QUEST SOFTWARE INC (QSFT)

10-K

Annual report pursuant to section 13 and 15(d)
Filed on 02/29/2012
Filed Period 12/31/2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Fiscal Year Ended December 31, 2011

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 No. 000-26937

QUEST SOFTWARE, INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware **(State or Other Jurisdiction of Incorporation or Organization)**	**33-0231678** **(I.R.S. Employer Identification No.)**
5 Polaris Way **Aliso Viejo, California** **(Address of Principal Executive Offices)**	**92656** **(Zip Code)**

Registrant's Telephone Number, Including Area Code: (949) 754-8000

Securities Registered Pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Exchange on Which Registered
Common Stock	The Nasdaq Stock Market LLC (Nasdaq Global Select Market)

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 ☒

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 ☒

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 ☒ No ☐

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ 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, 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.

Large accelerated filer	☒	Accelerated filer	☐
Non-accelerated filer	☐ (do not check if a smaller reporting company)	Smaller reporting company	☐

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

The aggregate market value of the voting stock held by non-affiliates of the Registrant was approximately $1.3 billion as of June 30, 2011, based upon the closing sale price reported for that date on The Nasdaq Global Select Market.

As of February 10, 2012, 83,432,567 shares of the Registrant's common stock were outstanding.

Documents Incorporated by Reference

Portions of the Registrant's Definitive Proxy Statement, to be delivered to stockholders in connection with the Registrant's 2012 Annual Meeting of Stockholders, are incorporated by reference into Part III of this Report.

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QUEST SOFTWARE, INC.
ANNUAL REPORT ON FORM 10-K
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Forward-Looking Statements

Discussions under the captions *"Business," "Risk Factors,"* and *"Management's Discussion and Analysis of Financial Condition and Results of Operations"* and other parts of this Annual Report on Form 10-K include or may include forward-looking statements within the meaning of the federal securities laws. We have based these forward-looking statements on currently available information and our current beliefs, expectations and projections about future events. All forward-looking statements contained herein are subject to numerous risks and uncertainties. Our actual results and the timing of certain events could differ materially from those projected in the forward-looking statements due to a number of factors including those discussed under the heading *"Risk Factors"* in this Report and in our other filings with the Securities and Exchange Commission ("SEC"). Should one or more of these risks or uncertainties materialize, or should the underlying estimates or assumptions prove incorrect, actual results or outcomes may vary significantly from those suggested by forward-looking information. Any forward-looking statements contained in this document are based on information available at the time of filing and we make no undertaking to update any of these forward-looking statements.

PART I

Item 1. *Business*

Overview

Quest Software, Inc. ("Quest," "Quest Software," the "Company," "we," "us" or "our") designs, develops, markets, distributes, and supports enterprise systems management software products. Our goal is to provide our customers with systems management products that improve the performance, productivity and reliability of their software applications and associated software infrastructure components such as databases, application servers, operating systems, and virtual environments. Quest is an "Independent Software Vendor," or "ISV," a company whose products are designed to support or to interact or interoperate with other vendors' software or hardware platforms. As such, we continually strive to innovate and evolve our product portfolio to support the dynamic nature of our markets, as well as those of our customers' information technology ("IT") environments. Our success has been predicated on identifying large and evolving markets, developing and acquiring new products and technologies, and then leveraging our sales organization and installed base of customers to further our growth. We began as a provider of software tools and solutions for the Oracle database market, and subsequently expanded our offerings into other adjacent markets with product portfolios for application, Windows, and virtualization management. Today, our products span six solution families, and, as embodied in our slogan, "Simplicity at Work," we seek to provide IT management software that is simple to use, saving our customers time and money across physical, virtual and cloud environments.

We generate revenues by licensing our software products, principally on a perpetual basis. In addition to perpetual software licenses, we sell a small amount of time-based software licenses (or term licenses) wherein customers pay a single fee for the right to use the software and receive maintenance for a defined period of time. We also provide support, maintenance and professional services for these products. As such, our reportable operating segments are Licenses, Maintenance Services and Professional Services. The Licenses segment develops, and markets and sells licenses to use, our software products. The Maintenance Services segment provides post-sale support for software products and the Professional Services segment provides fee-based training and consulting services related to our software products. We have a large product portfolio of high-value products offered through six solution families that span these three segments and include very technically complex solutions focused on improving the management and performance of mission-critical software applications and the underlying component infrastructure. We also have volume products and software tools that enable our customers to reduce capital and operating expenditures or leverage existing investments in personnel and IT systems. Acquisitions have historically been an important element of our corporate strategy and have served as a mechanism to broaden our product portfolio and enter new markets. For example, we entered the application management, Windows management, and virtualization management markets through a series of acquisitions which served to propel the Company beyond its database management roots. Within the last five fiscal years, we have invested approximately $610 million, in the aggregate, to acquire 25 companies. Our acquisition strategy is directed at broadening our product portfolio and strengthening our competitive position against both direct competitors and the continual improvements made by the platform vendors.

Through our six solution families: 1) Database Management, 2) Performance Monitoring, 3) Data Protection, 4) User Workspace Management, 5) Windows Server Management, and 6) Identity and Access Management, we offer a broad and deep portfolio of products that target common IT challenges and meet a wide array of IT management needs for physical, virtual or cloud environments. Examples of the benefits delivered by our products include:

- Improved application and database performance for large-scale, complex, mission-critical type systems

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- The ability to manage multi-tiered heterogeneous operating environments with integrated dashboards and metrics, to leverage existing investments and support new technologies
- Comprehensive migration, management and integration capabilities to simplify, automate and secure an organization's Windows infrastructure
- Solutions for business continuity, high availability and disaster recovery for virtualized infrastructure environments

Our Database Management solution family offers products that simplify the development process, accelerate release cycles and increase code quality for database and SharePoint applications, to help developers and managers meet tight deadlines and overcome the challenges of working in diverse and dispersed teams. Our Database Management solutions help manage the development process and boost application performance and availability, offering intuitive interfaces and built-in expert advice to help developers become more productive and deliver higher-quality results. Our solutions also include built-in automated testing capabilities to improve code quality, and are designed to help applications deliver optimal performance in production to provide business users with the best experience possible. With capabilities spanning coding, testing, modeling, and change management, the products in this solution portfolio support a variety of platforms, including Oracle, Oracle RAC, SQL Server, IBM DB2, MySQL, Sybase ASE and Visual Studio and includes our industry-leading Toad® product line.

Our Performance Monitoring solution family ensures performance and availability of mission-critical applications throughout their life cycles. Our solutions are focused on the monitoring and performance management of customers' primary enterprise software applications, whether packaged or custom developed, and whether housed in traditional data centers or in the cloud. Our products help manage and resolve performance issues to improve user satisfaction and ensure that applications are meeting the needs of the business. They are designed and priced to help IT organizations of any size align and grow with the business. Our flagship Foglight solution provides functionality that enhances visibility for an administrator who may be working within an environment encompassing both physical and virtual applications running concurrently. From a breadth perspective, our products manage custom web-based applications written in Java and .NET, as well as packaged applications like PeopleSoft, Oracle E-Business Suite and SAP. From a depth perspective, our products cover key databases such as Oracle, DB2 and SQL Server, as well as Oracle and IBM application servers and all key web servers in today's market. In May 2011, for the second consecutive year, Quest was named a leader in the Gartner Magic Quadrant for Application Performance Monitoring, a distinction that was driven by Foglight.

Our Data Protection solution family offers simplified backup and data recovery across physical, virtual and application environments**.** In addition to backup and recovery, our portfolio of data protection solutions possesses capabilities that provide disaster recovery, high availability, data replication, continuous data protection, data deduplication, and archiving. Our solutions minimize system downtime and ensure business continuity, lowering the total expense of managing enterprise backup and recovery. Disk-based data backup and deduplication eliminate data redundancy and improve storage efficiency, reducing required storage by up to 90 percent. Our continuous data protection ("CDP") technology enables customers to quickly access critical data after a recovery is initiated. Because it is scalable, our technology meets the needs of both small and large organizations, and customers can reduce both upfront and ongoing administration costs by leveraging a single user interface to back up a diverse set of platforms and applications.

Our User Workspace Management solution family includes the advanced, integrated tools necessary to help IT provide a secure user workspace that can be accessed from a variety of devices, platforms and locations, satisfying the desires of a mobile workforce while meeting the needs of the business. Our solutions enable deployment of Windows 7 and new versions of Internet Explorer with minimal business disruption, to deliver a productive user workspace on every device, including tablets and smartphones. The User Workspace Management solution portfolio further allows IT to manage and blend multiple desktop and application delivery technologies to make non-traditional technology work in Windows-centric enterprises, and secures corporate assets while empowering individuals to work by enabling IT to deliver a protected workspace to every user on any device, in any location. Our solutions enable IT to strategically deliver virtual desktops and applications while simultaneously supporting physical PCs, Macs and mobile devices, and managing the entire IT environment with consolidated dashboards and support models; manage supporting applications to achieve continued productivity across the user environment; and administer one user identity across all platforms, providing instant access with a consistent set of security privileges across physical, virtual and cloud environments.

Our Windows Server Management solution family provides a single source for help in efficiently moving and restructuring user accounts, data and systems without impacting users or business productivity. When an organization needs to migrate and consolidate systems, whether due to mergers and acquisitions or just a move to new versions of existing systems and infrastructure, it is crucial that IT plan every aspect of the transition to make sure users have access to all business-critical applications and information throughout the migration or consolidation project. Quest's migration and consolidation solutions perform impact assessments prior to any type of migration, and enable true coexistence for communication and collaboration during the length of the project. Our solutions easily restructure user accounts, data and systems during the migration, and can accommodate even the most complex migration scenarios. With capabilities for pre-migration analysis, migration, restructuring, and upgrading, Quest's Windows Server Management products support the following platforms: Active Directory, Exchange Server, Hyper-V, Lotus Notes, Novell GroupWise, Oracle Database, SharePoint, VMware, Windows Server, and Office 365.

Our Identity & Access Management solution family encompasses the Quest® One Identity Solutions portfolio, which simplifies identity and access management to increase security, efficiency and compliance by unifying identities, roles, workflows, and approvals around existing Identity and Access Management infrastructures and best practices. Quest One Identity Solutions reduces the complexity that exists when many users have multiple identities on too many systems, resulting in numerous passwords and accounts that take too much time and effort for IT to manage. With capabilities addressing single sign-on; provisioning; role-based management; identity intelligence; multifactor authentication; password management; privileged account management; framework optimization; and compliance, audits, and security, our Identity and Access Management solution family supports a multitude of platforms, including Active Directory, SAP, Siebel, DB2, Oracle E-Business suite, and Java, just to name a few. Our solutions ensure that identity and access management activities support business objectives; align user and administrator access to corporate data, policy and resources; and automate and unify provisioning, role management, password management, single sign-on, and privileged account management. Our solutions also provide segregation of duties and access control, and enable IT to achieve and maintain compliance with policies and regulations.

We invest a significant portion of our cash flow into our product development and management capabilities, and just over one-third of our employees work in product development, quality assurance or technical documentation roles. Our products perform across different combinations of existing infrastructure within our customers' IT configurations, thus we spend a significant amount of our R&D efforts to ensure that our products work consistently within heterogeneous IT environments. For example, a particular customer that deploys an Oracle financial application on an Oracle application server with an Oracle database may get different performance characteristics than another customer who deploys the same application on an IBM application server with a DB2 database. We test, evaluate and build capabilities within our products that help our customers manage these subtle differences, and this requires an extended effort to capture the potential and associated combinations and permutations of our customers' infrastructures. A large proportion of our R&D organization supports and develops existing product lines. As we increasingly seek new product opportunities within emerging markets, we have, at times, successfully leveraged our expertise from current products. An example of this is our entrance into the SharePoint market with products that share technical aspects found in a few of our other products. In other instances where time to market is essential, we have supplemented our own technical efforts with technology and products from acquired companies. For example, key technology components of our vFoglight® capabilities were derived from the inter-relationship between the R&D teams of Quest and a company that we acquired, Vizioncore.

In building our products, we stress technical innovation and depth; ease of deployment; ease of use; and tangible, readily articulated and measurable customer benefits. We sell our products primarily through our direct field sales force, our telesales organization and via indirect sales through resellers and distributors. We are a global company with offices located throughout the world.

We were incorporated in California in 1987 and reincorporated in Delaware in 2009. Our principal offices are located at 5 Polaris Way, Aliso Viejo, California, 92656. We operate on a calendar fiscal year.

Solutions, Products and Services

Solutions

We develop innovative products that increase the performance of applications, databases and infrastructure, and improve the productivity of the people who manage them, enabling customers to solve some of today's toughest IT challenges. IT organizations today rely on Quest to help achieve compliance, manage complex applications and simplify identity management.

Products

We market products grouped into six solution families: 1) Database Management, 2) Performance Monitoring, 3) Data Protection, 4) User Workspace Management, 5) Windows Server Management, and 6) Identity and Access Management. The capabilities and some major products of each solution family are as follows:

DATABASE MANAGEMENT

Our Database Management solution portfolio includes tools that provide intuitive interfaces and built-in expert advice to simplify development; automated code-testing to streamline deployment of accurate code to production; cross-platform database modeling software to speed and simplify everyday database design and modification tasks; and in-depth visibility into, and control over, Oracle E-Business Suite and PeopleSoft applications. Our Database Management products include:

- *Toad® for Oracle* combines deep functionality with extensive automation and intuitive workflows to ensure the greatest possible productivity in development and administration of Oracle databases.
- *Toad® for Cloud Databases* provides a SQL-based interface that makes it simple for IT to generate queries, migrate, browse, and edit data, as well as create reports and tables in a familiar SQL view.
- *Benchmark Factory® for Databases* is a database performance testing tool that allows IT to conduct database workload replay, industry-standard benchmark testing, and scalability testing. It helps deploy changes to the database environment, reducing the risks associated with patches, upgrades, migrations, and adjustments to virtual machine configurations through the incorporated load testing tools.
- *Toad® Data Modeler* helps create high-quality data models and easily deploy accurate changes to data structures.
- *Stat® for Oracle E-Business Suite* is a change management and version control solution that provides increased visibility into, and control over, application change, allowing an organization to be more responsive to change.

PERFORMANCE MONITORING

Our Performance Monitoring solution portfolio helps manage and resolve performance issues to improve user satisfaction and ensure that primary enterprise software applications meet the needs of the business. Our solutions have the capability to detect, isolate and resolve response-time issues; simplify management of the application server, the user transactions running through it, and the underlying infrastructure; provide simplified, consistent performance monitoring and management across heterogeneous database platforms; perform performance monitoring and capacity management of complex VMware ESX and Hyper-V environments; and provide full visibility of network resources and their metrics – including hardware, operating systems, virtualization, databases, middleware, applications, and services. Our Performance Monitoring products include:

- *Foglight® End User Business Analysis Suite* provides the visibility needed to understand how users are interacting with a web site. This information empowers the organization to grow revenue through increased customer satisfaction.
- *Foglight® for Oracle E-Business Suite* helps manage the availability of Oracle E-Business Suite applications. By monitoring performance degradations or application availability issues, Foglight plays a vital role in increasing the business value and lowering the total cost of ownership of the Oracle E-Business Suite.
- *Foglight® for Oracle* provides constant remote database monitoring and correlates performance data from across the technology stack. It extends the capabilities of basic database monitoring software, and empowers IT to take action immediately to maximize Oracle database resources.
- *vFoglight* offers a single solution for performance monitoring and capacity management of complex VMware ESX and Hyper-V environments. It helps optimize resources, monitor performance, plan for growth, and allocate costs across virtual, physical, and cloud infrastructures.

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DATA PROTECTION

Our Data Protection solution portfolio provides backup and data recovery across multiple physical, virtual and application environments. Our disaster recovery solutions protect the most critical applications and data with a combination of backup, replication and conversion capabilities, and our high availability solution for Oracle databases helps streamline the data replication process by replicating only what is needed. Our portfolio also includes data replication solutions that support physical, virtual and database platforms, as well as data deduplication, archiving, and continuous data protection solutions. Our Data Protection products include:

- *vRanger®* provides fast, easy-to-manage technology for VMware ESX and ESXi backup and replication, while minimizing the impact on network and storage requirements.
- *NetVault® Backup* is a cross-platform backup and recovery solution that safeguards data and applications in both physical and virtual environments, from one intuitive console. This scalable enterprise solution supports many server and application platforms, and its intuitive interface requires minimal experience to operate.
- *NetVault® Replicator* is a data replication solution offering simplified, cross-platform replication for Windows, Linux, Solaris and Mac OS X file-system data. It captures byte-level changes at the source and efficiently replicates those changes to one or many destinations, to simplify disaster recovery planning, remote office data protection and data **s**ynchronization.
- *NetVault® FastRecover* enables instant recovery after corruption or data loss. Patented Virtual On-Demand Recovery (VODR) technology delivers immediate availability of mission-critical applications with no need to wait for the full recovery before end users can resume activities.
- *NetVault® Smartdisk* delivers disk-to-disk backup and data deduplication that significantly reduce storage costs. With powerful, byte-level, variable block deduplication, and advanced data compression, the disk backup storage footprint can be reduced by up to 90 percent.

