UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

Amendment No. 1

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Fiscal Year Ended December 31, 2005

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Transition period from to

Commission File Number: 001-32283

QUADRAMED CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

DELAWARE	**52-1992861**
(State or Other Jurisdiction of Incorporation or Organization)	**(IRS Employer Identification No.)**

12110 SUNSET HILLS ROAD, SUITE 600

RESTON, VIRGINIA **20190**
(Address of Principal Executive Offices) **(Zip Code)**
(703) 709-2300

(Registrant s Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, $0.01 Par Value Per Share American Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No x

The aggregate market value of voting stock held by non-affiliates of the Registrant as of June 30, 2005, the last business day of the Registrant s most recently completed second quarter was approximately $49,578,647 (based upon the price at which the common stock was last sold as reported by the American Stock Exchange on June 30, 2005). Shares of common stock held by each officer, director and holder of 10% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

On July 26, 2006, 42,414,459 shares of the Registrant s common stock, $0.01 par value per share, were outstanding.

QUADRAMED CORPORATION

FORM 10-K/A

AMENDMENT TO THE ANNUAL REPORT

FOR THE YEAR ENDED DECEMBER 31, 2005

Explanatory Note

As previously reported by QuadraMed Corporation (the Company) in its Current Report on Form 8-K, Item 4.02 Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review, filed with the Securities and Exchange Commission (the SEC) on July 31, 2006, the Company is filing this amendment on Form 10-K/A to its Annual Report on Form 10-K, as filed with the SEC on March 16, 2006 (the 2005 Annual Report), in connection with the reclassification of a single line item presented in the 2005 Consolidated Statement of Cash Flows within the 2005 Annual Report as discussed below.

As noted in the Company s 2005 Annual Report and in other past filings with the SEC, in connection with the establishment in 2000 of a supplemental executive retirement plan (SERP) and related plans for the benefit of its former chairman and CEO, James Durham, the Company funded a trust (the SERP Trust) to satisfy the Company s payment obligations associated with the SERP and the related plans. In July 2005, the Company paid its obligations under the SERP and the related plans in part by liquidating the SERP Trust and applying the net proceeds. In its 2005 Consolidated Statement of Cash Flows in the 2005 Annual Report, the Company reported both the liquidation of the $3.1 million SERP Trust and the $3.1 million payment of the trust proceeds to the former executive as investing activities.

Based on a subsequent review of the transaction, and upon further consultation with the Company s independent registered public accounting firm, BDO Seidman, LLP, on July 25, 2006, the Audit Committee of the Company s Board of Directors concluded that the $3.1 million payment of the trust proceeds is more appropriately reportable as an operating activity in the 2005 Consolidated Statement of Cash Flows. Accordingly, the Company is filing this amendment to the 2005 Annual Report on Form 10-K/A for the sole purpose of reclassifying the payment of the trust proceeds to the former executive as an operating activity in the 2005 Consolidated Statement of Cash Flows. This reclassification increases cash provided by investing activities from $122,000, as originally reported, to $3,222,000 and decreases cash provided by operating activities from $14,857,000, as originally reported, to $11,757,000.

This reclassification does not affect: (i) the reported cash and cash equivalents balance as of December 31, 2005 of $33,042,000; (ii) the reported 2005 net increase in cash and cash equivalents of $10,613,000; (iii) any other item of the 2005 Consolidated Statement of Cash Flows; (iv) any aspect of the 2005 Consolidated Balance Sheet; nor (v) any aspect of the 2005 Consolidated Statement of Operations (including loss from operations, net loss and per share amounts.) In addition, *Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations* and *Item 8. Financial Statements and Supplementary Data* in the 2005 Annual Report have been amended in this Form 10-K/A as appropriate for the change.

This Form 10-K/A also corrects a typographical error in the table of cash flows in *Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations* (the Table of Cash Flows) as reported in the 2005 Annual Report. The Table of Cash Flows reported cash provided by (used in) financing activities as $4,366 (in thousands). The correct value for cash provided by (used in) financing activities is $(4,366) (in thousands).

With the exception of the foregoing, no other information in the Company s 2005 Annual Report has been supplemented, updated or amended.

Cautionary Statement on Risks Associated With Forward-Looking Statements

This Amendment to the Annual Report on Form 10-K/A contains forward-looking statements, as defined in Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, that are subject to risks and uncertainties. The words believe, expect, anticipate, predict, intend, plan, estimate, may, will, should, could and similar expressions and their negatives are intended to identify such sta Forward-looking statements are not guarantees of future performance and are to be interpreted only as of the date on which they are made. We undertake no obligation to update or revise any forward-looking statement.

We advise investors that we discuss other risks and uncertainties that could cause our actual results to differ from these forward-looking statements in *Item 1A. Risk Factors* of the 2005 Annual Report.

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PART II

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

Cautionary Statement on Risks Associated With Forward-Looking Statements

You should read the following discussion in conjunction with our Consolidated Financial Statements and related notes. This Amendment to the Annual Report on Form 10-K/A contains forward-looking statements as defined in Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 that are subject to risks and uncertainties. The words believe, expect, anticipate, predict, intend, plan, estimate, may, will, should, could and similar expressions and their negatives are intended to identify such statements. Forward-looking statements are not guarantees of future performance and are to be interpreted only as of the date on which they are made. We undertake no obligation to update or revise any forward-looking statement. You should not place undue reliance on these forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including the risks faced by us described in *Item 1A. Risk Factors* in the 2005 Annual Report, elsewhere in the 2005 Annual Report, in this Amendment to the Annual Report on Form 10-K/A, and in other documents we file with the SEC from time to time.

Financial Statement Overview

Our operations and financial performance during 2005 continued to be impacted by events in our recent past, most notably the required restatement of our financial statements which was completed during 2003; the delisting of our common stock by NASDAQ in 2003, which, among other things, triggered a repurchase event under our 5.25% Convertible Subordinated Debentures due 2005 (2005 Notes); the investigation by the SEC which was begun in 2002 and concluded in 2004; and the shareholder class action and derivative actions which began in 2003 and concluded in 2004. We also reported material weaknesses in our internal control over financial reporting and disclosure controls and procedures in our Annual Report on Form 10-K for the year ended December 31, 2004 and in our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2005, June 30, 2005 and September 30, 2005. These events may have adversely affected our sales activity, particularly with respect to sales to new Affinity customers because the very existence of such matters brought into question the financial stability and viability of our Company, particularly during 2003 and 2004 when the sales cycle began for many of the HIS systems that were awarded in 2004 and 2005. In spite of this history and the impact these events may have had on certain of our sales, we were able to effectively manage our business to improved financial performance in several of our key financial performance categories as indicated in the highlights presented below:

Total revenue decreased $2.5 million, or 2%, to $122.3 million in 2005 from $124.8 million in 2004. The majority of the decrease was due to decreased installation and other revenue, license revenue and hardware revenue, partially offset by increased revenue from services and maintenance.

Gross margin increased $2.3 million, or 3.1%, to $76.7 million in 2005 from $74.4 million in 2004. As a percentage of revenue, gross margin increased to 63% in 2005 from 60% in 2004. This was due in large part to increases in maintenance and services revenue, coupled with a reduction in lower margin hardware revenue.

Loss from operations decreased from $16.2 million in 2004 to $1.4 million in 2005, due primarily to the increase in gross margin noted above, and lower general and administrative and sales and marketing expense in 2005 compared to 2004. In addition, the 2004 results included a $4.2 million exit cost for our former headquarters in San Rafael, compared to a similar charge of $1.1 million in 2005.

Net loss decreased from $41.8 million in 2004 to $3.9 million in 2005. In addition to the reduction in the loss from operations between years, the 2004 net loss included a $14.9 million loss related to the early retirement of all of our debt, $4.2 million of interest expense related to the retired debt, and a $7.0 million loss related to the discontinued Financial Services Division; during 2005 the loss related to the discontinued operations was $2.4 million.

Cash and cash equivalents increased by $10.6 million to $33.0 million at December 31, 2005 from $22.4 million at December 31, 2004 due to cash provided from operating activities of $11.8 million in 2005 compared to $10.3 million used in operations in 2004.

Cash provided by investing activities totaled $3.2 million primarily as a result of the liquidation of a long-term investment asset to satisfy payment obligations to a former executive of the Company. Cash used by financing activities of $4.4 million was principally for the payment of preferred stock dividends.

Days sales outstanding (DSO) at December 31, 2005 were 81 days compared to 71 days for 2004. Billings in the fourth quarter of 2004 were significantly lower than in the fourth quarter 2005, due primarily to delays caused by the implementation of our PeopleSoft revenue cycle software. This resulted in lower outstanding receivables and higher unbilled revenues at December 31, 2004.

In February 2005, due to its increasing losses and negative cash flow, we closed our Financial Services Division located in San Marcos, California. Loss from discontinued operations was $3.7 million in 2004.

