of the Company s common stock. On October 24, 2002 and April 28, 2004 Actuate s Board of Directors extended the stock repurchase program by authorizing management to repurchase up to an additional $3.0 million and $1.5 million of the Company s common stock, respectively. On July 28, 2004, the Company s Board of Directors authorized management to repurchase, on an on-going basis, up to $1.5 million Actuate common stock each calendar quarter.

In January 2005, pursuant to the stock repurchase program announced in September 2001, the Board of Directors approved an on-going extension of the Company s stock repurchase program. This was further confirmed in April 2005, July 2005 and October 2005 when the Board of Directors authorized management to proceed with the repurchases. The Company is authorized to repurchase Actuate common stock in an amount not to exceed cash flow from operations during the prior quarter, with the actual amount to be approved in advance by the Board. During the fiscal year 2005, the Company repurchased a total of 3.0 million shares of the Company s common stock, totaling approximately $7.1 million.

10. Restructuring Charges

2004 Restructuring Plan

During fiscal year 2004, the Company underwent a restructuring that was carried out in two phases. The first occurred in the first quarter of fiscal year 2004 when the Company initiated a restructuring of its world wide

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

sales operations. The Company undertook this restructuring in order to size the operation to meet the expected business and economic environment for its products overseas and to shift its sales strategy in certain countries from one based primarily on direct sales to a strategy more dependent on indirect sales channels. This restructuring consisted primarily of a workforce reduction and associated legal expenses which resulted in a headcount reduction of five people and associated severance, benefit and related legal costs of $586,000 during the first quarter of 2004.

In early October 2004, Actuate implemented an additional restructuring. This company-wide restructuring was undertaken to align the Company s cost structure with future revenue expectations. The costs associated with this restructuring totaled $1.4 million in the fourth quarter of 2004 and were primarily comprised of severance and related costs. The restructuring plan resulted in the elimination of approximately 9% of the Company s worldwide workforce or 53 positions across all levels and functions. The employee termination benefits were communicated to the affected employees by December 31, 2004. The Company incurred additional expenditures of approximately $665,000 during fiscal year 2005 related to this restructuring. These additional charges are primarily related to idle facility costs of one of Actuate s international sales facilities.

2002 Restructuring Plan

In response to the continuing global economic slowdown, Actuate developed a workforce reduction and a facility exit plan in the third quarter of fiscal year 2002. As a result of this restructuring plan, Actuate recorded a charge of $27.1 million (consisting of a $24.8 million idle facility charge and a $2.3 million workforce reduction charge) in the third quarter of fiscal year 2002. The goal of this restructuring plan was to reduce costs and improve operating efficiencies to adjust to the current business environment. Specifically, it was the Company s decision, under this plan, to eliminate excess facility capacity in light of its revised facility requirements and to reduce worldwide headcount by approximately 14% (or 80 employees). These initial restructuring charges were based on assumptions and related estimates that were deemed appropriate for the economic environment that existed at the time these estimates were made. However, due to the changes to Actuate s previous assumptions and estimates of its severance and benefits liabilities and the final terms and conditions of its facility subleases, Actuate made the appropriate adjustments, in the second quarter of fiscal year 2003, to the initial restructuring charges recorded in fiscal year 2002. These adjustments were immaterial and had no net effect on Actuate s consolidated financial statements.

Actuate initially recorded a charge of $24.8 million related to the exit of its idle facility. The facility exit charge was calculated using management s best estimates and included $21.5 million of estimated future obligations for non-cancelable lease payments (net of $10.2 million of estimated sublease income) and estimated costs associated with subleasing the property (e.g., leasing commissions). The remaining $3.3 million was related to the write-off of furniture and fixtures associated with the 801 Gateway facilities. As discussed above, Actuate made an adjustment of $188,000 to increase this facility exit liability during the second quarter of fiscal year 2003. The facility had been idle since the leasing term began in May 2001 and Actuate formally made a decision to exit this facility during the third quarter of fiscal year 2002. The estimated costs of exiting the facility, including estimated costs to sublease, were based on market information and trend analysis. As of December 31, 2005, approximately $12.3 million of lease exit costs, net of anticipated sublease income, remain accrued and are expected to be fully utilized by fiscal year 2011. In calculating the facility exit charge, certain assumptions were made relating to such factors as the estimated time periods of vacancy and sublease rates and opportunities. Actual future cash requirements may differ materially from the accrual at December 31, 2005, particularly if the actual sublease income is significantly different from current estimates or if the Company is unsuccessful in its efforts to sublease its facility. The facility exit charge also included a $3.4 million write-off of property and equipment (primarily leaseholds improvements) as a result of the abandonment of leased facilities.