WINDOWS SERVER MANAGEMENT

Our Windows Server Management solution portfolio helps move and restructure user accounts, data and systems without impacting users or business productivity. Our migration and consolidation solutions analyze the source system, assess the impact of a proposed migration, enable coexistence between two platforms during the migration, and restructure and perform clean up after the migration. Our solutions can accommodate the most complex migration scenarios. Our Windows Server Management products include:

- *MessageStats®* reduces the complexity of email reporting and analysis across legacy and newly implemented platforms.
- *Server Administrator for SharePoint* provides maximum insight into the SharePoint server and farm configuration and customizations.
- *Coexistence Manager for Notes* ensures interoperability between Notes and Exchange 2007/2010, Exchange Online and hosted Exchange. It ensures the accuracy of email and calendar data, and preserves end-user collaboration by synchronizing directories and providing free/busy look ups between platforms.
- *Migrator for Cloud Email* securely migrates user accounts and data from on-premises versions of Microsoft Exchange and Google Gmail to Microsoft Office 365 and Live@edu environments.
- *Migration Manager for SharePoint* helps migrate and consolidate SharePoint 2003 and SharePoint 2007 content directly to SharePoint 2010, as well as reorganize SharePoint 2007 and 2010 site structures to streamline information access, optimize content storage and enhance recovery time objectives.

IDENTITY & ACCESS MANAGEMENT

The *Quest One Identity Solutions* portfolio offers the full spectrum of single sign-on (SSO), regardless of which systems, applications or databases are used; automated, codeless, business-driven provisioning of user identities and access privileges enterprise-wide; role-based management that granularly defines and administers roles; and identity intelligence through a single, well-controlled, and flexible Identity & Access Management structure that adjusts as needs and systems evolve. Our solution portfolio also offers multifactor authentication that provides strong alternatives to traditional username/password authentication; and password management tools that address many of the most pressing password management issues facing complex heterogeneous enterprises. Quest Identity & Access Management solutions also offer privileged account management; framework optimization; and regulation-specific auditing, reporting, retention, and alerting that allow IT to react to compliance problems quickly. Our Identity & Access Management products include:

- *Enterprise Single Sign-on* bases all logins on a user's existing Active Directory identity, requires no cumbersome infrastructure and streamlines both end-user management and enterprise-wide administration of single sign-on.

- *ActiveRoles® Server* provides strictly enforced role-based security, automated group management, workflow and easy-to-use web interfaces for self-service to achieve practical user and group lifecycle management for the Windows enterprise.
- *Quest® One Identity Manager* streamlines the management of user identities, access privileges and security. Quest One Identity Manager offers advanced role-based access control management, while automating complex Identity and Access Management tasks at a fraction of the time and expense of traditional solutions.
- *Access Manager* controls user and group access to resources throughout the Windows enterprise and network attached storage devices to meet security and compliance requirements, control operational costs and optimize infrastructure performance.
- *Defender®* enhances security by enabling two-factor authentication to network, Web and applications-based resources. The solution uses the scalability and security of Active Directory for identity storage and management, enabling administrators to use their existing skill set to manage two-factor authentication, and eliminating the costs and time involved in setting up and maintaining proprietary databases.
- *Password Manager* enables the end user to reset forgotten passwords securely, allowing administrators to implement stronger password policies while reducing the help desk workload.
- *Privilege Manager for Unix* enhances security by protecting the full power of root access from potential misuse or abuse through fine-grained, policy-based control. Privilege Manager helps to define a security policy that stipulates who has access to which root function, as well as when and where individuals can perform those functions.

Services

Maintenance Services

Product maintenance and technical support services is critical to the successful marketing and sale of our products and the development of long-term customer relationships. We have a reputation for providing a high level of global customer support, and believe that this is a competitive differentiator. Initial enrollment in our customer support program for one year is bundled with a sale of a software license, and entitles a customer to problem resolution services, new functional enhancements of a product, and ongoing compatibility with new releases of the database, application or other platforms supported by the product. Annual renewals are offered thereafter. We also offer multi-year support. Customer support is provided domestically through our offices in Aliso Viejo, and internationally through our offices in Europe, Canada and Singapore. We also offer SupportLink, a customer portal on our website, where customers can find product information and downloads, answers to questions, video tutorials, access to our various Quest communities, and many other support-related resources.

Professional Services

Our professional services include pre- and post-sales consulting, as well as education and training. Our consulting services include a wide range of offerings such as assistance with optimization; migration; simplifying an infrastructure or increasing its responsiveness; and installation and systems integration for the deployment of Quest products. We offer our consulting and training services with the initial deployment of our products, as well as on an ongoing basis to address the continuing needs of our customers. Our consulting and training services staff is located throughout the Americas, Europe and APAC, enabling us to perform installations and respond to customer demands across our global customer base.

We also have relationships with resellers, professional service organizations and system integrators including Accenture, Avanade, IBM and others, which include participation in the deployment of our products to customers. These relationships help promote Quest products and provide additional technical expertise that enables us to provide the full range of consulting and training services our customers may require to deploy our products.

We offer product education courses to train our business partners and customers on the implementation and use of our products. Product training is provided at our headquarters, online and at customer sites, as well as other regional and international locations.

Sales, Marketing and Distribution

We market and sell our products and services worldwide primarily through our direct sales organization, our telesales organization and via indirect sales channels with a group of value added resellers ("VARs") and distributors. Given the nature of our sales model and product price points, we generally transact significant sales volume at the end of a quarter, with the largest amount of the yearly volume occurring during the fourth quarter. However, our Federal government business typically has the highest volume during the third quarter, which coincides with the federal government fiscal year and budget cycle. As of December 31, 2011, we had 1,611 full-time sales and marketing employees, of whom 1,440 were full-time, sales representatives. We have 333 pre-sales systems engineers who work with our field sales teams to provide technical assistance and demonstrations to sales prospects. We have continued to invest in this area, and have supplemented our direct sales organization with an indirect sales channel that includes companies such as Dell and HP, in addition to resellers focused on governmental and commercial business. This activity requires broad-based programs to recruit, manage and expand our support operations to grow these relationships. We also employ local resellers in certain international territories not covered by our local sales offices.

We have sales offices throughout the world to facilitate close contact between current and potential customers and our field sales organization. Sales that originate outside of the United States are generally denominated in the foreign currency of the country of origin. As such, we have exposure to fluctuations in foreign exchange rates, which for the year ending December 31, 2011 contributed approximately $8.4 million to our overall increase in total revenues, when comparing 2011 average monthly rates to 2010.

Our marketing efforts are designed to create awareness, generate leads, and assist the worldwide sales organization with converting leads into closed sales. Marketing initiatives and programs focus on how Quest products address critical issues facing today's IT buyers. We use a full complement of marketing vehicles including industry trade shows and conferences, user groups and discussion forums, educational white papers and technical briefs, electronic and print advertising, webcasts, electronic direct marketing, and online advertising. Strategic and channel partners often assist us with the development, funding and execution of our marketing programs. Targeted campaigns and sales programs are developed based on objective, audience and product mix, and are executed in our regions around the world to maximize revenue opportunities as quickly as possible.

For information regarding our segment revenue and revenue by geographic area, please refer to Note 3 – Geographic and Segment Reporting of our Notes to Consolidated Financial Statements.

Research and Development

We believe that strong research and product development capabilities are essential to enhancing our core technologies and developing additional products. Quest products typically exhibit innovative capabilities, strong product engineering and rich user interfaces. Our commitment to ongoing product development is reflected in our investments in R&D, which were $166.2 million, $151.9 million and $144.4 million for the years ended December 31, 2011, 2010 and 2009, respectively. We have actively recruited key software engineers and developers with expertise in the areas of Oracle technologies, Java, Microsoft infrastructure technologies, ERP, virtualization, and CRM systems. We have also built up these competencies through acquisitions. In addition to the U.S., we have significant product development operations in Canada, Australia, Russia, Israel and China. Our internal R&D is supplemented by our acquisition strategy, which is focused primarily on emerging companies with recently developed and in-process technologies.

Competition

The market for enterprise systems management solutions is intensely competitive and characterized by rapidly changing technology and evolving standards. We expect competition to continue to increase both from existing competitors and new market entrants. We believe that our ability to compete effectively depends on many factors, including:

- The ease of use, performance, features, price, and reliability of our products as compared to those of our competitors
- The value proposition of our products in terms of return on investment and/or reduced cost of ownership
- The timing and market acceptance of new products and enhancements to existing products developed by us and our competitors

- The quality of our customer support
- The effectiveness of our sales and marketing efforts

We compete, in some instances, with the platform vendors of databases, applications, infrastructure, and other systems our products are designed to support. If these vendors include similar or equivalent functionality relative to our software as standard features of their underlying product, our revenues could be adversely affected. For example, competition with Oracle over the last several years has materially reduced license revenues generated by certain of our database management products, and has negatively impacted the growth rate of license revenues associated with our Oracle database development tools. Microsoft has continually upgraded the functionality of its platform offerings, which we believe will increase competitive pressure for our products in the future.

We also compete with other vendors of database, performance monitoring, Windows, and data protection tools. Public and private companies with whom we compete include:

- Oracle, BMC Software and CA in the Database Management product areas
- IBM/Tivoli, HP Software, CA, Compuware, and BMC Software in the Performance Monitoring product areas
- Symantec, NetIQ, Oracle and Sailpoint in the Windows Server Management product areas
- CommVault, Symantec and Veeam in the Data Protection product areas
- Oracle, IBM/Tivoli, Novell, and CA in the Identity & Access Management product areas

Some of our competitors and potential competitors have greater name recognition; a larger installed customer base company-wide; and significantly greater financial, technical, marketing, and other resources than we do. Competitors may also be able to respond more quickly to new or emerging technologies and changes in customer requirements, or devote greater resources to the development, promotion and sale of their products than we can.

Because there are relatively low barriers to entry in the software market, we may encounter additional competition as other established and emerging companies enter our field and introduce new products and technologies. Venture capitalists and others have funded numerous systems management companies. Accordingly, it is likely that new competitors or alliances among current and new competitors will emerge and see their offerings rapidly gain acceptance.

There can be no assurance that we will be able to compete successfully against current and future competitors. Increased competition could result in price reductions, fewer customer orders, reduced gross margins, and loss of market share, any of which could materially affect our business, operating results or financial condition.

Seasonality

We have experienced seasonality in our orders and revenues. We typically achieve the highest levels of orders and revenues for the year in the fourth quarter, which levels are usually higher than we achieve in the first quarter of the following year. As mentioned above, our U.S. government business typically experiences the highest volume during our third quarter in conjunction with the end of the fiscal year for the federal government. We believe that, in general, historical seasonality results primarily from the budgeting cycles of our customers, which typically are higher in the third and fourth quarters and, to a lesser extent, from the structure of our sales commission program. In addition, the tendency of some of our customers to wait until the end of a fiscal quarter to finalize orders has resulted in higher order volumes towards the end of the quarter. These factors, combined with the relatively fixed nature of our expenses, leads to seasonality of income from operations. We expect this seasonality to continue in the future.

Proprietary Rights

We rely on a combination of patents, copyrights, trademarks, service marks, trade secret laws, and contractual restrictions to establish and protect proprietary rights in our products and services. The source code for our products is protected both as a trade secret and as an unpublished copyrighted work. Despite our precautions, it may be possible for a third party to copy or otherwise obtain and use our products or technology without authorization. In addition, the laws of various countries in which our products may be sold may not protect our products and intellectual property rights to the same extent as the laws of the U.S. Our competitors may independently develop technologies that are substantially equivalent or superior to our technology. Please refer to Note 17 – Commitments and Contingencies of our Notes to Consolidated Financial Statements for discussions on patent litigation.

We rely on software that we license from third parties for certain components of our products and services to enhance our products and services, and meet evolving customer needs. The failure to license any necessary technology, or to maintain our existing licenses, could result in reduced demand for our products.

Because the software industry is characterized by rapid technological change, we believe such factors as the technological and creative skills of our personnel, new product developments, frequent product enhancements, name recognition, and reliable product maintenance are more important to establishing and maintaining a technology leadership position than the various legal protections of our technology.

Although we believe our products and services, and other proprietary rights, do not infringe upon the proprietary rights of third parties, third parties may assert intellectual property infringement claims against us in the future. Any such claims may result in costly, time-consuming litigation and may require us to enter into royalty or cross-license arrangements. Please refer to Note 17 – Commitments and Contingencies of our Notes to Consolidated Financial Statements for discussions on patent litigation.

We have trademarks and registered trademarks in the United States and other countries, including Quest, Quest Software, the Quest Software logo, Simplicity at Work, AccessManager, Active Administrator, ActiveDL, ActiveEntry, ActiveGroups, ActiveRoles, Akonix, Asempra, BakBone, Benchmark Factory, Big Brother, Box& Wave design, BridgeAccess, BridgeAutoEscalate, BridgeSearch, BridgeTrak, ChangeAuditor, Data Replicator, DataFactory, Defender, DeployDirector, Desktop Authority, Directory Analyzer, Directory Script, DS Analyzer, DS Expert, DS Proxy, Enterprise Security Explorer, ERDisk, FastLane, File System Auditor, FlashRestore, Foglight, GPOADmin, Help Desk Authority, I/Watch, InLook, InstantAssist, IntelliProfile, InTrust, iToken, JClass, JProbe, Kemma Software, KL Group and Design, Knowledge Xpert, Linked Structures design, LiteSpeed, LiveReorg, LogADmin, Mail Center, MessageStats, MultSess, NBSpool, NetBase, NetPro, NetVault, NetVault FastRecover, NetVault: TotalOps, NetVault SmartDisk; PacketTrap, PassGo, Patch Authority, PerformaSure, Point, Click, Done!, PowerGUI, Privilege Authority, QDesigner and design, Quest Central, Quest Distributed Monkey Engine, Quest vWorkspace Ready and design, RemoteScan, ReportADmin, RestoreADmin, ScriptLogic, Secure Copy, SecureWithin, Security Explorer, Security Lifecycle Map, SelectDL, SelfServiceADmin, SharePlex, Sitraka, Sitraka and droplet design, Spotlight, SQL Navigator, SQL Turbo, SQL Watch, SQLab Xpert, Stat, StealthCollect, Symlabs, Tag and Follow, TimeTrace, Toad, Toad (logo), T.O.A.D., Toad World, VaultDR, vConverter, vEcoShell, vFoglight, Vintela, Vizioncore, vKernel, Volcker Informatik AG, vRanger, vSpotlight, vToad, vWorkspace, WebDefender, Webthority, and XRT. Other trademarks and registered trademarks are the property of their respective owners.

Employees

As of December 31, 2011, we employed 3,850 full-time employees – including 1,611 in sales and marketing, 165 in consulting and training services and product fulfillment, 1,279 in research and development, 357 in customer service and support, and 438 in general and administrative, including information services personnel. We believe that our future success will depend in large part upon our continuing ability to attract and retain highly skilled managerial, sales, marketing, customer support, research and development, and general and administrative personnel. Like other software companies, we face intense competition for such personnel, and, at times, we have experienced, and continue to experience, difficulty in recruiting and retaining qualified personnel. None of our employees are represented by a labor union, although certain of our foreign employees are represented by workers' councils and similar organizations. We have never experienced any work stoppages and we believe that our relationships with our employees are good.

Website Access to United States Securities and Exchange Commission Filings

Our website is located at http://www.quest.com. Information at that website address shall not be deemed incorporated by reference into this report. We make available, on or through our website, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with, or furnished to, the Securities and Exchange Commission, or SEC. Information contained on our website is not part of this Annual Report on Form 10-K. Members of the public may read and copy any materials we file with, or furnish to, the SEC, at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549 on official business days during the hours of 10 a.m. to 3p.m. To obtain information on the operation of the Public Reference Room, please call the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site at http://www.sec.gov that contains the reports, proxy and information statements, and other information that we file electronically with the SEC.