Management now believes that the Company s internal control over financial reporting and disclosure controls and procedures are effective as of December 31, 2005. During 2005, the Company invested significant effort and resources in eliminating the Company s previously disclosed internal control deficiencies in the revenue and closing cycles and related weaknesses in disclosure controls and procedures. These remedial actions included establishing a revenue assurance group responsible for managing ongoing quality assurance; utilizing the PeopleSoft system for revenue related activities; increasing staffing, training and supervision of personnel; improving delineation of responsibilities and segregation of duties; and improving the general ledger account reconciliation and journal entry preparation and review processes.

Critical Accounting Policies and Estimates

Our critical accounting policies have a considerable impact on Management s Discussion and Analysis.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates, assumptions and judgments that affect the reported amounts of assets and liabilities, revenues and expenses. Significant estimates and assumptions have been made regarding revenue recognition, the allowance for doubtful accounts, contingencies, litigation, intangibles resulting from our purchase business combinations, charges associated with exit activities and other amounts. We base our estimates and assumptions on historical experience and on various other assumptions which management believes to be reasonable under the circumstances. Uncertainties are inherent in all of these estimates including the estimates underlying percentage-of-completion accounting method of revenue recognition. In addition, we annually review and test our estimates related to the valuations of intangibles including acquired technology, goodwill, customer lists, trademarks and other intangibles and capitalized software. Actual results may differ materially from these estimates.

Revenue Recognition

Our revenue is principally generated from three sources: (i) licensing arrangements; (ii) services; and (iii) hardware.

Our license revenue consists of fees for licenses of our proprietary software, as well as third-party software. Cost of license revenue primarily includes the costs of third-party software and royalties, and amortization of capitalized software and acquired technology. Our service revenue consists of maintenance, software installation, customer training and consulting services related to our license revenue. Cost of services consists primarily of salaries, benefits and allocated costs related to providing such services. Hardware revenue includes third-party hardware used to support our software installation. Cost of hardware revenue consists of third-party equipment and installation.

We market our products through our direct sales force. Our license agreements for such products do not provide for a right of return, and historically, product returns have not been significant.

We recognize revenue on our software products in accordance with Statement of Position (SOP) 97-2, *Software Revenue Recognition*, as amended; SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*; and the SEC s Staff Accounting Bulletin (SAB) 104, *Revenue Recognition*.

We recognize revenue when all of the following criteria are met: there is persuasive evidence of an arrangement; the product has been delivered; we no longer have significant obligations with regard to implementation; the fee is fixed and determinable; and collectibility is probable. Delivery is considered to have occurred when title and risk of loss have been transferred to the customer, which generally occurs when media containing the licensed programs is provided to a common carrier. We consider all arrangements with payment terms extending beyond 180 days to be neither fixed nor determinable. Revenue for arrangements with extended payment terms is recognized when the payments become due, provided all other recognition criteria are satisfied. If collectibility is not considered probable, revenue is recognized when the fee is collected.

We allocate revenue to each element in a multiple-element arrangement based on the element s respective fair value, with the fair value determined by the price charged when that element is sold separately. Specifically, we determine the fair value of the maintenance portion of the arrangement based as if sold separately and measured by the renewal rate offered to the customer. The professional services portion of the arrangement is based on hourly rates which we charge for these

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services when sold separately from software. If evidence of fair value of all undelivered elements exists but evidence does not exist for one or more delivered elements, then revenue is recognized using the residual method. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is recognized as revenue. The proportion of revenue recognized upon delivery varies from quarter to quarter depending upon the mix of licensing arrangements, perpetual or term-based, and the determination of vendor-specific objective evidence (VSOE) of fair value for undelivered elements. Many of our licensing arrangements include fixed implementation fees and do not allow us to recognize license revenue until these services have been performed. We have VSOE for all undelivered elements.

Certain of the licenses are term or time-based licenses. QuadraMed recognizes revenue from these contracts ratably over the term of the arrangement.

Contract accounting is applied where services include significant software modification, installation or customization. In such instances, the services and license fees are accounted for in accordance with SOP 81-1, whereby the revenue is recognized, generally using the percentage-of-completion method measured on labor input hours. If increases in projected costs-to-complete are sufficient to create a loss contract, the entire estimated loss is charged to operations in the period the loss first becomes known. The complexity of the estimation process and judgment related to the assumptions, risks and uncertainties inherent with the application of the percentage-of-completion method of accounting can affect the amounts of revenue and related expenses reported in our consolidated financial statements.

Service revenues from software maintenance and support are recognized ratably over the maintenance term, which in most cases is one year. Service revenues from training, consulting and other service elements are recognized as the services are performed.

Hardware revenue is generated primarily from transactions in which customers purchased bundled solutions that included the Company s software and third-party hardware. If the bundled solution includes services that provide significant modification, installation or customization, contract accounting is applied in accordance with SOP 81-1, whereby the revenue is recognized, generally using the percentage-of-completion method measured on labor input hours. Otherwise, hardware revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collection is reasonably assured.

Deferred revenue includes amounts billed to or received from customers for which revenue has not been recognized. This generally results from deferred maintenance; software installation, consulting and training services not yet rendered; and license revenue deferred until all revenue requirements have been met or as services have been performed. Additionally, there are term-based licenses for which revenues are recognized over the term of the contract, which is generally one year. Unbilled receivables are established when revenue is deemed to be recognized based on our revenue recognition policy, but for which we do not yet have the right to bill the customer per the contract terms.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable consist primarily of amounts due us from our customers for the delivery of products and services. We provide an allowance for doubtful accounts, which reflects our estimate of non-collection of accounts receivable based on past collection history and other specifically identified risks.

Intangible Assets

QuadraMed s acquisitions of other companies have historically resulted in the recording of certain intangible assets and goodwill.

Goodwill. On January 1, 2002, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*. Under SFAS No. 142, goodwill and intangible assets deemed to have indefinite lives are to be separately disclosed on the balance sheet, and are no longer amortized but are subject to annual impairment tests or whenever changes in circumstances indicate that the fair value of the Company is less than the carrying value.

Capitalized Software. Software development costs are capitalized upon the establishment of technological feasibility. In accordance with SFAS No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed*, we establish technological feasibility upon the completion of a working model and beta testing of the software product. The Company amortizes its capitalized software development costs on a straight-line basis generally over a period of five years.

Other Intangible Assets. Other intangible assets relate primarily to developed technology, trademarks and customer lists acquired in our business acquisitions. Other intangible assets also include acquired technology whose amortization is included in cost of license. On January 1, 2002, we adopted the provisions of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* The provisions of this statement did not have a significant impact on our financial condition or operating results.

Developed technology costs are amortized on a straight-line basis over a period of three years. The majority of other intangible assets are amortized on a straight-line basis over a period of three to five years. These assets are reviewed annually for impairment and written down to net realizable value, if necessary, in accordance with SFAS No. 144.

Recent Accounting Standards

In March 2004, the FASB issued a proposed statement, *Share-Based Payment*, which addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for equity instruments of the enterprise or liabilities that are based on the grant-date fair value of the enterprise s equity instruments or that may be settled by the issuance of such equity instruments. The proposed statement would eliminate the ability to account for share-based compensation transactions using Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and generally would require instead that such transactions be accounted for using a fair-value-based method. In December 2004, the FASB issued SFAS No. 123(R), *Share-Based Payment*, which is a revision of SFAS No. 123. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their grant-date fair values. Pro forma disclosure is no longer an alternative.

As permitted by SFAS No. 123, for 2005, the Company accounted for share-based payments to employees using APB Opinion No. 25 s intrinsic value method and, as such, generally recognized no compensation cost for employee stock options. Effective January 1, 2006, we have adopted SFAS No. 123(R) s fair value method of accounting for share based payments. Accordingly, the adoption of SFAS No. 123(R) s fair value method may have a significant impact on the Company s results of operations as we are required to recognize the cost of employee services received in exchange for awards of equity instruments based on the grant-date fair value of those awards. SFAS No. 123(R) permits public companies to adopt its requirements using either the modified prospective method or the modified retrospective method. The Company adopted SFAS No. 123(R) using the modified prospective method. In April 2005, the SEC delayed the effective date of SFAS No. 123(R), which is now effective for public companies for annual, rather than interim periods that begin after June 15, 2005. The impact of the adoption of SFAS No. 123(R) cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. However, had we adopted SFAS 123(R) in prior periods, the impact of that standard would have approximated the impact of SFAS 123 illustrated in the disclosure of pro forma net income and net income per share contained in Note 15 of our notes to consolidated financial statements included herein.