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ACTUATE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Actuate also recorded a workforce reduction charge of $2.3 million related to severance and fringe benefits for terminated employees. The restructuring resulted in the termination of 90 employees across all employee levels, business functions, operating units and geographic regions. As of December 31, 2002, approximately 70 employees had been terminated as a result of the restructuring. The remaining employee terminations were completed and the remaining severance amounts totaling $480,000 were paid in 2003.

The following table summarizes the analysis of the restructuring accrual activity for the fiscal years ended December 31, 2003, 2004 and 2005 (in thousands):

	Severance & Benefits	Facility Related	Total
Balance at December 31, 2002	$ 668	$ 20,195	$ 20,863
Cash payments	(480)	(3,767)	(4,247)
Changes in estimate	(188)	188	
Rents collected on the sublease		646	646
Balance at December 31, 2003		17,262	17,262
Restructuring charges	2,006		2,006
Cash payments	(612)	(3,649)	(4,261)
Changes in estimate	(125)		(125)
Rents collected on the sublease		1,352	1,352
Balance at December 31, 2004	1,269	14,965	16,234
Restructuring charges	744	(79)	665
Cash payments	(1,106)	(4,062)	(5,168)
Changes in estimate	(442)	278	(164)
Rents collected on the sublease		1,266	1,266
	465	12,368	12,833
Less: Current portion	(465)	(2,483)	(2,948)
Balance at December 31, 2005	$	$ 9,885	$ 9,885

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ACTUATE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. Income Taxes

Income Taxes

The provision for income taxes consists of the following (in thousands):

	Year ended December 31,		
	2005	2004	2003
Federal:			
Current	$ 1,855	$ 544	$ 153
Deferred			2,730
	1,855	544	2,883
State:			
Current	394	155	44
Deferred			234
	394	155	278
Foreign:			
Current	239	187	381
Deferred	(129)		
	110	187	381
Provision for income taxes	$ 2,359	$ 886	$ 3,542

The tax benefits associated with exercises of stock options reduced taxes currently payable as shown above by $2.1 million, $880,000 and $163,000 for the years ended December 31, 2005, 2004 and 2003, respectively. Such benefits were credited to additional paid-in capital when realized. Tax benefits associated with the reduction of tax reserves reduced taxes currently payable by $500,000 in 2005. Tax benefits associated with the utilization of acquired net operating loss carryforwards reduced taxes currently payable as shown above by $192,745 in 2005. Of these benefits, approximately $51,000 was credited to purchased technology and $142,000 to goodwill in fiscal year 2005.

The profit (loss) before income taxes for foreign operations was $3.7 million $(3.5) million and $(5.4) million, for the years ended December 31, 2005, 2004 and 2003, respectively. The profit before income taxes for domestic operations was $10.3, $5.7 million, and $4.4 million, for the years ended December 31, 2005, 2004 and 2003, respectively.

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ACTUATE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The difference between the provision for income taxes and the amount computed by applying the federal statutory rate (35 percent) to income before taxes is explained below (in thousands):

	Year ended December 31,		
	2005	2004	2003
Income taxes at federal statutory rate	$ 4,883	$ 764	$ (334)
Non-deductible goodwill			210
Operating loss not utilized		601	3,944
Foreign tax rate differential	(941)		
Valuation allowance	(1,134)		
State tax, net of federal benefit	172	125	181
Tax credits	(123)	(319)	(442)
Reduction of tax reserves	(500)	(333)	
Other	2	48	(17)
	$ 2,359	$ 886	$ 3,542

As of December 31, 2005, Actuate had federal and state net operating loss carryforwards of approximately $37 million and $1 million, respectively. The federal net operating loss carryforwards will expire at various dates beginning in the year 2020 through 2023 if not utilized. The state net operating loss carryforwards will expire at various dates beginning in the year 2013 through 2014 if not utilized. As of December 31, 2005 Actuate had federal and state research tax credit carryforwards of approximately $4.2 million and $5.6 million, respectively. The federal research credits will expire at various dates beginning in the year 2013 through 2024 if not utilized.

Utilization of the net operating losses and tax credits may be subject to a substantial annual limitation due to the ownership change limitations provided by Section 382 of the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of net operating losses and tax credits before utilization.

United States income and foreign withholding taxes have not been provided for on undistributed earnings for certain non-U.S. subsidiaries. The undistributed earnings on a book basis for the non-U.S. subsidiaries are $3.0 million. Actuate intends to reinvest these earnings indefinitely in its operations outside the U.S.