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Item 1A. ***Risk Factors***

An investment in our stock involves risks and uncertainties. You should carefully consider the factors described below before making an investment decision in our securities. The risks described below are the risks that we currently believe are material risks of the business and the industry in which we compete.

Our business, financial condition and results of operations could be adversely affected by any of the following risks. If we are adversely affected by such risks, then the trading price of our common stock could decline, and you could lose part or all of your investment.

Current economic conditions may harm our business and results of operations

In recent years, the U.S. and global economies have slowed dramatically as a result of a variety of serious problems, including turmoil in the credit, financial markets and sovereign debt, concerns regarding the stability and viability of major financial institutions, the state of the housing markets and volatility in worldwide stock markets. These economic conditions, which are beyond our control, could cause many of our existing and potential customers to delay or reduce purchases of our products or services for some time, which in turn could harm our business by adversely affecting our revenues, results of operations, cash flows and financial condition. We cannot predict the duration of these economic conditions or the impact they will have on our customers or business.

Our future success may be impaired and our operating results will suffer if we cannot respond to rapid market, competitive and technological conditions in the software industry

The market for our software products and services is characterized by:

- rapidly changing technology;
- frequent introduction of new products and services and enhancements to existing products and services by platform vendors of database, application, Windows and virtualization products and by our competitors;
- increasing complexity and interdependence of software applications;
- consolidation of the software industry;
- changes in industry standards and practices; and
- changes in customer requirements and demands.

To maintain our competitive position, we must continue to enhance our existing products and develop new products and services, functionality, and technology that address the increasingly sophisticated and varied needs of our customers and prospective customers. This requires significant investment in research and development resources and capabilities, involves significant technical and business risks and requires substantial lead-time and significant investments in product development. If we fail to anticipate new technology developments, customer requirements, industry standards, or if we are unable to develop new products and services that adequately address these new developments, requirements, and standards in a timely manner, or if we are incapable of timely bringing new or enhanced products to market, our products and services may become obsolete, we may not generate suitable returns from our research and development investments, and our ability to compete may be impaired, our revenue could decline, and our operating results may suffer.

A large portion of our revenue has been attributable to the growth of our Windows Server Management products and services, and we have relied upon cash flow generation from our Windows Server Management products to fund sales, marketing and research and development initiatives associated with our other product areas. We cannot provide any assurance that we will sustain or grow the revenues we derive from these product areas. In addition, over the last few years we have committed significant resources to development of new and enhanced application management products and have realigned our sales and services organizations to address anticipated business opportunities presented by our expanding application management product and services lines. We cannot provide any assurance that this strategy will be successful or that the release of our enhanced application management products or other new products or services will increase our revenue growth rate.

Our quarterly operating results will fluctuate in future periods and, as a result, we may fail to meet expectations of investors and analysts, causing our stock price to fluctuate or decline

Our revenues and operating results will vary significantly from quarter-to-quarter due to a number of factors. These factors include the following:

- the size and timing of customer orders (See "Variations in the size and timing of our customer orders and differing nature of our products and services could expose us to revenue fluctuations and higher operating costs");

- the discretionary nature of our customers' purchasing decisions and budget cycles;
- the timing of revenue recognition for sales of software products and services (See "Contractual terms or issues arising during software license negotiations may affect the timing of transactions and revenues");
- changes in U.S. GAAP that affect the timing of reporting revenues and costs;
- as discussed elsewhere within this section, Item 1A. Risk Factors, changes in foreign currency exchange rates and tax rate could affect our quarterly results;
- the extent to which our customers renew their maintenance contracts with us;
- exposure to general economic conditions and reductions in corporate or public sector IT spending (See "Current economic conditions may harm our business and results of operations");
- changes in our level of operating expenses and our ability to control costs;
- customers opting to license our products for a fixed term rather than on a perpetual basis which defers the accounting recognition of such license revenue;
- our ability to attain market acceptance of new products and services and enhancements to our existing products;
- our ability to introduce new products or enhancements to existing products and services in a timely manner;
- our ability to maintain our field and inside sales organizations with adequate numbers of sales and services personnel, and to minimize our costs of sales and marketing through efficient allocation of sales resources and methods to products having different sales characteristics and profiles;
- the introduction of new or enhanced products and services by our competitors and changes in the pricing policies of these competitors;
- the relative growth rates of competing operating system, database and application platforms and competitive conditions among vendors of these platforms;
- the unpredictability of the timing, level of sales and subsequent revenue recognition of our expanded efforts within our indirect sales channels;
- our ability to maintain vendor-specific objective evidence of fair value as used in applying U.S. GAAP via market acceptance of our legacy pricing practices or via market acceptance related to new pricing practices;
- costs related to acquisitions of technologies or businesses, including acquired in-process research and development and amortization costs for intangible assets and possible impairments and uncertainties arising from the integration of products, services, employees and operations of acquired companies; and
- the timing of releases of new versions of third-party software products that our products support or with which our products compete.

In addition, the timing of our software product revenues is difficult to predict and can vary substantially from product-to-product and customer-to-customer. We budget certain of our operating expenses on our expectations regarding future revenue levels. The timing of larger orders and customer buying patterns are difficult to forecast. Therefore, we may not learn of shortfalls in revenue or earnings or other failures to meet our expectations until late in a particular quarter. As a result, if total revenues for a particular quarter are below our expectations, we would not be able to proportionately reduce operating expenses for that quarter.

We have experienced seasonality in our orders and revenues. We typically achieve the highest levels of orders and revenues for the year in the fourth quarter, which levels are usually higher than we achieve in the first quarter of the following year. We believe that this seasonality results primarily from the budgeting cycles of our customers being typically higher in the third and fourth quarters and, to a lesser extent, from the structure of our sales commission program. In addition, the tendency of some of our customers to wait until the end of a fiscal quarter to finalize orders has resulted in higher order volumes towards the end of the quarter. These factors, combined with the relatively fixed nature of our expenses, leads to seasonality of earnings. We expect this seasonality to continue in the future.

Due to these factors, we believe that period-to-period comparisons of our results of operations are not necessarily meaningful and should not be relied upon as indications of future performance. Fluctuations in our results of operations are also likely to affect the market price of our common stock, if our operating results differ from expectations of investors or securities analysts, and may not be related to or indicative of our long-term performance.

In periods of poor economic conditions, our exposure to credit risk and payment delinquencies on our accounts receivable increases

Our outstanding accounts receivables are generally not secured. In addition, our standard terms and conditions permit payment within a specified number of days following the receipt of our product. While we have procedures to monitor and limit exposure to credit risk on our receivables and have not suffered any material losses, there can be no assurance that such procedures will continue to effectively limit our credit risk and avoid losses. As economic conditions have deteriorated, certain of our customers have faced and may face liquidity concerns and have delayed and may delay or may be unable to satisfy their payment obligations, which could have a material adverse effect on our financial condition, operating results and cash flows.

Our cash and cash equivalents could be adversely affected if the financial institutions in which we hold our cash and cash equivalents fail

Our cash and cash equivalents are highly liquid investments with original maturities of three months or less at the time of purchase. We maintain the cash and cash equivalents with major financial institutions. Deposits with these banks exceed the Federal Deposit Insurance Corporation ("FDIC") insurance limits or similar limits in foreign jurisdictions. While we monitor daily the cash balances in the operating accounts and adjust the balances as appropriate, these balances could be impacted if one or more of the financial institutions with which we deposit fails or is subject to other adverse conditions in the financial or credit markets. To date we have experienced no loss or lack of access to our invested cash or cash equivalents; however, we can provide no assurance that access to our invested cash and cash equivalents will not be impacted by adverse conditions in the financial and credit markets.

Variations in the size and timing of our customer orders and differing nature of our products and services could expose us to revenue fluctuations and higher operating costs

Our license revenues in any quarter are substantially dependent on orders booked and delivered in that quarter. Our revenues in a given quarter could be adversely affected if we are unable to complete one or more large license transactions or if the contract terms were to prevent us from recognizing revenue during that quarter. The sales cycles for certain of our software products can last from three to nine months or longer and often require pre-purchased evaluation periods and customer education, which can affect timing of orders. Further, we have often booked a large amount of our sales in the last month, weeks or days of each quarter and delays in the closing of sales near the end of a quarter could cause quarterly revenue to fall short of anticipated levels. Finally, while a portion of our revenues each quarter is recognized from previously deferred revenue, our quarterly performance will depend significantly upon current order volumes to generate license revenues for that quarter. These factors may cause significant periodic variation in our license revenues. In addition, we incur or commit to operating expenses based on anticipated revenue levels, and generally do not know whether revenues in any quarter will meet expectations until the end of that quarter.

Our product portfolio is engineered for a broad variety of operating system, database and application platforms, and has a diverse set of functions and features. Some products, such as our database management products and other component products, are directed at database administrators and are generally sold at lower price points, and we strive to generate demand for these products through our telesales organization and marketing programs designed to maximize lead generation and website traffic. Sales of other, enterprise-wide products, primarily SharePlex, Foglight, Identity and Access Management products and desktop virtualization products, require substantial time and effort from our sales and support staff as well as involvement by our professional services organizations and, to an increasing degree, our systems integrator partners. Large individual sales, or even small delays in customer orders, can cause significant variation in our license revenues and adversely affect our results of operations for a particular period. Historically, we have not placed significant reliance on large sales transactions in any given quarter, with a substantial volume of our revenues being driven from smaller transactions. However, if we encounter difficulty sustaining our component product volumes, and cannot generate a sufficient number of large customer orders, or if customers delay or cancel such orders in a particular quarter, our revenues and operating results may be adversely affected. For these reasons, we face increasing complexity in building and sustaining the optimum combination of field and inside sales personnel to address the various and changing sales and distribution characteristics of our products, which in turn impacts our ability to manage and minimize our sales and marketing costs.

We rely heavily on our direct sales activities for license and services revenues, including renewals of annual maintenance contracts. We have in the past restructured or made other adjustments to our sales force in response to management changes, product changes, performance issues and other internal considerations.

Accordingly, if our revenue growth rates slow or our revenues decline, or if we fail to efficiently correlate our sales and marketing resources to our various products and their differing sales and distribution strategies, our operating results could be seriously impaired because many of our expenses are relatively fixed in nature and cannot be easily or quickly changed.

Contractual terms or issues arising during software license negotiations may affect the timing of transactions and revenues

Because our software products are designed to work with critical elements of the information technology systems of our customers, pre-sales evaluations of our products by potential customers and contractual negotiations are often protracted and complex, and the time necessary to negotiate mutually acceptable terms and complete software license or services transactions often result in extended sales cycles. While we generally use standardized forms of software license agreements and order documentation in our transactions, it is not uncommon for large, more sophisticated IT customers to heavily negotiate terms and conditions for sales and services involving amendments to our standard forms or the use of alternative forms of agreements, which can also delay completion of transactions and recognition of the related revenue.

Several other factors may require us to defer recognition of license revenue for a period of time after entering into a license arrangement, including instances where we are required to deliver specified additional products, product upgrades or services for which we do not have vendor-specific objective evidence of fair value, licensing our product for a fixed term rather than on a perpetual basis, or where negotiated terms of the software license agreement affect other software revenue recognition requirements.

Many of our products are vulnerable to direct competition from Oracle and other platform vendors

We compete with Oracle in the market for database management solutions and the competitive pressure continues to increase. We expect that Oracle's commitment to and presence in the database management product market will increase in the future and therefore substantially increase competitive pressures. We believe that Oracle will continue to incorporate database management technology into its server software offerings and expand their development products possibly at no additional cost to its users. Competition from Oracle with certain of our database management products including SharePlex, Quest Central for Oracle and TOAD, our market leading database development product for Oracle databases, has increased over the last few years.

In addition to the increasing competitive pressure from Oracle, Microsoft has continually upgraded the functionality of its platform offerings, which we also believe will increase competitive pressure for our Microsoft products in the future.

In some cases these types of platform vendor-provided tools are bundled with the platform and in other cases they are separately chargeable products, albeit at significantly lower price points. The inclusion of the functionality of our software as standard features of the underlying database solution or application supported by our products or sale at much lower cost could erode our revenues, particularly if the competing products and features were of comparable capability to our products. Even if the functionality provided as standard features or lower costs by these system providers is more limited than that of our software, there can be no assurance that a significant number of customers would not elect to accept more limited functionality in lieu of purchasing our products. Moreover, there is substantial risk that the mere announcements of competing products or features by large competitors such as Oracle could result in the delay or cancellation of customer orders for our products in anticipation of the introduction of such new products or features.

Our migration products for Microsoft's Active Directory and Exchange are vulnerable to fluctuations in the rate at which customers migrate to these products

Our migration products for Microsoft's Active Directory and Exchange products contribute a significant portion of our Windows Server Management revenue. Our ability to sell licenses for our Active Directory and Exchange migration products depends in part on the rate at which customers migrate to newer versions of Microsoft's Active Directory or to newer versions of Microsoft Exchange, and from other messaging platforms to Exchange or other directory services to Active Directory. If these migration rates were to materially decrease, our license revenues from these migration products would likely decline.

Many of our products are dependent on database or application technologies of others; if these technologies lose market share or become incompatible with our products, or if these vendors introduce competitive products or acquire or form strategic relationships with our competitors, the demand for our products could suffer

We believe that our success has depended in part, and will continue to depend in part for the foreseeable future, upon our relationships with providers of major database and enterprise software programs, including Oracle, IBM, Microsoft, VMware, Cisco, Symantec and SAP. Our competitive advantage consists in substantial part on the integration between our products and products provided by these major software providers, and our extensive knowledge of their products and technologies. If these companies for any reason decide to promote technologies and standards that are not compatible with our technologies, or if they lose market share for their database or application products, our business, operating results and financial condition could be materially adversely affected. Furthermore, these major software vendors could attempt to increase their presence in the markets we serve by either introducing products that compete with our products or acquiring or forming strategic alliances with our competitors. These companies have longer operating histories, larger installed bases of customers and substantially greater financial, distribution, marketing and technical resources than we do, as well as well-established relationships with many of our present and potential customers, and may be in better position to withstand and respond to the current factors impacting this industry. As a result, we may not be able to compete effectively with these companies in the future, which could materially adversely affect our business, financial condition, operating results and cash flows.

If we fail to manage our operations and grow revenue or fail to continue to effectively control expenses, our future operating results could be adversely affected

The scope of our operations, the number of our employees and the geographic area of our operations and our revenue have grown. In addition, we have acquired both domestic and international companies and in 2011, a controlling but not 100% interest, in a consolidated subsidiary. This growth and the assimilation of acquired operations and their employees could continue to place a significant strain on our managerial, operational and financial resources. To manage our current operations and any future growth effectively, we need to continue to implement and improve additional management and financial systems and controls. We may not be able to manage the current scope of our operations or future growth effectively and still exploit market opportunities for our products and services in a timely and cost-effective way.

We cannot assure you that our operating expenses will be lower than our estimated or actual revenues in any given quarter. If we experience a shortfall in revenue in any given quarter, we likely will not be able to further reduce operating expenses quickly in response. Any significant shortfall in revenue could immediately and adversely affect our results of operations for that quarter.

Failure to develop and sustain additional distribution channels in the future may adversely affect our ability to grow revenues

We intend to direct additional efforts to drive domestic and international revenue growth through sales of our products and services through indirect distribution channels, such as global hardware and software vendors, systems integrators, or value-added resellers. Our recent acquisitions significantly increased the scope of business we conduct via indirect distribution channels. Our ability to increase future revenues depends on our ability to build out our channel organization and further expand our indirect distribution channels. If we fail in our efforts to maintain, expand and diversify our indirect distribution channels, our business, results of operations and financial condition could be adversely affected. Increasing activity in indirect distribution channels will present a number of additional risks, including:

- we may face conflicts between the activities of our indirect channels and our direct sales and marketing activities, which may result in lost sales and customer confusion;
- our channel partners can cease marketing and distributing our products and services with limited or no notice and with little or no penalty;
- our channel partners may not be able to effectively sell our products and services;
- our channel partners may experience financial difficulties that might lead to delays, or even default, in their payment obligations;
- we may not be able to recruit additional channel partners, or replace any of our existing ones;
- our channel partners may also offer competitive products and services, and may not give priority to marketing our products or services; and
- our channel partners may not adopt or fully accept new or revised channel pricing programs nor give priority to such programs when selling our products or services.