In March 2005, the FASB issued FIN 47, *Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143* (FIN 47), which requires an entity to recognize a liability for the fair value of a conditional asset retirement obligation when incurred if the liability s fair value can be reasonably estimated. FIN 47 is effective for fiscal years ending after December 15, 2005. We do not believe that the adoption of FIN 47 has had a material impact on our financial statements.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections*. SFAS No. 154 replaces APB No. 20, *Accounting Changes*, and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements*, and establishes retrospective application as the required method for reporting a change in accounting principle. SFAS No. 154 provides guidance for determining whether retrospective application of a change in accounting principle is impracticable and for reporting a change when retrospective application is impracticable. The reporting of a correction of an error by restating previously issued financial statements is also addressed. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. We do not believe that the adoption of SFAS No. 154 will have a material impact on our financial statements.

Results of Operations

The following table sets forth selected data for the indicated periods. Percentages are expressed as a percentage of total revenues, except for cost of revenue, which is expressed as a percentage of the related revenue classification.

	Year ended December 31,			
	2005		2004	
	(in thousands, except percentages)			
Revenue				
Services	$ 13,135	11%	$ 10,446	8%
Maintenance	54,453	44%	48,713	39%
Installation and other	11,060	9%	12,469	10%
Services and other	78,648	64%	71,628	57%
Licenses	41,067	34%	45,036	36%
Hardware	2,598	2%	8,140	7%
Total revenue	122,313	100%	124,804	100%
Cost of revenue				
Cost of services and other revenue	29,510	38%	30,252	42%
Royalties and other	9,779	24%	9,977	22%
Amortization of acquired technology and capitalized software	4,014	10%	4,138	9%
Cost of licenses revenue	13,793	34%	14,115	31%
Cost of hardware revenue	2,341	90%	6,062	74%
Total cost of revenue	45,644	37%	50,429	40%
Gross margin	76,669	63%	74,375	60%
Operating expenses				
General and administrative	26,874	22%	29,707	24%
Software development	30,476	25%	28,056	22%
Sales and marketing	14,730	12%	24,105	19%
Amortization of intangible assets and depreciation	4,904	4%	4,495	4%
Exit costs of facility closing	1,066	1%	4,190	3%
Total operating expenses	$ 78,050	64%	$ 90,553	73%
Loss from operations	$ (1,381)	-1%	$ (16,178)	-13%

Year Ended December 31, 2005 compared to 2004

Revenue

Revenue is recognized during the respective periods from various sources, including but not limited to amounts initially recorded as deferred revenue and for which the Company has now completed its contractual commitments; service revenue relating to installation, consulting and training; maintenance contracts that renew periodically, typically on an annual basis; and revenues recognized on a cash-basis.

Total revenue. Total revenue for 2005 of $122.3 million decreased $2.5 million, or 2%, over total revenue for 2004 of $124.8 million. The net decrease of $2.5 million is comprised of $1.4 million or 11% decrease in installation and other revenue, a $4.0 million or 9% decrease in license revenue and a $5.5 million or 68% decrease in hardware revenue, all offset by a $2.7 million or 26% increase in services revenue and a $5.7 million or 12% increase in maintenance revenue. For each quarter during 2005, total revenue was $30.4 million, $30.7 million, $30.0 million and $31.2 million, respectively.

Services and other revenue. Services and other revenue consists of professional services, such as implementation and installation services, training, maintenance which consists of technical support and product upgrades, hardware, reimbursable expenses and other service revenue. Professional services are typically provided over a period of three to six months for the HIM Software products and for two to three years for Affinity and other related Enterprise products. These services are provided subsequent to the signing of a software license arrangement and depend in large part on our software license revenues. Our maintenance revenues depend on both licenses of our software products and renewals of maintenance agreements by our existing customer base.

Services revenue increased approximately $2.7 million, or 26%, to $13.1 million in 2005 from $10.4 million in 2004. An increase of approximately $0.5 million is attributed to the Affinity and other Enterprise products, and an increase of $0.4 million is related to the HIM software products. In addition, services revenue for MPI products increased $1.8 million primarily as a result of completing work on two large contracts signed in 2005.

Maintenance revenue increased $5.7 million, or 12%, to $54.4 million, compared to $48.7 million in 2004. Of this overall increase in maintenance revenue, $4.4 million resulted from Affinity and related products, and is a function of contractually based increases in fees, as well as the installation of new customer software during the year. In addition, $2.4 million of the increase is from the TempusOne scheduling products, which is due primarily to the inclusion of only six months of activity in 2004 as a result of the acquisition of Tempus Software, Inc. on June 30, 2004. These increases are offset by a decrease of $1.0 million in maintenance for HIM products, over half of which pertains to the Cascade products which were sunset in 2005.

Installation and other revenue decreased $1.4 million, or 11%, to $11.1 million in 2005 from $12.5 million in 2004. This decrease is driven primarily by installation and other revenue for Affinity and related products which is $2.7 million lower in 2005; during 2004 we had only three new Affinity sales and in 2005 we had zero new Affinity sales. Although we had significant sales of products to the existing Affinity base customers, a significant amount of installation revenue is traditionally earned on new installations, and recognized on a percentage of completion basis. This decrease was offset by increases in installation revenues for HIM and government products, which are typically recognized upon completion of a contract; revenue from installation of these products increased by $1.3 million in 2005.

Licenses. License revenue consists of fees for licenses of our owned, proprietary software, as well as third-party owned software that we bundle into our suite of products. Overall, license revenue decreased $3.9 million, or 9%, in 2005 to $41.1 million from $45.0 million in 2004. This decrease is due primarily to a $3.7 million decrease in license revenue for our Affinity products, which is a result of the lack of sales to new Affinity customers; during 2004, we made only three new Affinity sales, and in 2005, we made no such sales.

Hardware. Hardware revenue decreased $5.5 million, or 68%, to $2.6 million for 2005, compared to $8.1 million in 2004. This decrease is primarily attributed to the recognition in the first quarter of 2004, of a $4.5 million hardware sale to a single customer.

Deferred Revenue

The following table presents a summary roll-forward schedule of the deferred revenue (in thousands) as of the respective balance sheet dates:

	For the year ended December 31, 2005 (unaudited)	For the year ended December 31, 2004 (unaudited)
Deferred revenue, beginning balance	$ 44,040	$ 48,502
Add: revenue deferred	126,359	113,394
Less: deferred revenue recognized	(117,393)	(120,622)
Add: revenue acquired in acquisition		2,766
Less: other	(837)	
Deferred revenue, ending balance	$ 52,169	$ 44,040

Cost of Revenue and Gross Margin

Cost of services and other revenue. Cost of services and other revenue consists of salaries and related expenses associated with services performed for customer support and implementation and consulting services. Most of these costs are incurred by individuals assigned to specific customer projects. Cost of services and other revenue decreased $0.8 million to $29.5 million in 2005, from $30.3 million in 2004. These costs are primarily driven by internal personnel. As a percentage of services and other revenue, cost of services and other revenue was 38% in 2005, compared to 42% in 2004.

Cost of licenses. Cost of licenses consists primarily of third-party software, royalties and amortization of acquired technology and capitalized software. A significant percentage of our total cost of revenue is attributable to the cost of third-party royalties and licenses pertaining to software embedded within our software applications. Generally, royalty fees for third-party licenses will fluctuate based on revenue or the number of the Company s customers and therefore may vary on a quarter-to-quarter basis. Royalties are associated primarily with our HIM and government product revenues. Cost of licenses decreased $0.3 million, or 2.2%, to $13.8 million in 2005 from $14.1 million in 2004. The decrease is comprised primarily of a $1.5 million decrease in third party software licenses and a decrease in amortization of capitalized software of $0.8 million, offset by $0.7 million increase related to the amortization of technology acquired with Détente Systems Pty Limited and Tempus Software, Inc., and a $1.3 million increase in royalty expense, most of which is related to our government products. Overall, the cost of royalties, as a percentage of government product revenues, has increased from 41% in 2004 to 44% in 2005.

Cost of hardware. Cost of hardware consists of third-party hardware and installation costs. Cost of hardware decreased $3.8 million, or 61%, to $2.3 million in 2005 from $6.1 million in 2004, primarily as a result of lower revenues in the respective periods. As previously discussed, the first quarter of 2004 included a $4.5 million sale of hardware to a single customer, the cost of which was approximately $3.5 million.

Gross margin. Total gross margin increased by approximately $2.3 million, or 3%, to $76.7 million in 2005 from $74.4 million in 2004. The increase in gross margin is primarily attributable to the combination of the $5.7 million or 11.8% increase in maintenance revenues, the $2.7 million or 26% increase in service revenues, and the $5.5 million reduction in low margin hardware revenues. These positive variances were partially offset by lower license and installation revenues. In addition, the costs of royalties for government and HIM products increased. Overall, gross margin for all license revenue declined from 69% in 2004 to 66% in 2005. Gross margin for services and other revenues increased from 58% in 2004 to 62% in 2005, and gross margin on hardware decreased from 25% in 2004 to 10% in 2005. In total, gross margin increased from 60% in 2004 to 63% in 2005.