The Company s foreign headquarters are located in Fribourg, Switzerland and currently benefit from a federal and cantonal tax exemption in that jurisdiction. The ten year tax exemption was granted October 4, 2001 but the Company was given five years to meet specific business objectives in order to trigger the automatic five year renewal of the exemption. The objectives were to be met by December 31, 2005. These objectives had not been met and the Company requested an extension of time to meet the objectives. On December 28, 2005 the Company received the renewal of the tax exemption for an additional three years until December 31, 2008. If the Company meets the business objectives as originally outlined by the end of 2008, the tax exemption will be automatically renewed for the remaining two years to December 31, 2010. If they are not met, the exemption will cease on December 31, 2008.

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ACTUATE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Significant components of deferred tax assets and liabilities for federal and states are as follows (in thousands):

	December 31,	
	2005	**2004**
Deferred tax assets		
Net operating loss carryforwards	$ 15,049	$ 15,454
Research credit carryforwards	8,418	7,753
Capitalized research and development		57
Depreciation and amortization	2,612	3,495
Accruals and allowances not currently tax deductible	7,334	9,417
Total deferred tax assets	33,413	36,176
Valuation allowance	(32,600)	(34,574)
Net deferred tax assets	$ 813	$ 1,602
Deferred tax liabilities		
Acquired intangible assets	$ 684	$ 1,602
Net deferred tax assets	$ 129	$

SFAS No. 109, Accounting for Income Taxes , provides for the recognition of deferred tax assets if realization of such assets is more likely than not. The net valuation allowance decreased by approximately $1.9 million during the year ended December 31, 2005 and increased $1.1 million during the year ended December 31, 2004. The $1.9 million decrease in fiscal year 2005 results from decreases in gross deferred tax assets of approximately $2.9 million, and decreases of approximately $1 million in gross deferred tax liabilities. The $1.1 million increase in fiscal 2004 results from increases in gross deferred tax assets of approximately $675,000 and decreases of approximately $458,000 in gross deferred tax liabilities. As of December 31, 2005, approximately $5.5 million of the valuation allowance reflected above relates to the tax benefits of stock option deductions that will be credited to additional paid-in capital when realized, and approximately $12.9 million of the valuation allowance reflected above relates to the tax attributes from acquisitions that will be credited to intangibles and goodwill, if realized.

The deferred tax assets for December 31, 2004 increased compared to the deferred tax assets reported on the 2004 Annual Report. The increase was due to additional deferred tax assets related to acquired net operating losses, acquired tax credits and foreign net operating losses. The valuation allowance was increased to fully offset the increase in deferred tax assets.

On October 22, 2004, the American Jobs Creation Act of 2004 (Jobs Act) was enacted. Among other provisions, the Jobs Act provides for a deduction for income from qualified domestic production activities phased in from 2005 to 2010, and a temporary incentive for U.S.

corporations to repatriate accumulated income earned abroad. Actuate has not and does not plan to repatriate foreign earnings under the Jobs Act and have determined the impact of the deduction for domestic production activities. Such deduction is available to the Company in 2005. However, the deduction does not have an impact on our provision for income taxes due to the net operating losses utilized.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

12. Geographic Information

Actuate s primary operations are located in the United States. Revenues from international sources relate to export sales, primarily to Europe and Japan. Actuate s revenues by geographic area are as follows (in thousands):

	Year ended December 31,		
	2005	2004	2003
Revenues:			
North America	$ 81,223	$ 82,272	$ 85,020
Europe	20,674	17,516	16,094
Asia Pacific and others	4,504	4,869	3,341
Total revenue	$ 106,401	$ 104,657	$ 104,455

International sales accounted for 24%, 21% and 18% of Actuate s total revenues in fiscal 2005, 2004 and 2003, respectively. No single customer has accounted for 10% or more of total revenues in fiscal years 2005, 2004 or 2003.

The following table summarizes Actuate s revenue by products and services (in thousands).

	Year ended December 31,		
	2005	2004	2003
Revenues:			
License revenue	$ 36,939	$ 42,703	$ 47,598
Maintenance and support revenue	52,671	45,419	39,580
Professional services, training, and other revenue	16,791	16,535	17,277
Total revenue	$ 106,401	$ 104,657	$ 104,455

13. Contingencies

MicroStrategy Lawsuit

In June 2003, the Fairfax County Circuit Court in Fairfax, Virginia, ruled in favor of the Company and two of Actuate s employees on all counts in the trade secret lawsuit filed by MicroStrategy Incorporated. In July 2003, MicroStrategy filed a Notice of Leave to Appeal with the Circuit Court and in September 2003, MicroStrategy filed a Petition for Appeal with the Virginia State Supreme Court. In March 2004, the Virginia State Supreme Court agreed to hear a portion of MicroStrategy s Petition for Appeal and such appeal was heard in June 2004. In September 2004, the Virginia State Supreme Court affirmed the trial court s decision.