Intense competition in the markets for our products could adversely affect our results of operations

The markets for our products are highly competitive. As a result, our future success will be affected by our ability to, among other things, outperform our competitors in meeting the needs of current and prospective customers and identifying and addressing new technological and market opportunities. Our competitors may develop more advanced technology, adopt more aggressive pricing policies and undertake more effective sales and marketing campaigns and may be able to leverage more extensive financial, technical or partner resources. If we are unable to maintain our competitive position, our revenues may decline and our operating results may be adversely affected.

Our operating results may be negatively impacted by fluctuations in foreign currency exchange rates

Our international operations are generally conducted through our international subsidiaries, with the associated revenues and related expenses, and balance sheets, denominated in the currency of the country in which the international subsidiaries operate. As a result, our operating results may be harmed by fluctuations in exchange rates between the U.S. Dollar and other foreign currencies. The foreign currencies to which we currently have the most significant exposure are the Canadian Dollar, the British Pound, the Euro, the Australian Dollar and the Russian Ruble. We have implemented a foreign exchange hedging program using derivative financial instruments to hedge certain of our foreign exchange exposures. However, we do not rely on our hedging program to eliminate all foreign currency exchange rate risk.

Our international operations expose us to certain risks

We maintain research and development operations in Canada, Australia, Russia, United Kingdom, China, Czech Republic, Hong Kong and Israel, and we also have significant sales activities around the globe. As a percentage of total revenues, revenues outside of the Americas were 38.6%, 34.6% and 32.8% for the years ended December 31, 2011, 2010 and 2009, respectively. As a result, we face risks from our international operations, including, among others:

- difficulties in staffing, managing and operating our foreign operations;
- difficulties in coordinating the activities of our geographically dispersed and culturally diverse operations;
- difficulties in adapting our existing foreign operations, particularly in Asia, to the control structure and requirements of a U.S. public entity given the historical environment and cultural approach to conducting business in Asian countries;
- longer payment cycles and difficulties in collecting accounts receivable;
- seasonal reductions in business activity during the summer months in Europe, the Middle East and Africa ("EMEA") and in other periods in other countries;
- increased financial accounting and reporting burdens and complexities;
- fluctuations in foreign currency exchange rates that are not wholly mitigated by our foreign currency hedging program;
- limitations on future growth or inability to maintain current levels of revenue from international operations if we do not invest sufficiently in our international operations;
- potentially adverse tax consequences;
- potential loss of proprietary information due to piracy, misappropriation or weaker laws regarding intellectual property protection;
- delays in localizing our products;
- political unrest or terrorism, particularly in areas in which we have facilities;
- our ability to adapt and conform to accepted local business practices and customs, including providing letters of credit or other forms of support to or for the benefit of our subsidiaries or resellers;
- compliance with a wide variety of complex foreign laws and treaties, including employment restrictions;
- compliance with licenses, tariffs and other trade barriers;
- activities by our employees, contractors or agents, especially in countries with developing economies, that are prohibited by U.S. laws and regulations such as the Foreign Corrupt Practices Act and by local laws prohibiting corrupt payments to government officials, in spite of our policies and procedures designed to ensure compliance with these laws;
- wage inflation in foreign countries where we have historically benefited from relatively low labor costs;
- integrating the foreign operations of our acquisition targets, including our BakBone acquisition, which significantly expands our presence in the Asia-Pacific ("APAC") region, particularly in Japan; and
- transition challenges arising from our newly-opened Business Operations and Advanced Technology Center for our EMEA region in Cork, Ireland and from downsized operations elsewhere in our EMEA region.

Operating in international markets also requires significant management attention and financial resources and places additional burdens on our management, administrative, operational and financial infrastructure. We cannot be certain that investment and additional resources required in establishing facilities in other countries will produce desired levels of revenue or profitability. In addition, we have limited experience in developing localized versions of our products and marketing and distributing them internationally.

Cash earned by our foreign subsidiaries is held at those subsidiaries and transferring this cash to the United States could have a negative impact on our earnings

A substantial portion of our cash balances result from the operations of, and are held by, our foreign subsidiaries. The repatriation of cash balances from certain of our foreign subsidiaries to fund our activities within the United States could have adverse tax consequences and be limited by foreign currency exchange controls. We do not plan to repatriate cash balances from our foreign subsidiaries to fund our operations within the U.S.

Acquisitions of companies or technologies may result in disruptions to our business and diversion of management attention, and may subject us to additional business challenges and risks

We have in the past made and we expect to continue to make acquisitions of complementary companies, products or technologies. Acquisitions require us to assimilate the operations, products and personnel of the acquired businesses and train, retain and motivate key personnel from the acquired businesses. We may be unable to maintain uniform standards, controls, procedures and policies if we fail in these efforts. Similarly, acquisitions may subject us to liabilities and risks that are not known or identifiable at the time of the acquisition or may cause disruptions in our operations and divert management's attention from day-to-day operations, which could impair our relationships with our current employees, customers and strategic partners. Certain acquisitions may subject us to additional business challenges and risks. For example, BakBone, our largest acquisition to date in terms of number of personnel and geographic scope, expands the breadth of our channel business, and significantly increases our presence in Japan and throughout the APAC region. We may have to use cash, incur debt or issue equity securities to pay for any future acquisitions. Use of cash or debt may affect our liquidity and use of cash could reduce our cash reserves and reduce our financial flexibility. The issuance of equity securities for any acquisition could be substantially dilutive to our stockholders. In addition, our profitability may suffer because of acquisition-related costs or amortization costs for intangible assets with indefinite useful lives. In consummating acquisitions, we are also subject to risks of entering geographic and business markets in which we have no or limited prior experience. If we are unable to fully integrate acquired businesses, products or technologies with our existing operations, we may not receive the intended benefits of an acquisition.

If our goodwill or amortizable intangible assets become impaired we may be required to record a significant charge to earnings

We review our goodwill and amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is required to be evaluated for impairment at least annually. Factors that may be considered a change in circumstances indicating that the carrying value of our goodwill or amortizable intangible assets may not be recoverable include a decline in stock price and market capitalization, decrease in future cash flows, and slower growth rates in our industry. We may be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined, resulting in an impact on our results of operations.

Accounting for investments in companies may affect our operating results

We have made debt and equity investments in other software companies and venture capital and private equity funds. We regularly consider opportunities to make investments in other companies focused on software development or marketing activities, and expect from time to time to complete additional investments. These investments are risky because the market for the products and technologies being developed by these companies are typically in the early stages and may never materialize. We have recognized accounting charges due to the impairment of the value of our investments in the past and may need to do so again in the future if we determine that the estimated fair value is below the investment's carrying value. If we are required to consolidate the operating results of these companies, use the equity method of accounting, or write down the value of our cost method investments, our operating results may be adversely affected.

Our investment portfolio may become impaired by deterioration of the capital markets

We invest our cash balances in high-quality issuers and limit the amount of credit exposure to any one issuer other than the United States government and its agencies. Our cash equivalent and investment portfolio as of December 31, 2011 consists of money market funds, deposit accounts, U.S. treasury securities, U.S. agency securities, corporate notes/bonds and certificates/term deposits. Our investments are subject to general credit, liquidity and market and interest rate risks. As a result, we may experience reductions in value or loss of liquidity of our investments. In addition, should any investment cease paying or reduce the amount of interest paid to us, our interest income would suffer. These market risks associated with our investment portfolio could have a material adverse effect on our business, results of operations, liquidity, and financial condition. Please refer to Note 4 – Cash and Cash Equivalents and Investments of our Notes to Consolidated Financial Statements for additional information about our cash equivalents and investment portfolio.

Changes in, or interpretations of, tax rules and regulations may adversely affect our effective tax rates

We are a U.S. based multinational company subject to tax in multiple U.S. and foreign tax jurisdictions. Changes in our tax rates could affect our future results of operations. Our future effective tax rates could be unfavorably affected by changes in, or interpretation of, tax rules and regulations in the jurisdictions in which we do business, by unanticipated decreases in the amount of revenue or earnings in countries with low statutory tax rates, by lapses of the availability of the U.S. research and development tax credit, or by changes in the valuation of our deferred tax assets and liabilities.

In addition, we are subject to the continual examination of our income tax returns by the IRS and other domestic and foreign tax authorities. These examinations are expected to focus on our intercompany transfer pricing practices as well as other matters. We regularly assess the likelihood of outcomes resulting from these examinations to determine the adequacy of our provision for income taxes and have reserved for potential adjustments that may result from the examinations. We believe such estimates to be reasonable; however, there can be no assurance that the final determination of any of these examinations will not have an adverse effect on our financial position, operating results and cash flows.

We face risks associated with governmental contracting

We derive a portion of our revenues from contracts with the United States government and its agencies and from contracts with state and local governments or agencies. Most of our government contracting is conducted indirectly through third party resellers and only an immaterial portion of our government contracting revenues arise from contracts in which we bear the risk of renegotiation of profits or contractual termination at the government's election. However, demand and payment for our products and services are impacted by public sector budgetary cycles and funding availability, with funding reductions or delays adversely impacting public sector demand for our products and services. Public sector customers may also change the way they procure new contracts and may adopt new rules or regulations governing contract procurement, including required competitive bidding or use of "open source" products, where available. These factors may limit the growth of or reduce the amount of revenues we derive from the public sector, which could negatively affect our results of operations.

We may not generate increased business from our current customers, which could slow our revenue growth in the future

Most of our customers initially make a purchase of our products for a single department or location. Many of these customers may choose not to expand their use of our products. If we fail to generate expanded business from our current customers, our business, operating results and financial condition could be materially adversely affected. In addition, as we deploy new modules and features for our existing products or introduce new products, our current customers may choose not to purchase this new functionality or these new products.

Maintenance revenue growth could decline

Our services revenues arising from maintenance services have increased over the last four years as a result of a growing base of installed products. Declines in our license bookings, adverse changes in our foreign currency exchange rates, increased discounting in maintenance renewal bookings and/or a reduction in the extent to which our customers renew maintenance contracts could lead to declines in our maintenance revenue growth rates. As maintenance revenue makes up a substantial portion of our total revenue, any decline in our maintenance revenue could have an adverse impact on our business and financial results.

Failure to develop or leverage strategic relationships could harm our business by denying us selling opportunities and other benefits

Our development, marketing, and distribution strategies rely increasingly on our ability to form strategic relationships with software and other technology companies. These business relationships often consist of cooperative marketing programs, joint customer seminars, lead referrals, and cooperation in product development. Many of these relationships are not contractual and depend on the continued voluntary cooperation of each party with us. Divergence in strategy or change in focus by, or competitive product offerings by, any of these companies may interfere with our ability to develop, market, sell, or support our products, which in turn could harm our business. Further, if these companies enter into strategic alliances with other companies or are acquired, they could reduce their support of our products. Our existing relationships may be jeopardized if we enter into alliances with competitors of our strategic partners. In addition, one or more of these companies may use the information they gain from their relationship with us to develop or market competing products.

Failure to adequately protect our intellectual property rights could harm our competitive position

Our success and ability to compete are dependent on our ability to develop and maintain the proprietary aspects of our technology. We generally rely on a combination of trademark, trade secret, patent, copyright law and contractual restrictions to establish and protect our proprietary rights in our products and services.

Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or to obtain and use information that we regard as proprietary. Litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets, and to determine the validity and scope of the proprietary rights of others. Any such resulting litigation, whether successful or unsuccessful, could result in substantial costs and diversion of management and financial resources, which could harm our business. Please refer to Note 17 – Commitments and Contingencies of our Notes to Consolidated Financial Statements for details of our patent litigation.

Our means of protecting our proprietary rights may prove to be inadequate and competitors may independently develop similar or superior technology. Policing unauthorized use of our products is difficult, and we cannot be certain that the steps we have taken will prevent misappropriation of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States. We also believe that, because of the rapid rate of technological change in the software industry, trade secret and copyright protection are less significant than factors such as the knowledge, ability and experience of our employees, frequent product enhancements and the timeliness and quality of customer support services.

Third parties may claim that our software products or services infringe on their intellectual property rights, exposing us to litigation that, regardless of merit, may be costly to defend

Our success and ability to compete are also dependent upon our ability to operate without infringing upon the proprietary rights of others. Third parties may claim that our current or future products infringe their intellectual property rights. Any such claim, with or without merit, could have a significant effect on our business and financial results. Any future third party claim could be time consuming, divert management's attention from our business operations and result in substantial litigation costs, including any monetary damages and customer indemnification obligations which may result from such claims. In addition, parties making these claims may be able to obtain injunctive or other equitable relief affecting our ability to license the products that incorporate the challenged intellectual property. As a result of such claims, we may be required to obtain licenses from third parties, develop alternative technology or redesign our products. We cannot be sure that such licenses would be available on terms acceptable to us, if at all. If a successful claim is made against us and we are unable to develop or license alternative technology, our business and financial results and position could be materially adversely affected. Please refer to Note 17 – Commitments and Contingencies of our Notes to Consolidated Financial Statements for details of our patent litigation.

Our business may be adversely affected if our software contains errors or security flaws, if we suffer breaches of data or network security, or if management software products provided by third party vendors experience similar issues or outages

The software products we offer are inherently complex. Despite testing and quality control, we cannot be certain that errors or security flaws will not be found in current versions, new versions or enhancements of our products after commencement of commercial shipments. Significant technical challenges also arise with our products because our customers purchase and deploy our products across a variety of computer platforms and integrate them with a number of third-party software applications and databases. If new or existing customers have difficulty deploying our products or require significant amounts of customer support, our operating margins could be harmed. Moreover, we could face possible claims and higher development costs if our software contains undetected errors or security flaws or if we fail to meet our customers' expectations. In addition, we use business management software products provided by third parties such as salesforce.com, and security flaws or outages in such products would adversely affect our operations. As a result of the foregoing, we could experience:

- loss of or delay in revenues and loss of market share;
- loss of customers;
- damage to our reputation;
- failure to achieve market acceptance;
- diversion of development resources;
- increased service and warranty costs;
- legal actions by customers against us which could, whether or not successful, increase costs and distract our management; and
- increased insurance costs.

The detection and correction of any security flaws can be time consuming and costly. In addition, a product liability claim, whether or not successful, could harm our business by increasing our costs and distracting our management.

We have network security, disaster recovery and systems management measures in place to protect our IT systems and related software applications. Despite these protections, our computer systems may be subject to attacks that penetrate our network security, create system disruptions or shutdowns, exploit security vulnerabilities in our products, result in the loss or misuse of proprietary and sensitive or confidential information, or damage our systems, resulting in disruption to our business.

We incorporate software licensed from third parties into some of our products and any significant interruption in the availability of these third-party software products or defects in these products could reduce the demand for, or prevent the shipping of, our products

Certain of our software products contain components developed and maintained by third-party software vendors. We expect that we may have to incorporate software from third-party vendors in our future products. We may not be able to replace the functionality provided by the third-party software currently offered with our products if that software becomes obsolete, defective or incompatible with future versions of our products or is not adequately maintained or updated. Any significant interruption in the availability of these third-party software products or defects in these products could harm our sales unless and until we can secure an alternative source. Although we believe there are adequate alternate sources for the technology licensed to us, such alternate sources may not provide us with the same functionality as that currently provided to us.

Natural disasters or power outages could disrupt our business

A substantial portion of our operations is located in California, and we are subject to risks of damage and business disruptions resulting from earthquakes, floods, wildfires and similar events, as well as from power outages. We have in the past experienced limited and temporary power outages in our California facilities due to power shortages, and in the future we may experience additional power losses. While the impact to our business and operating results has not been material, we cannot assure you that natural disasters or power outages will not adversely affect our business in the future. Since we have limited redundancy in our networking infrastructure, a natural disaster or other unanticipated problem could have an adverse effect on our business, including both our internal operations and our ability to communicate with our customers or sell and deliver our products.

Personnel turnover and failure to attract and retain personnel may negatively impact our business

Our success and ability to compete depends largely on the continued contributions of our key management, sales, engineering, marketing, support, professional services and finance personnel. We experience turnover throughout our organization and some key positions are held by people who are new to the Company or to their roles. We have an especially high number of new personnel within our overseas sales senior leadership team. If these people are unable to quickly become familiar with the issues they face in their roles or are not well suited to their new roles, then this could result in the Company having problems in executing its strategy or in reporting its financial results. We are highly dependent upon the talents, relationships and contributions of a few executives and have no guarantee of their retention. We have been targeted by recruitment agencies seeking to hire our key management, finance, engineering, sales and marketing and professional services personnel.