Operating Expenses

General and administrative. General and administrative (G&A) expense consists of compensation and benefit costs for executive, finance, legal, information technology and administrative personnel. G&A expense decreased $2.8 million, or 10%, to $26.9 million in 2005, from $29.7 million in 2004. As a percentage of total revenue, general and administrative expense was 22% in 2005 compared to 24% in 2004. G&A expenses decreased in 2005 as increases in professional fees and severance expenses were more than offset by decreases in rent, salaries, contractors and other expenses.

Professional and legal fees increased $1.3 million in 2005 primarily related to Sarbanes-Oxley Act consulting efforts, merger and acquisition expenses and other activities. Severance expense increased $1.6 million in 2005 primarily due to

severance payments to the Company s former CEO and CFO. These increases were largely offset by a decrease in salaries of $1.5 million in 2005. In 2004, salaries included the carrying of duplicate staff for at least the first three months of the year related to the transition of the headquarters to Reston, Virginia and salaries for both the CEO and COO positions, which were consolidated in late 2004. Rent expense decreased $1.4 million in 2005 from 2004, but our payments of rent were virtually the same year over year. Rent expense in 2004 included rent for the Company s prior headquarters in San Rafael, California, which was not included in 2005 because we recorded a facility exit cost related to that lease of $4.2 million in December 2004. Bad debt expense decreased $0.9 million in 2005 and other non-wage expenses decreased $1.2 million. In addition, the $0.4 million gain on the sale of the EDI division which we completed in September is included in 2005 as G&A.

Software development. Software development expenses include costs associated with the development of new products for which technological feasibility has not been achieved, enhancements of existing products, and quality assurance activities; these expenses are comprised mainly of compensation and benefits costs. These expenses are associated primarily with our software engineers as well as certain product development personnel. Software development expenses increased $2.4 million, or 9%, to $30.5 million in 2005 from $28.1 million in 2004. As a percentage of revenue, software development expenses were 25% in 2005 compared to 22% in 2004. There were no capitalized software development costs in 2005 or 2004.

Sales and marketing. Sales and marketing expenses include costs associated with our sales, marketing and certain product management personnel, and consist primarily of salaries and benefits, commissions and bonuses, and promotional and advertising expenses. Sales and marketing expenses decreased $9.4 million, or 39%, to $14.7 million in 2005 compared to $24.1 million in 2004. As a percentage of revenue, sales and marketing expense was approximately 12% in 2005 and 19% in 2004.

Sales and marketing salaries decreased $3.1 million in 2005 and other wage related costs decreased $0.5 million due to a reduction in headcount in 2005 compared to 2004. Travel and entertainment expenses decreased $0.9 million in 2005 primarily as a result of the reduction in the sales staff. Commission expenses decreased significantly in 2005 to $2.5 million compared to $7.1 million in 2004. In 2004, the Company adopted a more conservative approach to expensing commissions earned. In prior years, we matched commissions earned with the associated revenues, and as a consequence, deferred certain of these commissions even though they had been earned and paid. In 2004, we began expensing the commissions when earned and paid, and we also amortized approximately $2.1 million of commissions that were deferred in 2003; thus the commission expense for 2004 was higher than it would have otherwise been by this amount. The remainder of the difference in commission expense between years is due primarily to commissions earned on Affinity sales. If we remove the impact of the amortization of the deferred commissions from 2004 sales and marketing expenses, the 2005 sales and marketing expenses decreased by approximately $7.3 million, or 33%, from 2004 levels.

Amortization of intangible assets and depreciation. Amortization of intangible assets pertains to identifiable intangible assets such as customer lists and trade names. Depreciation expense pertains to computer and office equipment, office furniture and fixtures, and leasehold improvements. Amortization of intangible assets increased $0.2 million to $2.2 million in 2005 compared to $2.0 million in 2004. Depreciation expense increased $0.2 million to $2.7 million in 2005 compared to $2.5 million in 2004.

Exit cost of facility closing. During 2004, we moved our headquarters from San Rafael, California to Reston, Virginia and vacated and closed down the San Rafael office facility. The lease for this facility terminates at the end of 2009; our annual expense under the lease is approximately $1.2 million, and we have been actively seeking a qualified subtenant for the property. We estimated the closing costs for this facility based upon current market information available related to potential sublease rental income, sublease commission costs and the length of time expected to secure a sublease. In consideration of these facts, in 2004 we estimated a cost of approximately $4.2 million in connection with our future obligations on the lease, net of estimated sublease income, and recorded this as an expense and as an accrued exit cost at December 31, 2004. During the third quarter of 2005, we reevaluated our assumptions, and recorded an additional expense and an additional accrual of $1.1 million. Please see further discussion in Note 5 of our notes to consolidated financial statements included herein.

Other Income (Expense)

Other income (expense). Other income (expense) increased $19.0 million, from a net other expense of $18.6 million in 2004 to a net other income of $0.2 million in 2005. This change is due primarily to the inclusion in 2004 of the $14.9 million loss incurred in connection with the retirement of our 2005 and 2008 Notes in June and July of 2004; in addition, the 2004 other expense includes $4.2 million of interest expense related to the retired Notes. Interest expense for the years ended December 31, 2005, 2004 and 2003 included non-cash charges of $0.6 million, $1.6 million, and $2.8 million, respectively, relating to amortization of debt offering costs, warrant discount and preferred stock dividend discount.

Discontinued Operations of Financial Services Division

Due to increasing operating losses in our Financial Services Division, and the lack of a qualified buyer for the business, we announced the shutdown of this division on December 15, 2004. The shutdown of this division was effective February 14, 2005.

During 2005, the Company recorded a charge of approximately $1.8 million in connection with our future obligations on our San Marcos, California lease for this division, net of estimated sublease income. The lease for this facility terminates in May 2008; our annual expense under the lease is approximately $0.8 million, and we are actively seeking a qualified subtenant for the property. We have estimated facility closing costs based upon current market information available related to potential sublease rental income, sublease commission costs, and the length of time expected to secure a sublease.

The results of operations for the Financial Services Division are presented as a discontinued operation. Loss from discontinued operation of the Financial Services Division was comprised of the following (in thousands):

	Year ended December 31,		
	2005	**2004**	**2003**
Revenue	$ 223	$ 5,652	$ 9,150
Loss from operations	(704)	(3,690)	(4,896)
Exit cost of facility closing	(1,849)	(3,332)	
Other	118		
Total loss	$ (2,435)	$ (7,022)	$ (4,896)

Year Ended December 31, 2004 compared to 2003

The following table sets forth selected data for the indicated periods. Percentages are expressed as a percentage of total revenues, except for cost of revenue, which is expressed as a percentage of the related revenue classification.

	Year ended December 31, 2004		Year ended December 31, 2003	
	(in thousands, except percentages)			
Revenue				
Services	$ 10,446	8%	$ 9,617	8%
Maintenance	48,713	38%	41,354	36%
Installation and other	12,469	10%	13,400	12%
Services and other	71,628	57%	64,371	56%
Licenses	45,036	36%	46,790	40%
Hardware	8,140	7%	4,794	4%
Total revenue	124,804	100%	115,955	100%
Cost of revenue				
Cost of services and other revenue	30,252	42%	33,003	51%
Royalties and other	9,977	22%	5,775	12%
Amortization of acquired technology and capitalized software	4,138	9%	2,881	6%
Cost of licenses revenue	14,115	31%	8,656	18%
Cost of hardware revenue	6,062	74%	3,273	68%
Total cost of revenue	50,429	40%	44,932	39%
Gross margin	74,375	60%	71,023	61%
Operating expenses				
General and administrative	29,707	24%	34,643	30%
Software development	28,056	22%	23,798	21%
Sales and marketing	24,105	19%	20,955	18%
Amortization of intangible assets and depreciation	4,495	4%	4,525	4%
Exit costs of facility closing	4,190	3%		0%
Total operating expenses	$ 90,553	73%	$ 83,921	72%
Loss from operations	$ (16,178)	-13%	$ (12,898)	-11%

Revenue

Total revenue. Total revenue for 2004 of $124.8 million increased $8.8 million, or 8%, over total revenue for 2003 of $116.0 million. The net increase of $8.8 million is comprised of a $7.4 million, or 18%, increase in maintenance revenue and a $3.3 million, or 70%, increase in hardware revenue, an $0.8 million, or 9%, increase in services revenue offset by a $0.9 million, or 7%, decrease in installation and other revenue, and a $1.8 million, or 4%, decrease in license revenue. For each quarter in 2004, total revenue was $34.6 million, $30.5 million, $30.8 million and $28.9 million, respectively. The first quarter revenue of $34.6 million included an unusually large $4.5 million revenue transaction, consisting mainly of the sale of hardware to a single customer.