SEC Investigation

In January 2004, Actuate was informed that the staff of the Securities and Exchange Commission (SEC) terminated its investigation related to two software license transactions that Actuate completed with Unify Corporation in early 2000 and that no enforcement action has been recommended.

Actuate is also engaged in certain other legal actions arising in the ordinary course of business. Although there can be no assurance as to the outcome of such litigation, Actuate believes it has adequate legal defenses and it believes that the ultimate outcome of any of these actions will not have a material effect on its consolidated financial position or results of operations.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

14. Subsequent Events

In January 2006, the Company acquired all of the outstanding shares of capital stock of performancesoft Inc. performancesoft is a privately-held entity headquartered in Toronto, Canada, and is a leading provider of performance management solutions software and services. They provide a total performance management solution that helps organizations to measure their performance, manage all areas of their business, and outperform their competitors through more effective decision-making, efficient management reporting and increased accountability. The Company intends to enhance its current product offering by adding performancesoft s products and technology to its existing product line.

The acquisition principally consisted of an initial cash purchase price of $16.5 million and additional contingent cash consideration of up to $13.5 million based on the achievement of certain revenue and operating margin targets for 2006. This contingent consideration would be payable in 2007. Due to the fact that the contingent consideration is currently not determinable beyond a reasonable doubt, the Company does not expect to include this contingent consideration in the acquisition accounting at the date of acquisition. Rather, it will be recorded when the contingency is resolved. At that time, the Company will record the current fair value of any additional consideration as additional cost of the acquired enterprise. This cost would be allocated to the appropriate assets and amortized over the remaining useful lives. The acquisition will be accounted for in the first quarter of fiscal year 2006 under the purchase method of accounting in accordance with SFAS 141, Business Combinations . The Company will begin including the operating results of performancesoft in its consolidated financial statements from the date of acquisition, which was January 5, 2006.

In connection with the performancesoft acquisition, Actuate s Board of Directors duly authorized the issuance of stock options to eligible employees from the Company s 1998 Equity Incentive Plan. A total of 530,200 non-statutory stock options were issued in January of 2006 with the price of $3.36. Each grant shall fully vest in four years with 25% cliff vesting at the end of year one and the remaining balance to vest in thirty-six successive monthly installments.

In February 2006, a minority shareholder of Actuate Japan notified us that it wishes to exercise its right to put its equity interest in Actuate Japan. This is expected to result in an exercise of approximately 240 shares, for which the Company will pay an estimated $350,000. It is anticipated that the exercise will occur in the first quarter of fiscal year 2006.

Under the Company s stock repurchase program, the Company is authorized to repurchase Actuate common stock in an amount not to exceed cash flow from operations during the prior quarter, with the actual amount to be approved in advance by the Board. From the end of the fiscal year through February 14, 2006, the Company has repurchased a total of 289,000 shares for a total of approximately $989,000 in the open market under this stock repurchase plan.

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ACTUATE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

15. Selected Quarterly Financial Data (Unaudited)

The following tables set forth certain unaudited financial data for the eight quarters ended December 31, 2005 (in thousands, except per share data).

	Quarter Ended			
	March 31, 2005	June 30, 2005	September 30, 2005	December 31, 2005
Revenues	$ 24,625	$ 25,770	$ 26,845	$ 29,161
Income from operations	$ 54	$ 3,417	$ 4,589	$ 4,454
Net income	$ 245	$ 3,477	$ 3,740	$ 4,129
Net income per share:				
Basic	$	$ 0.06	$ 0.06	$ 0.07
Diluted	$	$ 0.06	$ 0.06	$ 0.07

	Quarter Ended			
	March 31, 2004	June 30, 2004	September 30, 2004	December 31, 2004
Revenues	$ 25,668	$ 27,849	$ 23,774	$ 27,366
Income (loss) from operations	$ (547)	$ 1,859	$ (1,376)	$ 1,426
Net income (loss)	$ (377)	$ 1,295	$ (848)	$ 1,228
Net income (loss) per share:				
Basic	$ (0.01)	$ 0.02	$ (0.01)	$ 0.02
Diluted	$ (0.01)	$ 0.02	$ (0.01)	$ 0.02

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SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS

(In thousands)

	Balance at beginning of period	Additions charged to costs and expenses	Additions charged to other accounts(1)	Deductions	Balance at end of period
Allowance for doubtful accounts:					
Year ended December 31, 2005	$ 1,489	$ 109	$ 80	$ (360)	$ 1,318
Year ended December 31, 2004	2,277	145	(288)	(645)	1,489
Year ended December 31, 2003	3,711	630	747	(2,811)	2,277

(1) Represents amounts charged to revenue and deferred revenue for sales returns and other revenue related items.