We use stock options as a component of our employee compensation program to align employees' interests with the interests of our stockholders, encourage employee retention and provide competitive compensation packages. We have also used restricted stock units ("RSUs") to compensate and retain key employees and to align the interests of our employees and stockholders. For example, beginning in 2008 we designed an employee reward program for key employees, which provide us with the ability to make awards under the program in the form of RSUs or stock options. If we are unable to hire or retain qualified personnel, or if newly hired personnel fail to develop the necessary skills or fail to reach expected levels of productivity, our ability to develop and market our products will be weakened.

Our revolving line of credit agreement and our loan agreement limit our flexibility in managing our business, and defaults of any financial and non-financial covenants in these agreements could adversely affect us

Our revolving line of credit agreement with Wells Fargo Capital Finance LLC, as well as our loan agreement with Mutual of Omaha Bank which is secured by our real property at our headquarters in Aliso Viejo, California, impose operating restrictions on us in the form of financial and non-financial covenants (please refer to Note 8 – Loans Payable of our Notes to Consolidated Financial Statements for additional details). These restrictions limit the manner in which we can conduct our business and may restrict us from engaging in favorable business opportunities. These restrictions limit our ability, among other things, to incur debt, grant liens, make acquisitions and other investments, make certain restricted payments such as dividend payments, and dispose of assets. If we were to fail to comply with these covenants and not obtain a waiver from our lenders, we would be in default under these agreements, in which case our lenders could, among other things, terminate the facilities, demand immediate repayment of any outstanding amounts, and foreclose on our collateral.

Unforeseen difficulties with the implementation and operation of our Oracle computerized accounting system, with the implementation of our Salesforce.com sales force automation system, or with the upgrading or implementation of our other computerized accounting, finance and sales support systems, could adversely affect our operating results, our ability to manage our business effectively, and the effectiveness of our internal controls over financial reporting

In October 2009, we began implementing an upgrade to our Oracle financial system. As part of the first stage of this process, which we completed in August 2010, we implemented a full rollout of all financial system upgrade modules in the United States, Canada, Australia and certain parts of our EMEA region, which together comprise the largest part of our business. The implementation of the upgrade to our Oracle financial system to the rest of our company is ongoing. In addition, in May 2011, we expanded our use of the Salesforce.com sales force automation system to enhance our existing automated sales management system.

The Oracle upgrade project will require changes to certain aspects of our existing system of internal controls over financial reporting. If we encounter unanticipated delays in upgrading our systems and implementing new systems, we may be unable to complete our testing of internal controls within the required time periods, which could create a material weakness or significant deficiency in our overall internal controls. Due to the number of controls examined, the complexity of our processes, and the subjectivity involved in determining the effectiveness of controls, we cannot be certain that, in the future, all of our controls will continue to be considered effective by management or, if considered effective by our management, that our external auditors will agree with such assessment. Consequently, we could be subject to regulatory sanctions or lose investor confidence in the accuracy or completeness of our financial reports. Management believes that it has taken the necessary steps to monitor and maintain appropriate internal controls during this implementation period and that our internal controls have been enhanced by the new financial accounting system.

Designing and implementing these systems is a major undertaking, both financially and from a management and personnel perspective. Costs and risks inherent in the conversion to our upgraded and new systems may include disruption to our normal procedures, technical and administrative problems, interruptions in sales processes, potential delays, expenditure overruns beyond the projects' budgets, and problems achieving accuracy in the conversion of electronic data. Failure to properly or adequately address these issues could result in increased costs and the diversion of management's attention and resources, negatively impacting our operating results and ability to effectively manage our business. Once upgraded and new systems are implemented, they may not operate as we expect them to. Any significant failure or malfunction may result in disruptions of our operations.

Failure to maintain effective internal control over financial reporting could cause investors to lose confidence in our reported financial information and have a negative effect on our business

Pursuant to rules adopted by the SEC implementing Section 404 of the Sarbanes-Oxley Act of 2002, our management is required to assess the effectiveness of our internal controls over financial reporting and report whether such internal controls are effective. Our management's assessment for the year ended December 31, 2011 identified a material weakness in our internal control over financial reporting with respect to our income tax provision process. As a result, our management has concluded that our internal control over financial reporting was not effective as of the end of our fiscal year 2011. See Item 9A, Controls and Procedures, of this Report for more information on this matter. As a result of this material weakness and any future weakness or deficiency in our internal control over financial reporting, investors could lose confidence in our financial reports, we could be subject to sanctions or investigations by the NASDAQ Global Market, the Securities and Exchange Commission, or other regulatory authorities, our ability to obtain financing on favorable terms or at all could be affected, and the market price of our common stock could be adversely affected.

Our stock price could become more volatile and your investment could lose value

All of the factors discussed in this section could affect our stock price. The timing of announcements in the public market regarding new products, product enhancements or technological advances by our competitors or us, and any announcements by us of acquisitions, major transactions, or management changes could also affect our stock price. Changes in the amounts and frequency of our share repurchases could adversely affect our stock price as well. Our stock price is subject to speculation in the press and the analyst community, changes in recommendations or earnings estimates by financial analysts, changes in investors' or analysts' valuation measures for our stock, our credit ratings, and market trends unrelated to our performance. In addition, if the market for technology stocks, or the stock market in general, experiences uneven investor confidence, the trading price of our common stock could decline for reasons unrelated to our business, operating results, or financial condition. A significant drop in our stock price could expose us to the risk of securities class actions lawsuits, which could result in substantial costs and divert management's attention and resources, which could adversely affect our business.

Item 1B. ***Unresolved Staff Comments***

None.

Item 2. ***Properties***

Our corporate and administrative headquarters and certain research and development, sales and marketing and support personnel are located at two buildings that comprise our 170,000 square foot facility that we own in Aliso Viejo, California. We also lease properties throughout the United States and foreign countries to house additional research and development, sales and marketing, general and administrative and support personnel. Our largest leased facilities include:

Location	Area Leased (sq. ft.)	Lease Expiration
Dublin, Ohio	51,307	August 2013
St. Petersburg, Russia	38,470	December 2015
Cork, Ireland	29,704	October 2012
Zhuhai, China	29,447	October 2013
Maidenhead, England	28,627	December 2015
Ontario, Canada	27,263	May 2013
Toronto, Canada	27,237	December 2013
Austin, Texas	26,943	December 2012
Boca Raton, Florida	25,909	April 2015
Halifax, Canada	25,047	July 2013
Buffalo Grove, Illinois	21,677	March 2017

We believe that our properties are in good condition, adequately maintained and suitable for the conduct of our business. Certain of our lease agreements provide options to extend the lease for additional specified periods. For additional information regarding our obligations under leases, please refer to Note 17 – Commitments and Contingencies of our Notes to Consolidated Financial Statements.

Item 3. ***Legal Proceedings***

The information set forth under Note 17 - Commitments and Contingencies of our Notes to Consolidated Financial Statements, included in Part IV, Item 15, Financial Statements, of this Report, is incorporated herein by reference. For an additional discussion of certain risks associated with legal proceedings, see the section entitled Part I, Item 1A, Risk Factors, of this Report.

Item 4. ***Mine Safety Disclosures***

Not applicable.

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PART II

Item 5. ***Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***

Market Information

Our common stock is listed on The Nasdaq Global Select Market (formerly the NASDAQ National Market) under the symbol "*QSFT*." The following table sets forth the high and low sale prices on The Nasdaq Global Select Market for our common stock for the periods indicated.

	High	Low
2011:		
First Quarter	$28.47	$23.65
Second Quarter	26.15	20.74
Third Quarter	23.36	14.61
Fourth Quarter	20.12	14.67
2010:		
First Quarter	$18.73	$15.16
Second Quarter	20.60	15.93
Third Quarter	25.04	17.36
Fourth Quarter	28.20	23.56

Holders

On February 10, 2012, the closing sale price of our common stock on The Nasdaq Global Select Market was $21.30 per share. As of February 10, 2012, there were 122 holders of record of our common stock (not including beneficial holders of shares held in "street name").

Dividends

We have never declared or paid any cash dividends on our common stock and do not expect to do so in the foreseeable future. We currently intend to retain all available funds for use in the operation and expansion of our business. Any future determination to pay dividends will be at the discretion of our board of directors and will depend on our results of operations, financial condition, contractual and legal restrictions and other factors the board deems relevant.

Issuer Purchases of Equity Shares

The table below summarizes information about our purchases of equity securities registered pursuant to Section 12 of the Exchange Act during the quarterly period ended December 31, 2011 (please refer to Note 12 – Stockholders' Equity of our Notes to Consolidated Financial Statements for information with respect to the entire year).

Period	Total Number of Shares of Common Stock Purchased (1)	Price Paid per Share of Common Stock (2)	Total Number of Shares of Common Stock Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Approximate Dollar Value of Shares of Common Stock that May Yet Be Purchased Under the Plans or Programs (in millions)
Oct. 1, 2011 through Oct. 31, 2011	334,203	$ 15.70	334,203	$ 68.0
Nov. 1, 2011 through Nov. 30, 2011	—	$ —	—	$ 68.0
Dec. 1, 2011 through Dec. 31, 2011	—	$ —	—	$ 68.0
Total	334,203	$ 15.70	334,203	$ 68.0

(1) In May 2011, our Board of Directors authorized a stock repurchase program covering up to $200 million of our common stock. Any stock repurchases may be made through open market and privately negotiated transactions, at times and in such amounts as management deems appropriate, including pursuant to one or more Rule 10b5-1 trading plans. Rule 10b5-1 permits Quest to establish, while not in possession of material nonpublic information, prearranged plans to buy stock at a specific price in the future, regardless of any subsequent possession of material nonpublic information. The timing and actual number of shares repurchased will depend on a variety of factors including market conditions, corporate and regulatory requirements, and capital availability. The stock repurchase program does not have an expiration date and may be limited or terminated at any time without prior notice.

(2) The price paid per share of common stock does not include the related transaction costs.

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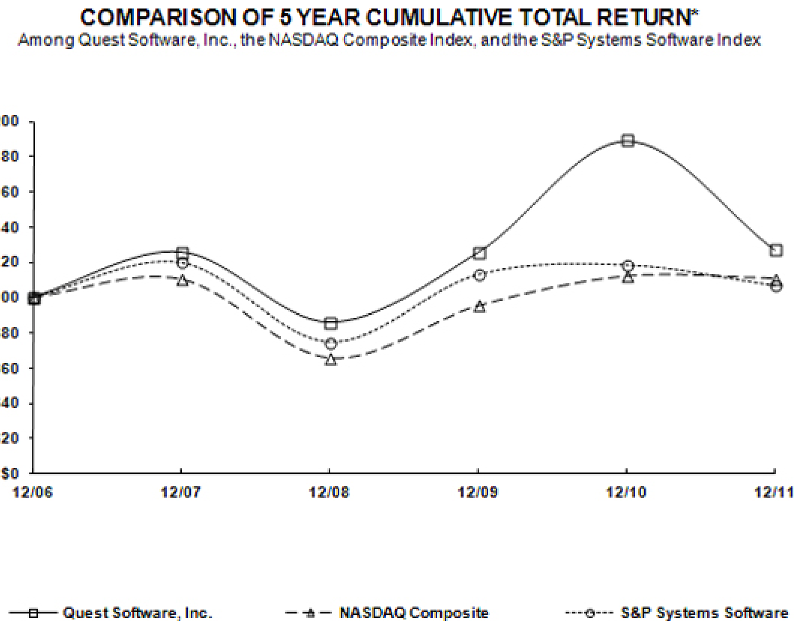
Performance Graph

The following graph shows a comparison of cumulative total shareholder return, calculated on a dividend reinvested basis, for Quest Software, Inc., the NASDAQ Composite Index (the "NASDAQ Index"), and the S&P Systems Software Index (the "Industry Index"). The graph assumes $100 was invested in each of the Common Stock of Quest Software, the NASDAQ Index and the Industry Index on December 31, 2006. Note that historic stock price performance is not necessarily indicative of future stock price performance.



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Item 6. ***Selected Financial Data***

	2011 (1)	2010 (2)	2009 (3)	2008 (4)	2007 (5)
	Year ended/As of December 31 (in thousands, except per share amounts)				
Consolidated Income Statement Data:					
Revenues:					
Licenses	$ 337,889	$ 320,683	$ 279,238	$ 334,083	$ 308,652
Services	519,526	446,414	415,998	401,294	322,329
Total revenues	857,415	767,097	695,236	735,377	630,981
Cost of revenues:					
Licenses	10,913	8,303	7,581	8,586	6,111
Services	88,431	67,809	58,528	62,060	55,173
Amortization of purchased technology	23,774	16,101	19,393	20,231	14,459
Total cost of revenues	123,118	92,213	85,502	90,877	75,743
Gross profit	734,297	674,884	609,734	644,500	555,238
Operating expenses:					
Sales and marketing	343,411	304,934	272,944	312,493	275,037
Research and development	166,191	151,896	144,370	153,464	122,592
General and administrative	110,198	84,808	76,748	84,954	81,758
Amortization of other purchased intangible assets	23,972	12,670	13,159	11,302	7,345
In-process research and development	—	—	—	955	220
Litigation loss provision, net (6)	—	—	19,025	—	—
Total operating expenses	643,772	554,308	526,246	563,168	486,952
Income from operations	90,525	120,576	83,488	81,332	68,286
Other (expense) income, net	(4,802)	(5,657)	2,549	1,030	22,422
Income before income tax provision	85,723	114,919	86,037	82,362	90,708
Income tax provision	33,657	16,352	15,678	14,319	27,589
Net income	52,066	98,567	70,359	68,043	63,119
Net loss attributable to noncontrolling interest (including $8,237 increase of redeemable noncontrolling interest to redemption value)(9)	(8,091)	—	—	—	—
Net income attributable to Quest Software, Inc.	$ 43,975	$ 98,567	$ 70,359	$ 68,043	$ 63,119
Net income per share attributable to Quest Software, Inc. stockholders:					
Basic	$ 0.50	$ 1.09	$ 0.77	$ 0.65	$ 0.62
Diluted	$ 0.49	$ 1.06	$ 0.75	$ 0.64	$ 0.60
Weighted–average common shares outstanding:					
Basic	87,104	90,411	91,926	104,192	101,819
Diluted	88,992	93,282	94,066	106,261	105,284
Consolidated Balance Sheet Data:					
Cash and cash equivalents and short-term and long-term investments (7)	$ 257,792	$ 492,829	$ 386,256	$ 260,362	$ 365,715
Total assets	1,697,651	1,635,584	1,465,138	1,345,659	1,319,130
Current and long-term portion of deferred revenue	499,838	424,385	372,138	338,712	285,660
Short-term obligations	202,313	93,818	114,049	88,804	96,302
Long-term obligations (8)	93,351	85,115	86,159	44,391	39,842
Redeemable noncontrolling interest (9)	22,000	—	—	—	—
Quest Software, Inc. stockholders' equity	867,200	1,032,266	892,792	873,752	897,326

	Year ended/As of December 31				
	2011 (1)	2010 (2)	2009 (3)	2008 (4)	2007 (5)
	(in thousands, except per share amounts)				
Consolidated Balance Sheet Data:					
Noncontrolling interest (9)	12,949	—	—	—	—
Total equity	880,149	1,032,266	892,792	873,752	897,326

(1) In 2011, we completed eight acquisitions for total purchase consideration of approximately $240 million (please refer to Note 2 – Acquisitions of our Notes to Consolidated Financial Statements).
(2) In 2010, we completed two acquisitions for total purchase consideration of $57.2 million (please refer to Note 2 – Acquisitions of our Notes to Consolidated Financial Statements).
(3) In 2009, we completed one acquisition for total purchase consideration of $15.0 million (please refer to Note 2 – Acquisitions of our Notes to Consolidated Financial Statements).
(4) In 2008, we completed five acquisitions for total purchase consideration of $144.3 million.
(5) In 2007, we completed nine acquisitions for total purchase consideration of $157.1 million.
(6) Litigation loss provision recorded during 2009 with our settlement of the shareholder class action relating to our completed stock option investigation.
(7) As of December 31, 2011, includes $4.0 million of restricted cash related to our acquisitions and designated for payments relating to customer contracts that will be renewed under Quest licensing agreements. As of December 31, 2010, includes $0.5 million of restricted cash primarily related to bank guarantees for our office leases overseas. As of December 31, 2009, includes $0.8 million of restricted cash primarily designated for our acquisition of PacketTrap Networks, Inc. As of December 31, 2008, includes $2.4 million of restricted cash designated for the satisfying of certain indemnification obligations related to escrow agreements with acquired companies where Quest is the holder of the escrow money. As of December 31, 2007, includes $48.9 million of restricted cash designated for the acquisition of PassGo Technologies Limited which closed on January 2, 2008.
(8) Includes $51.3 million, $41.4 million, $44.4 million, $40.8 million and $37.1 million as of December 31, 2011, 2010, 2009, 2008 and 2007, respectively, in long-term taxes payable recorded in compliance with provisions set forth in FASB's standard on *Accounting for Uncertainty in Income Taxes—An Interpretation of FASB's standard on Accounting for Income Taxes*, which we adopted on January 1, 2007.
(9) During the fourth quarter of 2011, we acquired a 60 percent voting equity interest in Smarsh, Inc., a privately held company. The minority shareholder was granted the right to require us to purchase half of the 40 percent noncontrolling interest. This 20 percent noncontrolling interest is accounted for as redeemable noncontrolling interest because redemption is outside our control. As such, the redeemable noncontrolling interest is reported in the mezzanine section as temporary equity in our consolidated balance sheets. The remaining 20 percent is presented within total equity in our consolidated balance sheets. We present the amount of consolidated net income that is attributable to Quest Software, Inc. and the noncontrolling interest in our consolidated income statements. Net income per share is calculated based on net income attributable to Quest Software, Inc. stockholders. As of December 31, 2011, the carrying amount of the redeemable noncontrolling interest was increased to the redemption value of $22 million. The increase of $8.2 million was recorded in net loss attributable to noncontrolling interest, thereby directly affecting net income attributable to Quest Software, Inc. (please refer to Note 11 – Noncontrolling Interest of our Notes to Consolidated Financial Statements for additional details).