Services and other revenue. Services and other revenue consists of professional services, such as implementation and installation services, training, maintenance, which consists of technical support and product upgrades, hardware, reimbursable expenses and other service revenue. Professional services are typically provided over a period of three to six months for the HIM software products and for two to three years for Affinity and other related Enterprise products. These services are provided subsequent to the signing of a software license arrangement and depend in large part on our software license revenues. Our maintenance revenues depend on both licenses of our software products and renewals of maintenance agreements by our existing customer base. Services and other revenue increased approximately $7.3 million, or 11%, to $71.6 million in 2004 from $64.4 million in 2003.

The majority of the increase was attributed to the growth in maintenance revenue of $7.3 million, or 18%, to $48.7 million, compared to $41.4 million in 2003. Of this overall increase in maintenance revenue, $3.5 million resulted from Affinity and related products and is a function of increases in contractually-based annual fees, as well as the installation of new customer software during the year. In addition, $1.4 million of the increase in maintenance revenue is from the acquired Lab and Radiology products of Détente Systems Pty Limited and $1.9 million is from the acquired enterprise scheduling products of Tempus Software, Inc. Without these acquisitions, maintenance revenue would have increased 11%. Hardware revenue increased $3.3 million, or 70%, to $8.1 million for 2004, compared to $4.8 million in 2003. After removing the impact of the $3.8 million in revenue from a single customer in the first quarter of 2004, hardware revenue in 2004 was lower than in 2003 by approximately $0.5 million, or 10%.

Licenses. License revenue consists of fees for licenses of our owned, proprietary software, as well as third-party owned software that we bundle into our suite of products. License revenue overall decreased $1.8 million, or 4%, in 2004 to $45.0 million from $46.8 million in 2003. This decrease is a combination of a $1.2 million decrease for Affinity and related products and a $0.6 million decrease for HIM products. License revenue from our MPI, Performance Measurement, EDI and PFS products experienced modest increases year-over-year, and our Pharmacy and Imaging software showed modest decreases. In addition, license revenues for Lab and Radiology from the acquisition of Détente Systems Pty Limited and license revenues for enterprise scheduling from the acquisition of Tempus Software, Inc. together added $0.6 million in 2004.

For HIM products, license revenue declined by $0.6 million in 2004, as license revenue in 2003 included a higher percentage of revenue from perpetual contracts, for which greater amounts of revenue were recognized earlier, than term contracts, for which revenue is recognized over the term of the contract, usually one, three or five years. We had very strong third and fourth quarter sales for our HIM products to government agencies, primarily for Veteran Health Administration facilities, in both 2003 and 2004, which contributed to the increase in revenue in that area. Typically the revenue from these contracts is recognized on a straight-line basis over the twelve month terms.

Revenue recognized for the year ended December 31, 2004 includes:

- Amounts initially recorded as deferred revenue in which the Company has now completed its contractual commitments;
- Service revenue relating to installation, training, seminars and financial services during the period; and
- Revenues recognized on a cash-basis.

The following table is a summary roll-forward schedule of the deferred revenue (in thousands):

	For the year ended December 31, 2004 (unaudited)
Deferred revenue, beginning balance	$ 48,502
Add: revenue deferred	113,394
Less: deferred revenue recognized	(120,622)
Add: revenue acquired in acquisition	2,766
Deferred revenue, ending balance	$ 44,040

Cost of Revenue and Gross Margin

Cost of services and other revenue. Cost of services and other revenue consists of salaries and related expenses associated with services performed for customer support and implementation and consulting services. Most of these costs are incurred by individuals assigned to specific customer projects. Cost of services and other revenue was $30.3 million in 2004 and $33.0 million in 2003. These costs are primarily driven by internal personnel. As a percentage of services and other revenue, cost of services and other services was 42% in 2004, down from 51% in 2003.

Cost of licenses. Cost of licenses consists primarily of third-party software, royalties and amortization of acquired technology and capitalized software. A significant percentage of our total cost of revenue is attributable to the cost of third-party software royalties and licenses relating to third-party software embedded within our software applications. Generally, royalty fees for third-party licenses will fluctuate based on revenue or the number of the Company s customers and therefore will fluctuate on a quarter-to-quarter basis. Royalties are associated primarily with our HIM and government product revenues. Cost of licenses increased $5.5 million, or 63%, to $14.1 million in 2004 from $8.7 million in 2003. The increase is comprised primarily of $1.9 million related to the amortization of technology acquired with Détente and Tempus, offset by a decrease in amortization of capitalized software of $0.7 million, and a $2.9 million increase in royalty payments, most of which is related to our government products. The balance of the increase is related to third-party software licenses and other costs. Overall, the cost of royalties, as a percentage of government revenues, has increased from 32% in 2003 to 41% in 2004.

Gross margin. Total gross margin increased by approximately $3.4 million, or 5%, to $74.4 million in 2004 from $71.0 million in 2003. The increase in gross margin is primarily attributable to the combination of the $7.4 million, or 18%, increase in maintenance revenues and the $2.8 million reduction in cost of services. These positive variances were partially offset by higher costs of royalties for government and HIM products, and the amortization of acquired technology. Overall, gross margin for all license revenue declined from 82% in 2003 to 69% in 2004. Gross margin for services and other revenues increased from 49% in 2003 to 58% in 2004, and gross margin on hardware decreased from 32% in 2003 to 26% in 2004. In total, gross margin decreased slightly from 61% in 2003 to 60% in 2004.

Operating Expenses

General and administrative. General and administrative expense consists of compensation and benefit costs for executive, finance, legal, information technology, and administrative personnel. General and administrative expenses, decreased $4.9 million, or 14%, to $29.7 million in 2004 from $34.6 million in 2003. As a percentage of total revenue, general and administrative expense was 24% in 2004 compared to 30% in 2003. General and administrative expense decreased in 2004 due primarily to a decrease in fees paid to accountants, attorneys and consultants incurred in connection with the restatement, the shareholder litigation and the SEC investigation, which in 2003 amounted to approximately $7.5 million, compared to $0.8 million in 2004. This was offset in part by a $2.9 million increase in legal, accounting and consulting fees not related to the restatement in 2004, as well as a $0.8 million increase in bad debt expense for 2004. In 2003 we incurred approximately $4.8 million for severance and retention pay, primarily related to the period during the restatement and SEC investigation, and related to the transfer of our headquarters from San Rafael, California to Reston, Virginia; this compares to $1.3 million of similar expense in 2004, a decrease of $3.5 million between years. Finally, salaries were $1.3 million higher in 2004, due primarily to the carrying of duplicate staff for at least the first three months of the year related to the transition of the headquarters to Reston.

Software development. Software development expenses include costs associated with the development of new products for which technological feasibility has not been achieved, enhancements of existing products, and quality assurance activities; these expenses mainly relate to compensation and benefits costs. Software development expenses increased $4.3

million, or 18%, to $28.1 million in 2004 from $23.8 million in 2003. As a percentage of revenue, software development expenses were 23% in 2004 compared to 21% in 2003. The majority of the increase in software development expenses between years is attributable to major activities in the Enterprise product portfolio, specifically the joint development activity with one of our largest customers for the Clinical Workstation which required the efforts of over twenty dedicated software developers. In addition, we continued to invest in the development of Computerized Physician Order Entry and the suite of HIM products such as Quantim Abstracting and Quantim Electronic Document Management. There were no capitalized software development costs in 2004 or 2003.

Sales and marketing. Sales and marketing expenses include costs associated with our sales, marketing and product management personnel, and consist primarily of salaries and benefits, commissions and bonuses, and promotional and advertising expenses. Sales and marketing expenses increased $3.1 million, or 15%, to $24.1 million in 2004 compared to $21.0 million in 2003. As a percentage of revenue, sales and marketing expense was approximately 19% for 2004 and 18% for 2003.

The increase in sales and marketing expenses in 2004 over 2003 is primarily a result of a more conservative approach to expensing commissions earned in 2004. In prior years, we matched commissions earned with the associated revenues and, as a consequence, deferred certain of these commissions even though they had been earned and paid. In 2004, we began expensing the commissions when earned and paid, and we also amortized approximately $2.1 million of commissions that were deferred in 2003; thus the commission expense for 2004 was higher than it would have otherwise been by this amount. If we remove the impact of the amortization of the deferred commissions from 2004 sales and marketing expenses, the 2004 expenses increased by approximately $1.0 million, or 5%, from 2003 levels. The remainder of the variance is due to personnel costs and certain marketing expenses.

Amortization of intangible assets and depreciation. Amortization of intangible assets pertains to identifiable intangible assets such as customer lists and trade names. Depreciation expense pertains to computer and office equipment, office furniture and fixtures and leasehold improvements. Amortization of intangible assets increased $0.4 million to $2.0 million in 2004, compared to $1.6 million in 2003. Depreciation expense decreased $0.4 million to $2.5 million in 2004, compared to $2.9 million in 2003. The change in amortization expense occurred principally as a result of an increase in identifiable intangible assets related to Détente Systems Pty Limited and Tempus Software, Inc. The change in depreciation expense occurred as a result of certain assets becoming fully depreciated.

Exit cost of facility closing. During 2004, we moved our headquarters from San Rafael, California to Reston, Virginia and vacated and closed down the San Rafael office facility. The lease for this facility terminates at the end of 2009; our annual expense under the lease is approximately $1.2 million, and we have been actively seeking a qualified subtenant for the property. We have estimated the closing costs for this facility based upon current market information available related to potential sublease rental income, sublease commission costs, and the length of time expected to secure a sublease. In consideration of these facts we have estimated that we will incur a cost of approximately $4.2 million in connection with our future obligations on the lease, net of estimated sublease income. We have recorded this expense in the fourth quarter of 2004.

The following table sets forth a summary of the exit cost of facility closing charged and accrued facility cost as of December 31, 2004 (in thousands):

	December 31, 2004	
Estimated exit cost of facility closing and sublease losses	$	4,048
Write off of leasehold improvement upon facility closing		142
Total exit cost as of December 31, 2004	$	4,190
Accrued exit cost as of December 31, 2004		
Short-term		1,150
Long-term		2,898
Total		4,048

Other Income (Expense)

Other expense. Other expense increased $12.5 million, from a net expense of $6.1 million in 2003 to a net expense of $18.6 million in 2004. This increase is comprised primarily of the $14.9 million loss incurred in connection with the retirement of our 2005 and 2008 Notes in June and July of 2004, offset in part by the reduction in related interest expense. Interest expense for the years ended December 31, 2004, 2003 and 2002 included non-cash charges of $1.6 million, $2.8 million, and $0.4 million, respectively, relating to amortization of debt offering costs, warrant discount and preferred stock dividend discount. In 2004, the Company received an income tax benefit of $0.2 million, which represents tax refunds received in the first quarter of 2004 as a result of the restatement of the Company s 2001 financial statements.

Liquidity and Capital Resources

Balance Sheet

We generate cash from licensing our software and providing professional services. In addition, we generate cash through maintenance renewals where customers generally pay us at the beginning of the contract term. These contract terms commence at different times throughout each year. We primarily use cash to pay our employees salaries, commission and benefits, pay landlords to lease office space, procure insurance, pay taxes, pay dividends on Series A Preferred Stock and pay vendors for services and supplies. In addition, we use cash to procure capital assets to support the business. These capital assets are typically information technology related.

As of December 31, 2005, we had $33.0 million in cash and cash equivalents, compared to $22.4 million as of December 31, 2004. As of December 31, 2005, we had net working capital of $(6.9) million compared to $(15.1) million as of December 31, 2004. Management believes that we have adequate liquidity to meet our short-term cash requirements.

Accounts receivable, net of allowance for doubtful accounts, increased by $1.5 million to $27.1 million as of December 31, 2005 from $25.6 million as of December 31, 2004. Accounts receivable increased primarily because of the volume of billings generated in the fourth quarter related to government contracts. In addition, accounts receivable at the end of 2004 was lower than expected due primarily to delays caused by the implementation of our PeopleSoft revenue cycle software during the fourth quarter. For the year ended December 31, 2005, bad debt expense was $2.3 million. As of December 31, 2005, the allowance for doubtful accounts increased to $4.7 million from $3.3 million as of December 31, 2004. QuadraMed maintains an allowance for doubtful accounts to reflect the expected non-collection of accounts receivable based on past collection history and specific risks identified within the portfolio. If the financial condition of QuadraMed s customers were to deteriorate resulting in an impairment of their ability to make payments, or if payments from customers are significantly delayed, additional allowance might be required.

Unbilled receivables decreased by $3.2 million to $3.4 million as of December 31, 2005, from $6.6 million as of December 31, 2004. This decrease is mainly due to a greater mix of contracts that the Company was able to bill in advance of revenue recognition in 2005, and due to the aforementioned delays in billings caused by the implementation of our PeopleSoft revenue cycle software, which caused higher than expected unbilled receivables during the fourth quarter of 2004.

Prepaid expenses and other current assets increased by $3.9 million as of December 31, 2005 to $11.9 million, compared to $8.0 million in December 31, 2004. The increase is primarily due to the inclusion in the 2005 balance of $3.4 million in deferred hardware expense related to a single customer.

Capitalized software development costs, net of accumulated amortization, decreased by $0.9 million to $0.5 million as of December 31, 2005 from $1.4 million as of December 31, 2004 as a result of standard amortization.

Other intangible assets, net of accumulated amortization, decreased by $5.3 million to $7.1 million as of December 31, 2005, from $12.5 million as of December 31, 2004, as a result of standard amortization.

Other long-term assets decreased by $2.4 million to $4.7 million as of December 31, 2005 from $7.1 million as of December 31, 2004. This decrease is primarily due to the liquidation of a $3.1 million trust in connection with a payment to a former executive (please see Note 20 of our notes to consolidated financial statements included herein).

Other accrued liabilities increased by $1.6 million to $10.1 million as of December 31, 2005 from $8.5 million as of December 31, 2004. This increase is primarily related to accruals for commission expense, royalties and taxes, offset by a reduction in accrued contract costs and legal fees.

Dividends payable decreased by $4.7 million to $9.1 million as of December 31, 2005 from $13.8 million as of December 31, 2004. This decrease resulted from the payment of dividends in 2005, and corresponds to the payment of $7.6 million in dividends on the Company s Series

A Preferred Stock issued in 2004 (please see Note 12 of our notes to consolidated financial statements included herein) offset by the amortization of the dividend discount. Generally, the Series A Preferred Stock is entitled to quarterly dividends of $0.34 (5.5% per annum) per share. However, as provided in the Certificate of Designation relating to the Series A Preferred Stock, because a registration statement relating to the resale of the Series A Preferred Stock and shares of common stock issuable on conversion thereof was not declared effective by the SEC on or before June 15, 2005, quarterly dividends for such stock have increased to $0.40625 (6.5% per annum) commencing on June 16, 2005, and such dividends will apply until the date the registration statement is declared effective.

Deferred revenue increased by $8.1 million to $52.2 million as of December 31, 2005 from $44.0 million as of December 31, 2004. A significant portion of the increase is due to the inclusion in the 2005 balance of approximately $4.7 million in deferred hardware revenue related to a single customer. The remainder of the increase in deferred revenue is due to the timing associated with reaching billing milestones and revenue recognition criteria. In most instances, deferred revenue is increased when the Company invoices a customer, and is decreased when revenue is recognized based on percentage completion or attainment of a milestone in the customer contract. Deferred revenue includes amounts billed to or received from customers for which revenue has not been recognized. This generally results from deferred maintenance, software installation, consulting and training services not yet rendered and license revenue deferred until all revenue requirements have been met or as services have been performed. Additionally, there are term-based licenses for which revenues are recognized over the term of the contract. Unbilled revenue represents revenue that has been earned and recognized, but for which an invoice has not yet been generated for the customer. Invoices that have been issued and remain uncollected are recorded in the deferred revenue and accounts receivable balances. In determining the allowance for doubtful accounts the Company excludes invoices that remain recorded both in deferred revenue and accounts receivable since no revenue has been recognized on these balances.

Accrued exit cost of facility closing pertains to the long-term portion of the accrued future lease obligations related to the closed facilities in San Marcos, California and San Rafael California. The balance in the accrual increased by $0.7 million to $3.6 million as of December 31, 2005 from $2.9 million as of December 31, 2004. This increase is due to the accrued costs for the San Marcos lease recorded when we shut down the Financial Services Division in February 2005, and when we re-evaluated the assumptions of that lease in September 2005. In addition, amounts recorded in 2004 pertaining to the San Rafael lease were also re-evaluated in September 2005, and an additional accrual was made for that lease at that time. The short-term portion of these obligations is recorded in current liabilities.

Other long-term liabilities decreased by $2.7 million to $2.7 million as of December 31, 2005 from $5.4 million as of December 31, 2004. This decrease was primarily the result of the 2005 settlement with, and payment to, a former executive (please see Note 20 of our notes to consolidated financial statements included herein).