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

The following discussion of our financial condition and results of operations ("MD&A") should be read in conjunction with the consolidated financial statements and notes to those statements included elsewhere in this Report. Certain statements in this Report, including statements regarding our business strategies, operations, financial condition, and prospects are forward-looking statements. Use of the words *"believe," "expect," "anticipate," "will," "contemplate," "would," "project," "plan," "may," "could," "intend," "likely," "might," "estimate," "continue"* and similar expressions that contemplate future events may identify forward-looking statements.

Numerous important factors, risks and uncertainties affect our operations and could cause actual results to differ materially from those expressed or implied by these or any other forward-looking statements made by us or on our behalf. Readers are urged to carefully review and consider the various disclosures made in this Report, including those described under Part I, Item 1A, Risk Factors, and in other filings with the SEC that attempt to advise interested parties of certain risks and factors that may affect our business, which are available on the SEC's website at http://www.sec.gov. Readers are cautioned not to place undue reliance on these forward-looking statements, which are based on current expectations and reflect management's opinions only as of the date thereof. We do not assume any obligation to revise or update forward-looking statements. Finally, our historic results should not be viewed as indicative of future performance.

Overview

Our Company and Business Model

Quest Software, Inc. delivers simple-to-use IT management software that saves time and money across physical, virtual, and cloud environments. In each of our solution families –Database Management, Performance Monitoring, Data Protection, User Workspace Management, Windows Server Management, and Identity and Access Management – we concentrate on developing practical, innovative solutions to make IT tasks easier and less costly for our customers, who number more than 100,000 around the world. Our products are designed to simplify even the most complex IT tasks.

We have a diverse product portfolio that address customer needs across Windows technologies; databases; and applications in physical, virtual or cloud environments. We also offer support and professional services to our customers. The assistance of skilled support professionals is delivered through support centers located around the world. In addition, our professional services personnel are available to help with platform migrations and identity and access management, as well as optimizing, simplifying and extending IT infrastructure.

Our initial core competency as a database management company was built upon expertise within the Oracle database platform, where we assembled a portfolio of products to manage and speed the development on the platform. Today, Quest is best known for our Toad products, but we also offer many other types of database management, development and administration tools that help our customers improve IT productivity, and boost database performance for Oracle, SQL Server, DB2, MySQL, Sybase ASE and Visual Studio.

Foglight remains our flagship product and the largest revenue component of our Performance Monitoring product area, and we have continually evolved the development of products for this market. With the addition of vFoglight, which offers monitoring and capacity management of complex VMware ESX and Hyper-V environments, our solutions today simplify performance monitoring and management across multiple technologies (Java, .NET, virtual or physical servers, databases, networks), and also monitor the experience of users interacting with those applications to enable organizations to improve user satisfaction. Our Foglight and vFoglight solutions are complemented by the technology of vKernel, the leading provider of capacity planning products, which we acquired in November 2011.

Our broad portfolio of Windows management products spans most of our six solution families. These products simplify IT tasks on almost every Microsoft platform, and represent the largest portion of our total revenues. Today, Quest is one of Microsoft's leading independent software vendors with solutions that help our customers automate, secure and extend Microsoft infrastructure and Windows desktops. In February 2011, we acquired e-DMZ Security to expand our Quest One Identity Solutions product portfolio for Identity and Access Management, adding significant functionality to our privileged account management solution. In June 2011, we continued our investment in Identity and Access Management with the acquisition of Symlabs, adding strong middleware technology capabilities to Quest One Identity Solutions, as well as expanding our migration capabilities for Active Directory, and across the enterprise. In October 2011, we acquired a 60 percent voting equity interest in Smarsh, the managed service leader in secure and reliable email archiving solutions for message compliance and records retention, proactive litigation readiness, and mail server data management. In December 2011, we acquired BitKOO to further extend the strength of Quest One Identity Solutions in access governance.

Our Data Protection product area grew out of our presence in the virtualization and cloud management market, into which we made our entrance with the acquisition of Vizioncore in 2005. In January 2011, we acquired BakBone Software to complement our data protection portfolio, particularly in the areas of virtual server backup and recovery. This acquisition brings additional technologies and products which provide data protection solutions across heterogeneous physical, virtual and application-level environments.

Our User Workspace Management product area was strengthened in May 2011, when we acquired RemoteScan to expand our presence in the workspace management market, increasing the range of peripherals and devices that Quest solutions support in virtualized Windows environments. In October 2011, we acquired ChangeBASE to take the next step to provide solutions that empower IT to deliver a productive, protected, dynamic user workspace on every device.

Strategic acquisitions and investments have been a key part of our corporate strategy. Over the past three years, we spent approximately $305 million on 11 acquisitions and invested approximately $40 million in 20 private companies. This strategic deployment of capital covered many of our existing solution families, including Data Protection; Identity & Access Management; and Performance Monitoring. We intend to continue to identify and acquire companies in adjacent or contiguous markets, as we have done in the past. We have also used acquisitions and investments to build upon or extend our core competencies with incremental technology to increase our existing product functionality or complete a key portion of a deliverable on the product roadmap.

We derive revenues from three primary sources: (1) software licenses, (2) post-contract technical support services ("maintenance") and (3) consulting and training services. Our software licensing model is primarily based on perpetual license fees. In addition to perpetual software licenses, we sell a small amount of time-based software licenses (or term licenses), wherein customers pay a single fee for the right to use the software and receive maintenance for a defined period of time. Our license fees are typically calculated either on a per-server basis, per managed user or a per-seat/user basis.

Maintenance contracts entitle a customer to telephone or internet support and unspecified maintenance releases, updates and enhancements. First-year maintenance contracts are typically sold with the related perpetual software license and renewed on an annual basis thereafter at the customer's option. Generally, annual maintenance renewal fees are priced as a percentage of the net initial customer purchase price (which includes both the fee for a perpetual license and first year maintenance). Revenue is allocated to first year maintenance based on vendor-specific objective evidence ("VSOE") of fair value and amortized over the term of the maintenance contract, typically 12 months, although at times, we sell maintenance with terms of greater than 12 months.

We also provide consulting and training services that relate to the installation and configuration of our products, but do not include significant customization to or development of the underlying software code. Revenue allocated to consulting and training services is measured based on VSOE of fair value and recognized as the services are performed. Such revenues represented 11.1 percent, 10.4 percent and 9.1 percent of total services revenues for the years ended December 31, 2011, 2010 and 2009, respectively.

Summary of Consolidated Financial Results

As discussed in more detail throughout our MD&A, for the year ended December 31, 2011 compared to the year ended December 31, 2010, we delivered the following financial performance:

- Total revenues increased by $90.3 million, or 11.8%, to $857.4 million;
- Total expenses increased by $120.4 million, or 18.6%, to $766.9 million;
- Income from operations decreased by $30.1 million, or 24.9%, to $90.5 million;
- Other expense, net decreased by $0.9 million, or 15.1% to $4.8 million;
- Diluted earnings per share decreased by $0.57, or 53.8%, to $0.49;
- Weighted average basic and diluted shares outstanding decreased from 90.4 million and 93.2 million in 2010 to 87.1 million and 89.0 million in 2011.

The comparison of our operating results for fiscal year 2011 against the same period in 2010 is impacted by our acquisitions, which are included only from their dates of acquisition. We acquired BakBone in the first quarter of 2011 to complement our data protection portfolio, particularly in the areas of physical server backup and recovery. The BakBone acquisition gives us additional technologies to provide data protection solutions across heterogeneous physical, virtual and application-level environments, enhancing our competitive position in the data protection market. During the fourth quarter of 2011, we acquired a 60 percent interest in Smarsh, Inc., a privately-held provider of secure and reliable email archiving solutions for message compliance and records retention, proactive litigation readiness, and mail server data management. In addition, we have acquired six other private companies in the year ended December 31, 2011. In our discussion of changes in our results of operations, we quantify the contribution of these 2011 acquisitions.

Our 2011 total revenues increased by 11.8% compared to the same period in 2010. Our Americas sales region, which includes United States, Canada and Latin America, contributed 61.4% of total revenues, and the rest of the world, comprised of our Asia Pacific ("APAC") sales region and our Europe, Middle East and Africa ("EMEA") sales region, contributed 38.6% of total revenues, as compared to 65.4% and 34.6%, respectively, in the same period last year. Our EMEA and APAC sales regions performed well throughout the year. Total revenues from our Americas sales region were comparable to the same period in 2010.

The increase in our total revenues was due to increased sales of our Windows migration and Identity and Access Management products and related services across all sales regions. The strength in our Windows migration products was due to our customers' migration to Exchange Server 2010 and Sharepoint 2010. The continued need for IT system access controls to comply with existing and new regulations and the growing need to automate and control end-user access to IT resources are driving our Identity and Access Management growth. Our 2011 acquisitions contributed $44.8 million, or 49.6%, of the overall increase in total revenues compared to the same period in 2010.

Total revenues were positively impacted by the weak U.S. Dollar relative to certain non-U.S. Dollar currencies. This resulted in higher U.S. dollar equivalent sales for several currencies. Since certain of our international sales are denominated in these non-U.S. Dollar currencies, the positive impact from foreign currency exchange rates was $8.4 million when comparing average monthly 2011 rates to 2010.

Total expenses increased compared to the same period in 2010. Our expenses primarily consist of personnel costs, which include compensation, benefits and payroll related taxes and are primarily a function of our worldwide headcount. Our average full-time employee headcount for fiscal year 2011 increased to 3,827 compared to 3,336 for fiscal year 2010. Our average full-time employee headcount in locations outside of the United States was 1,866 for fiscal year 2011 compared to 1,517 for fiscal year 2010. The increase in our headcount in 2011 compared to 2010 was primarily due to our acquisitions. These acquisitions contributed $61.2 million, or 50.8%, of the overall increase in total expenses relating to their operating costs.

Our total expenses in fiscal year 2011 were impacted by the weak U.S. Dollar which resulted in higher U.S. Dollar equivalent expenses. Our total expenses in fiscal year 2011 increased by $14.5 million compared to the same period in 2010 as a result of the impact of foreign currency exchange rates when comparing average monthly 2011 rates to 2010.

Foreign Currency

While we are a U.S. Dollar functional company on a world-wide basis, we transact business and operate using multiple foreign currencies. As such, the value of our revenues, expenses, certain account balances and cash flows are exposed to fluctuations in foreign currencies against the value of the U.S. Dollar. For example, when the U.S. Dollar strengthens against several non-U.S. Dollar currencies, our foreign revenues and thus our total revenues can be negatively impacted. A stronger U.S. Dollar translates into lower expenses in those entities where we have operations and our personnel and occupancy expenses are denominated in non-U.S. Dollars, resulting in lower total expenses. Conversely, a weaker U.S. Dollar would have the opposite effects on total revenues and expenses. In certain geographic regions and within specific currencies, partial offsets between revenues and expenses or balance sheet positions may reduce this exposure. In other instances, we can manage our operations to reduce foreign currency exposure or utilize derivative instruments to manage this exposure. Please refer to Note 15 – Derivative Instruments of our Notes to Consolidated Financial Statements for additional details.

Results of Operations

The following are as a percentage of total revenues:

	Year Ended December 31		
	2011	**2010**	**2009**
Revenues:			
Licenses	39.4%	41.8%	40.2%
Maintenance Services	53.9	52.1	54.4
Professional Services	6.7	6.1	5.4
Total revenues	100.0	100.0	100.0
Cost of revenues:			
Licenses	1.3	1.1	1.1
Maintenance Services	4.9	4.1	4.1
Professional Services	5.4	4.7	4.3
Amortization of purchased technology	2.8	2.1	2.8
Total cost of revenues	14.4	12.0	12.3
Gross profit	85.6	88.0	87.7

	Year Ended December 31		
	2011	2010	2009
Operating expenses:			
Sales and marketing	40.0	39.8	39.3
Research and development	19.4	19.8	20.8
General and administrative	12.8	11.0	11.0
Amortization of other purchased intangible assets	2.8	1.7	1.9
Litigation loss provision, net	—	—	2.7
Total operating expenses	75.0	72.3	75.7
Income from operations	10.6	15.7	12.0
Other (expense) income, net	(0.6)	(0.7)	0.4
Income before income tax provision	10.0	15.0	12.4
Income tax provision	3.9	2.1	2.3
Net income	6.1	12.9	10.1
Net loss attributable to noncontrolling interest (including $8.2 million increase of redeemable noncontrolling interest to redemption value)	(1.0)	—	—
Net income attributable to Quest Software, Inc.	5.1%	12.9%	10.1%

Previously, we had two reportable operating segments, Licenses and Services. During the first quarter of 2011, we revised our reportable operating segments by separating our Services segment into our Professional Services segment and our Maintenance Services segment. We separated these two previously aggregated segments because the Professional Services component has experienced significant growth and has become more distinct and robust relative to all Services, and also has become more separately managed and analyzed. Previously reported segment data have been reclassified to conform to the 2011 presentation.

Comparison of Fiscal Years Ended December 31, 2011 and 2010

Revenues

Total revenues and year-over-year changes are as follows (in thousands, except for percentages):

	2011	2010	Increase/(Decrease) Dollars	Increase/(Decrease) Percentage
Revenues:				
Licenses				
Americas	$ 190,302	$ 204,089	$ (13,787)	(6.8)%
Rest of World	147,587	116,594	30,993	26.6%
Total license revenues	337,889	320,683	17,206	5.4%
Maintenance Services				
Americas	298,048	266,656	31,392	11.8%
Rest of World	163,745	133,245	30,500	22.9%
Total maintenance service revenues	461,793	399,901	61,892	15.5%
Professional Services				
Americas	37,690	30,823	6,867	22.3%
Rest of World	20,043	15,690	4,353	27.7%
Total professional service revenues	57,733	46,513	11,220	24.1%
Total revenues	$ 857,415	$ 767,097	$ 90,318	11.8%

Our revenues for fiscal year 2011 are comprised of 39.4% of Licenses revenues, 53.9% of Maintenance Services revenues and 6.7% of Professional Services revenues compared to 41.8% of Licenses revenues, 52.1% of Maintenance Services revenues and 6.1% of Professional Services revenues in fiscal year 2010.

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Licenses Revenues — We generate revenues by licensing our software products, principally on a perpetual basis. In addition to perpetual software licenses, we sell time-based software licenses (or term licenses) wherein customers pay a single fee for the right to use the software and receive maintenance for a defined period of time. The increase in licenses revenues for fiscal year 2011 compared to the same period last year was primarily due to Windows migration and Identity and Access Management products in EMEA and APAC sales regions. Our 2011 acquisitions contributed $14.8 million, or 86.0%, of the overall increase in license revenues for the year ended December 31, 2011. The impact from foreign currency comprised approximately $7.3 million of the overall increase in licenses revenues for the year ended December 31, 2011 when comparing average monthly 2011 rates to 2010.

Maintenance Services Revenues — Maintenance services revenues are derived from post-contract technical support services. Maintenance services revenues are generated from support and maintenance services relating to current year sales of new software products and from the renewal of existing maintenance agreements for software licenses sold in prior periods. The increase in maintenance services revenues for fiscal year 2011 compared to the same period last year was primarily due to Windows migration and Identity and Access Management related maintenance services across all sales regions. Our 2011 acquisitions contributed $29.7 million, or 48.0%, of the overall increase in maintenance services revenues for the year ended December 31, 2011.

Maintenance services revenues continue to contribute a larger percentage of our total revenues. This is primarily due to our growing installed base of customers and because maintenance contract growth exceeds that of license contracts from time to time. The core customer base is also further augmented from acquired companies. Thus, as our maintenance customer base grows, maintenance renewals have a larger influence on the maintenance revenue growth rate and the amount of new software license revenues has a diminishing effect. Therefore, the growth rate of total revenues does not necessarily correlate directly to the growth rate of new software license revenues in a given period. The primary determinant of changes in our maintenance revenue profile is the extent to which our customers renew their annual maintenance agreements, taking into account the number of products and licenses for which each customer renews, and the timing of the renewals by each such customer. If our maintenance renewals were to decline materially, our maintenance revenues, total revenues and cash flows would likely decline materially as well.

Professional Services Revenues — Professional services revenues are derived from consulting and training services. The increase in professional service revenues for the year ended December 31, 2011 compared to the same periods last year was primarily due to related professional services for Windows migration across all sales regions.

Cost of Revenues

Total cost of revenues and year-over-year changes are as follows (in thousands, except for percentages):

			Increase/(Decrease)	
	2011	**2010**	**Dollars**	**Percentage**
Cost of Revenues:				
Licenses	$10,913	$ 8,303	$ 2,610	31.4%
Maintenance Services	42,183	31,370	10,813	34.5%
Professional Services	46,248	36,439	9,809	26.9%
Amortization of purchased technology	23,774	16,101	7,673	47.7%
Total cost of revenues	$ 123,118	$ 92,213	$ 30,905	33.5%

Cost of Licenses — Cost of licenses primarily consists of third-party software royalties, product packaging, delivery, and personnel costs. Cost of licenses as a percentage of license revenues was 3.2% and 2.6% for the year ended December 31, 2011 and 2010.

Cost of Maintenance Services — Cost of maintenance services primarily consists of personnel, outside consultants, facilities and systems costs used in providing maintenance services. Cost of maintenance services does not include development costs related to bug fixes and upgrades which are classified in research and development and which are not separately determinable. Cost of maintenance services as a percentage of maintenance services revenues was 9.1% and 7.8% for the year ended December 31, 2011 and 2010, respectively. Cost of maintenance services increased primarily due to an increase of $7.9 million in personnel related costs for the year ended December 31, 2011 compared to the same period in 2010. Average full-time maintenance services employee headcount increased by 56 for the year ended December 31, 2011 compared to the same period last year. Our 2011 acquisitions contributed $5.8 million, or 53.3%, of the overall increase in cost of maintenance services for the year ended December 31, 2011.

Cost of Professional Services — Cost of professional services primarily consists of personnel, outside consultants, facilities and systems costs used in providing consulting and training services. Cost of professional services as a percentage of professional services revenues was 80.1% and 78.3% for the year ended December 31, 2011 and 2010, respectively. Cost of professional services for the year ended December 31, 2011 increased primarily due to an increase of $6.0 million in personnel related costs. Average full-time professional services employee headcount increased by 37 for the year ended December 31, 2011 compared to the same period in 2010.

Amortization of Purchased Technology — Amortization of purchased technology includes amortization of the fair value of purchased technology associated with acquisitions. The increase for the year ended December 31, 2011 compared to the same period last year was primarily due to acquisitions completed in 2011.

Operating Expenses

Year-over-year changes in the principal components of our operating expenses are as follows (in thousands, except for percentages):

			Increase/(Decrease)	
	2011	**2010**	**Dollars**	**Percentage**
Operating Expenses:				
Sales and marketing	$ 343,411	$ 304,934	$ 38,477	12.6%
Research and development	166,191	151,896	14,295	9.4%
General and administrative	110,198	84,808	25,390	29.9%
Amortization of other purchased intangible assets	23,972	12,670	11,302	89.2%
Total operating expenses	$ 643,772	$ 554,308	$ 89,464	16.1%

Sales and Marketing — Sales and marketing expenses consist primarily of compensation and benefit costs for sales and marketing personnel, sales commissions, and costs of trade shows, travel and entertainment and various discretionary marketing programs. Sales and marketing expenses as a percentage of total revenues for 2011 was 40.0%, which is comparable to 39.8% in 2010. The increase in sales and marketing expenses during the year ended December 31, 2011 over the comparable period in 2010 was due primarily to an increase in personnel related costs of $24.1 million and general expenses of $6.8 million (higher consulting and other professional fees, advertising expenses and subscription costs to SalesForce.com). Our average full time sales and marketing employee headcount for the year ended December 31, 2011 increased by 225 employees. Our 2011 acquisitions contributed $23.5 million, or 61.2%, of the overall increase in sales and marketing expenses during the year ended December 31, 2011 compared to the same period in 2010. The impact from foreign currency exchange rates comprised approximately $7.6 million of the overall increase in sales and marketing expenses for the year ended December 31, 2011 when comparing average monthly 2011 rates to 2010.

Research and Development — Research and development expenses consist primarily of compensation and benefit costs for software developers who develop new products, bug fixes and upgrades to existing products, and at times provide engineering support for maintenance services, software product managers, quality assurance and technical documentation personnel, and payments made to outside software development consultants in connection with our ongoing efforts to enhance our core technologies and develop additional products. Research and development expenses as a percentage of total revenues was 19.4% and 19.8% for the year ended December 31, 2011 and 2010, respectively. The increase in research and development expenses during the year ended December 31, 2011 as compared to the same period in 2010 was due primarily to an approximately $21 million increase in personnel related costs offset by a decrease of approximately $8 million in general expenses because of the change in fair value of acquisition-related contingent consideration during the year (please refer to Note 16 – Fair Value Measurements of our Notes to Consolidated Financial Statements for details). Our average full-time research and development employee headcount for 2011 was 1,288 compared to 1,150 in 2010. Our 2011 acquisitions contributed $12.6 million, or 88.5%, of the overall increase in research and development expenses during the year ended December 31, 2011 compared to the same period in 2010. Also, research and development expenses increased due to the impact of the weak U.S. Dollar in fiscal year 2011 as a significant portion of our developers are located outside of the U.S. The impact from foreign currency exchange rates for the year ended December 31, 2011 comprised approximately $3.3 million of the overall increase in research and development expenses when comparing average monthly 2011 rates to 2010.

General and Administrative — General and administrative expenses consist primarily of compensation and benefit costs for our executive, finance, legal, human resources, administrative and information services personnel, and professional fees for audit, tax and legal services. General and administrative expenses as a percentage of total revenues was 12.8% and 11.0% for the year ended December 31, 2011 and 2010, respectively. The increase in general and administrative expenses during the twelve months ended December 31, 2011 over the comparable period in 2010 was due mainly to an increase in personnel related costs of $13.1 million, and general expenses of $10.8 million because of higher legal fees related to patent infringement litigations and professional fees related to corporate development activities. Our average full-time general and administrative employee headcount for 2011 was 439 compared to 404 in 2010. Our 2011 acquisitions contributed $4.7 million, or 18.4%, of the overall increase in general and administrative expenses during the year ended December 31, 2011 compared to the same period in 2010.

Amortization of Other Purchased Intangible Assets — Amortization of other purchased intangible assets includes the amortization of customer lists, trademarks and trade names, non-compete agreements and maintenance contracts associated with acquisitions. The increase for the year ended December 31, 2011 compared to the same period last year was due to acquisitions completed in 2011 and impairments of certain purchased intangible assets (please refer to Note 6 – Goodwill and Intangible Assets, Net of our Notes to Consolidated Financial Statements for more details).

Other Expense, Net

Other expense, net consists of the following (in thousands):

			Increase/(Decrease)	
	2011	2010	Dollars	Percentage
Interest income	$ 2,056	$ 2,393	$ (337)	(14.1)%
Interest expense	(3,957)	(4,445)	488	(11.0)%
Foreign currency losses, net	(4,300)	(3,211)	(1,089)	33.9%
Forward foreign currency contracts gains (losses), net	1,952	(459)	2,411	N/M
Other (expense) income, net	(553)	65	(618)	N/M
Total other expense, net	$ (4,802)	$ (5,657)	$ 855	(15.1)%

Other expense, net primarily includes interest income generated by our investment portfolio, interest expense from our borrowings, gains and losses from foreign exchange fluctuations and gains or losses on other financial assets as well as a variety of other non-operating expenses. The largest impact to other expense, net this year was attributed to forward foreign currency contracts gain of $2.0 million during the year ended December 31, 2011 compared to a loss of $0.5 million in the same period in 2010. Forward foreign currency contracts gains (losses), net relates to changes in fair value of our forward foreign currency contracts not designated as hedging instruments. Such increase was partially offset by foreign currency losses, net of $4.3 million during the year ended December 31, 2011 compared to $3.2 million for the same period in 2010. Our foreign currency gains or losses are predominantly attributable to translation gains or losses relative to the U.S. Dollar on the re-measurement of monetary assets and liabilities, which were primarily denominated in the Euro, and to a lesser extent, the British Pound and Canadian Dollar. Interest expense was $4.0 million and $4.4 million in the year ended December 31, 2011 and 2010, respectively. Please refer to Note 8 – Loans Payable of our Notes to Consolidated Financial Statements for additional information regarding our debt agreements. Interest income was $2.0 million and $2.3 million in the year ended December 31, 2011 and 2010, respectively.

Income Tax Provision

During the year ended December 31, 2011, the provision for income taxes increased to $33.7 million from $16.4 million in the comparable periods in 2010. The effective income tax rate for the year ended December 31, 2011 was approximately 39.3% as compared to 14.2% for the year ended December 31, 2010 respectively. The change in the provision for income taxes and the effective income tax rate is primarily a result of the mix of pre-tax income between high and low tax jurisdictions, and other discrete items impacting the year ended December 31, 2011. Discrete items primarily include additional valuation allowances recorded against foreign deferred tax assets for Brazil, Mexico and China, excess shortfalls associated with the exercise, cancellation and expiration of stock options, and decreases due to release of reserves from the expiration of the U.S. federal income tax statute for the fiscal year 2007 and closure of the Canada Revenue Agency income tax audit for the fiscal years 2006 through 2007.

Our effective income tax rate is subject to change as a result of shifts of taxable income earned by entities in jurisdictions which have a range of differing income tax rates. The effective income tax rate is also subject to shifts of net operating losses that cannot be benefited between certain jurisdictions. Our effective income tax rate is more sensitive to shifts of income between our Americas and EMEA regions and more specifically between our United States and Irish operating entities. This is primarily due to the disparity in the income tax rates between these jurisdictions. Accordingly, an increase or decrease in the ratio of income earned by our U.S. operating entities compared to the income before taxes earned by our non-U.S. operating entities, most notably our Irish operating entities, may cause a corresponding increase or decrease in our overall effective tax rate.

We are currently under examination by the Internal Revenue Service, California Franchise Tax Board, German Tax Authorities, Her Majesty's Revenue & Customs (UK), and the French tax authority. During the third quarter of 2011, we received notice from the Canadian Revenue Agency informing us they have closed the audit period with no proposed adjustments. We believe appropriate provisions for all outstanding issues have been made for all jurisdictions and all open years. However, due to the risk that audit outcomes and the timing of audit settlements are subject to significant uncertainty and as we continue to evaluate such uncertainties in light of current facts and circumstances, our current estimate of the total amounts of unrecognized tax benefits could increase or decrease for all open tax years. As of the date of this report, we do not anticipate that there will be any significant change in the unrecognized tax benefits associated with these audits within the next twelve months.

Noncontrolling Interest

In connection with our acquisition of Smarsh, Inc. in October 2011, the minority shareholder was granted the right to require us to purchase half of the 40 percent noncontrolling interest. This 20 percent noncontrolling interest is accounted for as redeemable noncontrolling interest because redemption is outside our control. As such, the redeemable noncontrolling interest is reported in the mezzanine section as temporary equity in our consolidated balance sheets. The remaining 20 percent is presented within total equity in our consolidated balance sheets. We present the amount of consolidated net income that is attributable to Quest Software, Inc. and the noncontrolling interest in our consolidated income statements. Net income per share is calculated based on net income attributable to Quest Software, Inc. stockholders. As of December 31, 2011, the carrying amount of the redeemable noncontrolling interest was increased to the redemption value of $22 million. The increase of $8.2 million was recorded in net loss attributable to noncontrolling interest, thereby directly affecting net income attributable to Quest Software, Inc. Please refer to Note 11 – Noncontrolling Interest of our Notes to Consolidated Financial Statements for additional details.

Comparison of Fiscal Years Ended December 31, 2010 and 2009

Revenues

Total revenues and year-over-year changes are as follows (in thousands, except for percentages):

			Increase/(Decrease)	
	2010	**2009**	**Dollars**	**Percentage**
Revenues:				
Licenses				
Americas	$ 204,089	$ 177,120	$ 26,969	15.2%
Rest of World	116,594	102,118	14,476	14.2%
Total license revenues	320,683	279,238	41,445	14.8%
Maintenance Services				
Americas	266,656	254,688	11,968	4.7%
Rest of World	133,245	123,267	9,978	8.1%
Total maintenance services revenues	399,901	377,955	21,946	5.8%
Professional Services				
Americas	30,823	26,690	4,133	15.5%
Rest of World	15,690	11,353	4,337	38.2%
Total professional services revenues	46,513	38,043	8,470	22.3%
Total revenues	$ 767,097	$ 695,236	$ 71,861	10.3%

Our revenues for fiscal year 2010 are comprised of 41.8% of license revenues, 52.1% of maintenance services revenues and 6.1% of professional services revenues compared to 40.2% of license revenues, 54.4% of maintenance services revenues and 5.4% of professional services revenues in fiscal year 2009.

Licenses Revenues — The increase in license revenues was due primarily to increased sales of our Windows Server Management products across all geographic regions. Our Windows Server Management products, led by migration, continued to perform well due to customers' adoption of our Exchange 2010 products. Also, our Identity and Access Management products continued to expand and gain market share with the Quest One Identity Solutions. Our 2010 license revenues were also positively impacted by the weak U.S. Dollar relative to certain non-U.S. Dollar currencies in 2010, partially offset by strong U.S. Dollar relative to the Euro and British Pound. This resulted in a higher U.S. Dollar equivalent for several currencies. Since certain of our international sales are denominated in these non-U.S. Dollar currencies, the impact from foreign currency comprised approximately $1.6 million, or 3.8% of the overall increase in license revenues.

Maintenance Services Revenues — The increase was primarily due to our Windows Server Management products across geographic regions. Maintenance revenues from our Database Management products decreased particularly in the Americas region. Revenue from consulting and training services as a percentage of total service revenues was approximately 10.4% and 9.1% of total service revenues in the twelve months ended December 31, 2010 and 2009, respectively.

Professional Services Revenues — Revenue from consulting and training services as a percentage of total service revenues was approximately 10.4% and 9.1% of total service revenues in the year ended December 31, 2010 and 2009, respectively.

Cost of Revenues

Total cost of revenues and year-over-year changes are as follows (in thousands, except for percentages):

	2010	2009	Increase/(Decrease) Dollars	Increase/(Decrease) Percentage
Cost of Revenues:				
Licenses	$ 8,303	$ 7,581	$ 722	9.5%
Maintenance Services	31,370	28,599	2,771	9.7%
Professional Services	36,439	29,929	6,510	21.8%
Amortization of purchased technology	16,101	19,393	(3,292)	(17.0)%
Total cost of revenues	$ 92,213	$ 85,502	$ 6,711	7.8%

Cost of Licenses — Cost of licenses as a percentage of license revenues was 2.6% and 2.7% for the year ended December 31, 2010 and 2009, respectively.

Cost of Maintenance Services — Cost of maintenance services as a percentage of maintenance services revenues was 7.8% and 7.6% in the year ended December 31, 2010 and 2009, respectively. The increase was primarily due to the increase in personnel related costs of $1.6 million.

Cost of Professional Services — Cost of professional services as a percentage of professional service revenues was 78.3% and 78.7% in the year ended December 31, 2010 and 2009, respectively. Personnel related costs and general expenses increased by $2.6 million and $2.1 million, respectively.

Amortization of Purchased Technology — Amortization of purchased technology includes amortization of the fair value of purchased technology associated with acquisitions. The decrease is due to past acquisition-related purchased technology being fully amortized prior to January 1, 2010 coupled with fewer acquisitions completed during the past 18 months compared to the same period in 2009.