Cash Flows

	Year ended December 31,		
(in thousands)	**2005**	**2004**	**2003**
Cash provided by (used in) operating activities	$ 11,757	$ (10,348)	$ 802
Cash provided by (used in) investing activities	$ 3,222	$ (12,178)	$ 3,613
Cash provided by (used in) financing activities	$ (4,366)	$ 8,011	$ 8,866
Net increase (decrease) in cash and cash equivalents	$ 10,613	$ (14,515)	$ 13,281

Cash provided by (used in) operating activities was $11.8 million in 2005, compared to $(10.3) million in 2004 and $0.8 million in 2003. The net loss of $8.7 million in 2005 was offset by non-cash items totaling approximately $20.9 million, including depreciation and amortization of $11.4 million, bad debt expense of $2.3 million, preferred stock accretion of $4.8 million and exit cost associated with facility closings of $2.8 million. In addition, changes in current assets and liabilities resulted in an additional source of cash of $2.7 million in 2005, comprised of an increase in deferred revenue of $8.2 million, a decrease in prepaid and other expenses of $1.2 million, all partially offset by a decrease in accounts payable and accrued liabilities of $1.1 million, and an increase in accounts receivable of $3.2 million. In addition, $3.1 million was paid to a former executive who left the Company several years ago, out of a long-term trust asset set up for such purpose.

In 2004, by comparison, the $(10.3) of cash used in operations arose from the $44.3 million net loss and approximately $12.9 million in decreases in accounts payable and accrued liabilities and deferred revenue, offset by $40.1 million of non-cash expenses and approximately $6.7 million in decreases in accounts receivable and prepaid expenses and other assets. The $0.8 million of cash provided by operations in 2003 arose from the $23.9 million net loss offset by non-cash expenses of $14.5 million and $10.2 million provided by changes in other working capital items.

Net cash provided by (used in) investing activities was $3.2 million in 2005, compared to $(12.2) million in 2004 and $3.6 million in 2003. Investing activities in 2005 included $1.5 million provided by a reduction in restricted cash related to letters of credit, $1.3 million used for capital expenditure purchases, and $3.1 million provided by the liquidation of a long-term trust asset which was then immediately paid to a former executive who left the Company several years ago. Investing activities used $12.2 million of cash in 2004, including $4.5 million for capital expenditure purchases primarily related to our PeopleSoft System and $9.4 million for the acquisitions of Détente Systems Pty Limited and Tempus Software, Inc.; in addition, there were reductions in restricted cash of $1.6 million in 2004. Investing activities provided $3.6 million of cash in 2003, primarily due to $4.2 million in cash received in 2003 from the sale of assets associated with the EZ-CAP managed care software business and HIM Services division, and $2.4 million from the redemption of short-term investments; in addition we used $3.3 million for capital expenditure purchases in 2003.

Net cash used in financing activities was $4.4 million in 2005, compared to $8.0 million provided by financing activities in 2004 and $8.9 million provided in 2003. The $4.4 million used in financing activities in 2005 is primarily due to the payment of dividends on our Series A Preferred Stock of $5.8 million. The $8.0 million of cash generated from financing activities in 2004 arose from $96.1 million in proceeds from the issuance of Series A Preferred Stock, $88.1 million of which was used for the early retirement of our 2005 Notes and 2008 Notes. The $8.9 million of cash generated from financing activities in 2003 arose from $8.5 million in proceeds received in connection with the refinancing of our 2005 Notes and the issuance of our 2008 Notes in April 2003.

Cash provided by (used in) operating activities was $(0.8) million, $8.9 million, $2.7 million and $1.0 million sequentially for the four quarters of 2005. The changes primarily relate to the fluctuations between net (loss) and net income during the year, which were $(3.7) million, $0.1 million, $(5.2) million and $24,000 per quarter, respectively, from the first through fourth quarters of 2005. Non-cash items included in the net income (loss) for the quarterly results averaged approximately $5.2 million per quarter. In the third quarter, a $3.1 million payment was made to a former executive who left the Company several years ago, out of a long-term trust asset set aside for such purpose. In addition, changes in working capital items increased (decreased) cash in the amounts of $(2.9) million, $4.5 million, $4.1 million and $3.0 million per quarter, sequentially for the four quarters of 2005.

Commitments

The following table summarizes financial data for our contractual obligations and other commercial commitments, including accrued future dividends on our Series A Preferred Stock, as of December 31, 2005 (in thousands):

		Payments Due by Period			
Contractual Obligations	**Total**	**Less than 1 year**	**1-3 years**	**4-5 years**	**After 5 years**
Accrued dividends (1)	$ 9,054	$ 5,407	$ 3,647	$	$
Operating leases (2)	21,784	4,804	12,775	4,200	
Total contractual obligations	$ 30,838	$ 10,211	$ 16,422	$ 4,200	$
Other Commercial Commitments					
Standby letters of credit (3)	$ 2,375	$ 2,026	$	$	$ 349
Total commercial commitments	$ 2,375	$ 2,026	$	$	$ 349

(1) The Series A Preferred Stock holders have an option to convert and receive, when declared by the Board, dividends equal to the total previously unpaid dividends payable from effective date of conversion through June 1, 2007 at a rate of $1.375 per annum, discounted to present value at a rate of 5.5% per annum, payable in cash or common shares or any combination thereof at the option of the Company. Please see Note 12 of our notes to consolidated financial statements included herein.

(2) The Company plans to sublease the vacant San Rafael, California facility in 2006. The San Rafael lease payments total approximately $4.9 million for years 2006 through 2009. Of this amount, the minimum rent payments totaling $3.8 million are included in the schedule above. As a result, these amounts may become payable prior to the original contract term.

(3) The less than 1 year amount of $2.0 million includes a $1.0 million letter of credit in favor of the State of New Jersey under its contract and a $1.0 million letter of credit in favor of another customer under its contract. The remainder represents security deposits for leased facilities.

As of December 31, 2005, we had approximately $21.8 million in minimum operating lease commitments that will be paid through 2011. In addition, we have $2.4 million of funds in certificates of deposit held as collateral for the aforementioned standby letters of credit under bank financing agreements. These amounts reflect current requirements as of December 31, 2005, and may be reduced in the future.

We expect that cash provided by operating activities may fluctuate in future periods as a result of a number of factors, including fluctuations in our operating results, specifically the timing of when we recognize revenue, our accounts receivable collections and the timing of other payments. In addition, cash used in investing activities may fluctuate due to our software development efforts, any acquisition or disposition we may undertake and costs associated with our investments in fixed assets and information technology. For additional discussion, see *Item 1 A. Risk Factors* of our 2005 Annual Report.

We depend on licenses from a number of third-party vendors for certain technology, including the computer hardware, operating systems, database management systems, programming language and runtime environment, upon which we develop and operate our products. We are materially reliant upon licenses with the following third-party vendors: InterSystems Corporation, Document Storage Systems, Inc., Megas Corporation, Unicor Medical, Oracle, Microsoft, Quovadx, the American Medical Association (AMA), 3M and the American Hospital Association (AHA). Most of these licenses expire within three to five years. Such licenses can be renewed only by mutual consent and may be terminated if we breach the license terms and fail to cure the breach within a specified time period. If such licenses are terminated, we may not be able to continue using the technology on commercially reasonable terms or at all. As a result, we may have to discontinue, delay or reduce product shipments until equivalent technology is obtained, which could have a material adverse effect on our business, financial condition and results of operations. However, as all application software companies, including QuadraMed and our competitors, are reliant on licensed technology and third-party components, we believe our reliance on such technology and licenses places us at no competitive disadvantage. For additional discussion, see *Item IA. Risk Factors* of our 2005 Annual Report.

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At present, there is no equivalent technology for the InterSystems Corporation technology, an integral component of our Affinity product line, that is immediately available to us. The Company has entered into several agreements with InterSystems Corporation regarding the licensed technology relating to our Affinity product line. However, if InterSystems Corporation ceased to offer this technology and no other vendor provided the technology, we would be required to migrate our Affinity products to a new database platform or redesign our products to work with new software tools. This could be very costly and difficult to achieve and could have a material adverse effect on our business, financial condition and results of operations. There can be no assurance that we would successfully migrate our Affinity products to a new platform.

Off-Balance Sheet Arrangements

We do not have any intercompany loans or any off-balance sheet arrangements.

Inflation

The majority of our revenue is derived from perpetual and long-term customer contracts. The term of contracts range from one to five years and the contracts generally allow for price increases annually based on specified rates or external measures of inflation. We have increased some of our prices under certain contract provisions. Our maintenance contract terms also provide for annual price increases based on specified rates or external measures of inflation. Accordingly, inflation has not had, and we do not believe that it will have, a significant impact on our financial condition.

Item 8. Financial Statements and Supplementary Data

Our financial statements and supplementary data are included in this Amendment to the Annual Report on Form 10-K/A beginning on page F-1 and are incorporated by reference into this Amendment to the Annual Report on Form 10-K/A.

PART IV

Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K

(a) The following documents are filed as a part of this Amendment to the Annual Report on Form 10-K/A:

1. Financial Statements. Reference is made to the consolidated financial statements and notes incorporated herein begin on page F-1.

2. Financial Statement Schedule. Reference is made to Schedule II Valuation and Qualifying Accounts on page F-35.

3. Exhibits. Reference is made to the Exhibit List of this Amendment to the Annual Report on Form 10-K/A.

(b) Reports filed on Form 8-K during the last quarter of the year covered by this Amendment to the Annual Report on Form 10-K/A:

1. Form 8-K, dated October 17, 2005, regarding the commencement of Keith B. Hagen s tenure as the Company s Chief Executive Officer and his appointment to the Company s Board of Directors, the departure of Directors F. Scott Gross, William K. Jurika and Cornelius T. Ryan, and amendment of the Company s Bylaws to eliminate the requirement that the Chairman of the Company s Board of Directors be an officer of the Company.

2. Form 8-K, dated October 31, 2005, reporting the results of the Company s annual meeting, including the shareholder approval of an amendment to the Certificate of Designation for the Company s Series A Preferred Stock.

3. Form 8-K, dated November 15, 2005, press release on November 9, 2005, announcing earnings and other financial results for the Company s third fiscal quarter ended September 30, 2005.

4. Form 8-K, dated November 17, 2005, attaching a transcript from the investor conference call held on November 9, 2005 regarding the Company s earnings and other financial results for the third quarter ended September 30, 2005.

5. Form 8-K, dated November 28, 2005, announcing the appointment of Steven V. Russell as the Company s Senior Vice President of Corporate Development, effective November 21, 2005, and the entry into definitive agreements in connection with his appointment.

The exhibits listed on the accompanying Exhibit Index or incorporated by reference are filed as part of this Amendment to the Annual Report on Form 10-K/A.

QuadraMed, Affinity, Quantim, Tempus, pcMAR, MPIspy, SmartMerge, TempusOne, TempusXpress, nCoder+, WinCoder+, MEDREC Millennium, COPE, Intelligent Care Sets, WinPFS, LinkSearch, SmartScan and SmartID, among others, are trademarks or registered trademarks of QuadraMed Corporation or its subsidiaries in the United States and other countries. All other brands, products, or service names are or may be trademarks or service marks of, and are used to identify, products or services of their respective owners.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	QUADRAMED CORPORATION	
Date: August 17, 2006	By:	/s/ KEITH B. HAGEN **Keith B. Hagen** **Chief Executive Officer**
Date: August 17, 2006	By:	/s/ DAVID L. PIAZZA **David L. Piazza** **Chief Financial Officer**

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

	/s/ KEITH B. HAGEN **Keith B. Hagen**	Chief Executive Officer, Director (Principal Executive Officer)	August 17, 2006
	/s/ DAVID L. PIAZZA **David L. Piazza**	Executive Vice President, Chief Financial Officer (Principal Financial and Accounting Officer)	August 17, 2006
	/s/ ROBERT L. PEVENSTEIN* **Robert L. Pevenstein**	Chairman of the Board	August 17, 2006
	/s/ LAWRENCE P. ENGLISH* **Lawrence P. English**	Director	August 17, 2006
	/s/ ROBERT W. MILLER* **Robert W. Miller**	Director	August 17, 2006
	/s/ JAMES E. PEEBLES* **James E. Peebles**	Director	August 17, 2006
*By:	/s/ KEITH B. HAGEN **Keith B. Hagen**	Attorney-in-Fact	August 17, 2006

EXHIBIT INDEX

Certain of the following exhibits have been previously filed with the SEC and are incorporated herein by reference from the document described in parentheses. Certain others are filed herewith.

Exhibit Number	Exhibit Description
2.1	Agreement and Plan of Merger, dated as of June 30, 2004, by and among QuadraMed Corporation, Sawgrass, LLC, Tempus Software, Inc. and each of the shareholders of Tempus Software, Inc. (Exhibit 2.1 to our Current Report on Form 8-K, as filed with the SEC on July 15, 2004.)
3.1	Third Amended and Restated Certificate of Incorporation of QuadraMed. (Exhibit 3.5 to our Annual Report Amended on Form 10-Q/A, as filed with the SEC on August 24, 1998.)
3.2	Amendment to the Third Amended and Restated Certificate of Incorporation of QuadraMed. (Exhibit 3.3 to our Registration Statement on Form S-1, No. 333-112040, as filed January 21, 2004.)
3.3	Amended and Restated Bylaws of QuadraMed. (Exhibit 3.1 to our Current Form on Form 8-K, as filed with the SEC on October 17, 2005.)
4.1	Certificate of Amendment Amending and Restating the Certificate of Designation, Powers, Preferences and Rights of the Series A Cumulative Mandatory Convertible Preferred Shares. (Exhibit 3.1 to our Current Report on Form 8-K, as filed with the SEC on October 31, 2005)
4.2	Form of Common Stock certificate. (Exhibit 4.2 to our Registration Statement on Form SB-2, No. 333-5l80-LA, as filed with the SEC on June 28, 1996, as amended by Amendment No. l, Amendment No. 2 and Amendment No. 3 thereto, as filed with the SEC on July 26, 1996, September 9, 1996, and October 2, 1996, respectively.)
4.3	Warrant Agreement, including Form of Warrant, dated as of April 17, 2003, by and between QuadraMed Corporation and The Bank of New York, as warrant agent. (Exhibit 4.3 to our Current Report on Form 8-K, as filed with the SEC on April 30, 2003.)
4.4	Registration Rights Agreement, dated as of April 17, 2003, among QuadraMed, the investors listed on the signature pages thereto, and Philadelphia Brokerage Corporation. (Exhibit 4.5 to our Current Report on Form 8-K, as filed with the SEC on April 30, 2003.)
4.5	Registration Rights Agreement dated as of June 15, 2004, by and between QuadraMed and the investors identified on the signature pages thereto. (Exhibit 4.1 to our Current Report on Form 8-K, as filed with the SEC on June 17, 2004.)
4.6	Registration Rights Agreement dated as of June 30, 2004, by and between QuadraMed and the shareholders identified on the signature pages thereto. (Exhibit 4.1 to our Current Report on Form 8-K, as filed with the SEC on July 30, 2004.)
4.7	Form of Preferred Stock certificate for the Series A Cumulative Mandatory Convertible Preferred Shares. (Exhibit 4.17 to our Pre-Effective Amendment No. 3 to our Registration Statement on Form S-1, No. 333-112040, as filed with the SEC on August 25, 2004.)
10.1	Summary Plan Description, QuadraMed Corporation 401(k) Plan. (Exhibit 10.3 to our Registration Statement on Form SB-2, No. 333-5l80-LA, as filed with the SEC on June 28, 1996, as amended by Amendment No. l, Amendment No. 2 and Amendment No. 3 thereto, as filed with the SEC on July 26, 1996, September 9, 1996, and October 2, 1996, respectively.)
10.2	1996 Stock Incentive Plan of QuadraMed. (Exhibit 10.1 to our Registration Statement on Form SB-2, No. 333-5l80-LA, as filed with the SEC on June 28, 1996, as amended by Amendment No. l, Amendment No. 2 and Amendment No. 3 thereto, as filed with the SEC on July 26, 1996, September 9, 1996, and October 2, 1996, respectively.)

Exhibit Number	Exhibit Description
10.3	1999 Supplemental Stock Option Plan of QuadraMed. (Exhibit 10.5 to our Annual Report on Form 10-K, as filed with the SEC on March 30, 2000, as amended by May 1, 2000.)
10.4	2002 Employee Stock Purchase Plan of QuadraMed. (Exhibit 99.1 to our Registration Statement on Form S-8, No. 333-87426, as filed with the SEC on May 2, 2002, as amended by Exhibit C to our Schedule 14A, as filed with the SEC on April 6, 2004.)
10.5	2004 Stock Compensation Plan of QuadraMed. (Exhibit 4.36 to our Registration Statement on Form S-8, No. 333-118581, as filed with the SEC on August 26, 2004.)
10.6	Form of Indemnification Agreement between QuadraMed and its directors and executive officers. (Exhibit 10.6 to our Annual Report on Form 10-K, as filed with the SEC on March 16, 2006.)
10.7	Separation Agreement dated June 12, 2000, between James D. Durham and QuadraMed. (Exhibit 10.64 to our Quarterly Report on Form 10-Q for the quarter ended September 30, 2000, as filed with the SEC on August 14, 2000.)
10.8	Separation Agreement dated January 5, 2005, between Michael S. Wilstead and QuadraMed. (Exhibit 10.15 to our Quarterly Report on Form 10-Q for the quarter ended September 30, 2005, as filed with the SEC on November 9, 2005.)
10.9	Separation Agreement dated as of August 17, 2005, between John C. Wright and QuadraMed. (Exhibit 99.1 to our Current Report on Form 8-K, as filed with the SEC on August 26, 2005.)