Operating Expenses

Year-over-year changes in the principal components of our operating expenses are as follows (in thousands, except for percentages):

	2010	2009	Increase/(Decrease) Dollars	Increase/(Decrease) Percentage
Operating Expenses:				
Sales and marketing	$ 304,934	$ 272,944	$ 31,990	11.7%
Research and development	151,896	144,370	7,526	5.2%
General and administrative	84,808	76,748	8,060	10.5%
Amortization of other purchased intangible assets	12,670	13,159	(489)	(3.7)%
Litigation loss provision, net	—	19,025	(19,025)	(100.0)%
Total operating expenses	$ 554,308	$ 526,246	$ 28,062	5.3%

Sales and Marketing — Sales and marketing expenses consist primarily of compensation and benefit costs for sales and marketing personnel, sales commissions, and costs of trade shows, travel and entertainment and various discretionary marketing programs. Sales and marketing expenses as a percentage of total revenues for 2010 was 39.8%, which is comparable to 39.3% in 2009. The increase in sales and marketing expense during the twelve months ended December 31, 2010 over the comparable period in 2009 was due primarily to an increase in personnel related costs of $25.2 million, $17.9 million of which relates to higher sales commissions expense and bonuses due to higher revenues compared to the twelve months ended December 31, 2009 and the performance salary increase program effective July 1, 2010. We implemented a sales plan incentive that is tied to achieving consistent performance throughout the year. We started the year with fewer sales employees which in turn yielded larger territories. Thus, as our sales employees exceeded plan during each quarter, we had more sales employees enter into the higher tiers of their compensation plans. Our average full time sales and marketing employee headcount for the twelve months ended December 31, 2010 decreased by 74 employees. Also, travel-related expenses and general expenses increased by approximately $7.0 million compared to the same period in 2009, primarily due to the events of VM World and Oracle Open World. The impact from foreign currency comprised approximately 5.1% of the overall increase in sales and marketing expenses.

Research and Development — Research and development expenses consist primarily of compensation and benefit costs for software developers who develop new products, bug fixes and upgrades to existing products and at times provide engineering support for maintenance services, software product managers, quality assurance and technical documentation personnel, and payments made to outside software development consultants in connection with our ongoing efforts to enhance our core technologies and develop additional products. Research and development expenses as a percentage of total revenues was 19.8% and 20.8% for the twelve months ended December 31, 2010 and 2009, respectively. The increase in research and development expense during the twelve months ended December 31, 2010 as compared to the same period in 2009 was due primarily to a $5.7 million increase in personnel related costs (partly due to our performance salary increase program effective July 1, 2010), $2.6 million of which relates to stock-based compensation expense. Our average full-time research and development employee headcount for 2010 was 1,150 compared to 1,197 in 2009. Also, research and development expenses increased due to the impact of the weak U.S. Dollar in fiscal year 2010, partially offset by a strong U.S. Dollar relative to the Euro and British Pound in the second half of 2010, as a significant portion of our developers are located outside of the U.S. Foreign currency had a negative impact of approximately 45.7% of the increase in research and development expenses for the twelve months ended December 31, 2010.

General and Administrative — General and administrative expenses consist primarily of compensation and benefit costs for our executive, finance, legal, human resources, administrative and information services personnel, and professional fees for audit, tax and legal services. General and administrative expenses as a percentage of total revenues was 11.0% for the twelve months ended December 31, 2010 and 2009. The increase in general and administrative expense during the twelve months ended December 31, 2010 over the comparable period in 2009 was due mainly to an increase in personnel related costs of $7.0 million (partly due to our performance salary increase program effective July 1, 2010), $3.1 million of which relates to stock-based compensation expense.

Amortization of Other Purchased Intangible Assets — Amortization of other purchased intangible assets includes the amortization of customer lists, trademarks and trade names, non-compete agreements and maintenance contracts associated with acquisitions. The decrease is due to past acquisition-related other purchased intangible assets being fully amortized prior to January 1, 2010 coupled with fewer acquisitions completed during the past 18 months compared with the same period in 2009.

Litigation Loss Provision, Net — In 2009, we recorded a litigation loss provision, net of $19.0 million related to the settlement of our completed stock option investigation. Approximately $10 million of the $29 million settlement was paid by our insurance providers.

Other (Expense) Income, Net

Other (expense) income, net consists of the following (in thousands):

			Increase/(Decrease)	
	2010	2009	Dollars	Percentage
Interest income	$ 2,393	$ 1,863	$ 530	28.4%
Interest expense	(4,445)	(2,827)	(1,618)	57.2%
Foreign currency (loss) gain, net	(3,211)	3,640	(6,851)	N/M
Forward foreign currency contracts loss, net	(459)	(893)	434	(48.6)%
Other income	65	766	(701)	(91.5)%
Total other (expense) income, net	$ (5,657)	$ 2,549	$ (8,206)	N/M

Other (expense) income, net primarily includes interest income generated by our investment portfolio, interest expense from our borrowings, gains and losses from foreign exchange fluctuations and gains or losses on other financial assets as well as a variety of other non-operating expenses. Other (expense) income, net was $(5.7) million in the twelve months ended December 31, 2010 compared to $2.5 million in the same period of 2009. Interest expense was $4.4 million and $2.8 million in the twelve months ended December 31, 2010 and 2009, respectively. The increase in interest expense is due to debt agreements entered into in the second half of 2009. Please refer to Note 8 – Loans Payable of our Notes to Consolidated Financial Statements for additional information regarding our debt agreements. Interest income was $2.3 million and $1.9 million in the twelve months ended December 31, 2010 and 2009, respectively. The increase in interest income was due primarily to higher average investment yields and average cash and investment balances. We had a foreign currency (loss) gain of $(3.2) million and $3.6 million for the twelve months ended December 31, 2010 and 2009, respectively. Our foreign currency gains or losses are predominantly attributable to translation gains or losses relative to the U.S. Dollar on the re-measurement of monetary assets and liabilities, which were primarily denominated in the Euro, and to a lesser extent, the British Pound and Canadian Dollar.

Income Tax Provision

During the twelve months ended December 31, 2010, the provision for income taxes increased to $16.4 million from $15.7 million in the comparable period of 2009, representing an increase of $0.7 million. The effective income tax rate decreased to 14.2% in 2010, compared to 18.2% in 2009. The decrease in the effective tax rate is primarily related to a combination of factors including the mix of income between high and low tax jurisdictions, incremental tax credit benefits and the release of reserves associated with the passing of the statute of limitations relating to U.S. federal income taxes for the tax years ended December 31, 2005 and December 31, 2006.

Inflation

Economic inflation has not had a significant effect on our results of operations or financial position for the years ended December 31, 2011, 2010 and 2009.

Liquidity and Capital Resources

Cash and cash equivalents and short-term and long-term investments were approximately $253.8 million and $492.3 million as of December 31, 2011 and 2010, respectively. Of these amounts, $223.0 million and $282.6 million as of December 31, 2011 and 2010, respectively, are domiciled in locations outside of the U.S. If such funds are needed for our U.S. operations, the repatriation of cash balances from our foreign subsidiaries would result in the recognition and payment of U.S. income taxes. We do not plan to repatriate cash balances from our foreign subsidiaries to fund our operations within the U.S.

We maintain positions in certain foreign currencies which may at times create unrealized gains or losses. Unrealized foreign currency gains/losses should have been presented as an adjustment to reconcile net income to net cash provided by operating activities in our consolidated statement of cash flows in prior years. Effective during the third quarter of 2011, we presented such unrealized foreign currency gains/losses in our consolidated statement of cash flows. This change impacts our cash flow presentation and does not impact earnings or cash balances. Management has concluded that the change of presentation is not material to any periods affected. We have adjusted previously reported statement of cash flows to conform to the current year presentation (please refer to Note 1 – Summary of Significant Accounting Policies of our Notes to Consolidated Financial Statements for the impact to prior periods).

Summarized annual cash flow information is as follows (in thousands):

	2011	2010	2009
Cash provided by operating activities	$ 195,035	$ 187,678	$ 157,672
Cash used in investing activities	(219,869)	(116,451)	(70,084)
Cash used in financing activities	(137,571)	(6,175)	(3,706)
Effect of exchange rate changes on cash and cash equivalents	(1,963)	(1,459)	(6,837)
Net (decrease) increase in cash and cash equivalents	$ (164,368)	$ 63,593	$ 77,045

Operating Activities

Cash provided by operating activities is primarily comprised of net income, adjusted for non-cash activities such as depreciation and amortization, compensation expense associated with stock-based payments, impairment of intangible assets, change in fair value of contingent consideration and unrealized foreign currency losses, net related to the re-measurement of monetary assets and liabilities in our foreign subsidiaries.

The non-cash adjustments represent charges reflected in net income, therefore, to the extent that non-cash items increase or decrease our future operating results, there will be no corresponding impact on our cash flows. After excluding the effects of these non-cash charges, the primary changes in cash flows relating to operating activities resulted from changes in operating assets and liabilities. The analyses of the changes in our operating assets and liabilities are as follows:

- Accounts receivable increased to $201.6 million at December 31, 2011 from $179.6 million at December 31, 2010 resulting in an increase in operating assets and reflecting a cash outflow of $6.2 million. Day's sales outstanding, or DSO, were 75 days and 76 days as of December 31, 2011 and December 31, 2010, respectively, and our daily sales was $2.7 million for the quarter ended December 31, 2011 compared to $2.4 million for the quarter ended December 31, 2010. Collection of accounts receivable and related DSO could fluctuate in future periods due to the timing and amount of our revenues and their linearity and the effectiveness of our collection efforts.
- Deferred revenue increased to $499.8 million at December 31, 2011 from $424.4 million at December 31, 2010, resulting in an increase in operating liabilities and reflecting a cash inflow of $50.1 million for the year ended December 31, 2011. The increase in deferred revenue was due to an increase in time-based software licenses, growth of our maintenance services customer base and acquired deferred revenue balances from acquisitions.
- Total income taxes payable increased by $31.3 million to $44.6 million at December 31, 2011 compared to December 31, 2010 resulting in an increase in operating liabilities and reflecting a cash inflow of $24.2 million for the year ended December 31, 2010. Net cash paid for income taxes for the year ended December 31, 2011 was $1.1 million.

Investing Activities

Cash outflows from investing activities for the year ended December 31, 2011 included approximately $220 million paid for acquisitions. We acquired BakBone, a publicly-held provider of data protection software, in January 2011 for cash consideration, net of cash acquired, of approximately $53 million. BakBone gives us additional technologies to provide data protection solutions across heterogeneous physical, virtual and application-level environments. In October 2011, we acquired 60 percent voting equity interest of Smarsh, Inc., a privately-held provider of secure and reliable email archiving solutions for message compliance and records retention, proactive litigation readiness, and mail server data management, for cash consideration, net of cash acquired, of approximately $54 million. In addition, we acquired six other private companies in the year ended December 31, 2011 for cash consideration, net of cash acquired, of approximately $109 million. We had $31.5 million paid in cost method investments for the year ended December 31, 2011. Also, we paid $28.3 million for purchases of investment securities, $1.6 million paid for intellectual property and $29.7 million in capital expenditures. We received $101.4 million in proceeds from the sale and maturities of our investment securities.

During the second quarter of 2011, we entered into a land contract and development agreement for facilities to house our Business Operations and Advanced Technology Center in Cork, Ireland. Under the development agreement, we will temporarily lease office space during the construction of the building. Total expected cost of the land and building is approximately $30 million. As of December 31, 2011, we incurred $5.2 million for the land and $6.4 million for the construction of the building. We anticipate moving into our new building during the fourth quarter of 2012.

We expect that we will continue to purchase property and equipment needed in the normal course of our business. We plan to use excess cash generated from operations to invest in short and long-term investments consistent with past investment practices. Also, we plan to use cash generated from operations and/or proceeds from our investment securities to fund other strategic investment and acquisition opportunities that we continue to evaluate.

Financing Activities

Cash flows from financing activities in the year ended December 31, 2011 included $261.8 million paid for repurchases of our common stock, proceeds from loans payable of $91 million and net proceeds received of $32.4 million from the issuance of our common stock due to exercises of stock options.

In May 2011, our Board of Directors authorized a new stock repurchase program covering up to $200 million of our common stock. This program replaced the $150 million stock repurchase program previously authorized in February 2011. Any stock repurchases may be made through open market and privately negotiated transactions, at times and in such amounts as management deems appropriate, including pursuant to one or more Rule 10b5-1 trading plans. Rule 10b5-1 permits Quest to establish, while not in possession of material nonpublic information, prearranged plans to buy stock at a specific price in the future, regardless of any subsequent possession of material nonpublic information. The timing and actual number of shares repurchased will depend on a variety of factors including market conditions, corporate and regulatory requirements, and capital availability. The stock repurchase program does not have an expiration date and may be limited or terminated at any time without prior notice. During the year ended December 31, 2011, we repurchased 11.9 million shares at a weighted-average price per share of $21.95, for a total cost of $261.8 million pursuant to the two authorizations discussed above. As of December 31, 2011, a total of $68.0 million remains available pursuant to our stock repurchase authorization.

In 2009, we entered into a two year revolving line of credit agreement for up to $100 million with Wells Fargo Foothill, LLC as the arranger, administrative agent and lender. On February 17, 2011, this line of credit agreement was amended and renewed for a subsequent five-year term with Wells Fargo Capital Finance, LLC (formerly known as Wells Fargo Foothill, LLC), as arranger, administrative agent and lender (for additional information on our loans payable, please refer to Note 8 – Loans Payable of our Notes to Consolidated Financial Statements). In October 2011, we used approximately $56 million of this line of credit to fund our acquisition of a 60% voting equity interest in Smarsh, Inc. In addition, we partly funded another acquisition in November 2011 for $35 million through this line of credit. As of December 31, 2011, we had an outstanding loan balance of $91 million recorded in current liabilities in our consolidated balance sheets. In February 2012, we paid $20 million of the outstanding balance (please refer to Note 18 – Subsequent Events of our Notes to Consolidated Financial Statements).

In August 2009, we entered into a loan agreement with Mutual of Omaha Bank whereby we borrowed an aggregate principal amount of $34 million. The loan is secured by our real property at our headquarters in Aliso Viejo, California. We used the proceeds from the loan for working capital and other general corporate purposes. The loan matures in five years, during which time we will make equal monthly principal and interest payments at a 7.03% interest rate on a fixed rate, 25-year amortization schedule. Events of default include, among other things, payment defaults, breaches of covenants and bankruptcy events. In the case of a continuing event of default, the lender may, among other things, accelerate the payment of any unpaid principal and interest amounts, increase the then-current interest rate by 5% and foreclose on the real estate collateral. As of December 31, 2011, we had an outstanding loan balance of $0.6 million and $32.1 million recorded in current liabilities and long-term liabilities, respectively, in our consolidated balance sheets.

We were in compliance with all debt-related covenants at December 31, 2011. For additional information on our loans payable, please refer to Note 8 – Loans Payable of our Notes to Consolidated Financial Statements.

As we continue to evaluate potential acquisitions, potential future stock repurchases or other general corporate expenditures which may be in excess of current cash available within certain operating entities, sourcing cash to fund these activities requires financial flexibility afforded by financing instruments. As such, we plan to continue to evaluate potential debt financings when and if reasonable financing terms become available to us.

Based on our current operating plan, we believe that our existing cash, cash equivalents, investment balances, cash flows from operations and available debt financing will be sufficient to finance our operational cash needs through at least the next 12 months. Our ability to generate cash from operations is subject to substantial risks described under Part I, Item 1A, Risk Factors, of this Report. One of these risks is that our future business does not stay at a level that is similar to, or better than, our recent past. In that event, we may be unable to generate or sustain positive cash flow from operating activities. We would then be required to use existing cash, cash equivalents, investment balances and debt financing to support our working capital and other cash requirements. Also, acquisitions are an important part of our business model. As such, significant amounts of cash could and will likely be used in the future for additional acquisitions or strategic investments. If additional funds are required to support our working capital requirements, acquisitions or other purposes, we may seek to raise funds through public or private equity or, as discussed above, debt financing or from other sources. We can provide no assurance that additional financing will be available at all or, if available, that we would be able to obtain additional financing on terms favorable to us.

Contractual Obligations and Off-Balance Sheet Arrangements

As of December 31, 2011, our contractual obligations or commercial commitments include our facility lease commitments and operating leases for office facilities and certain items of equipment. We do not have any other off-balance sheet arrangements that could reduce our liquidity.

The following table summarizes our obligations as of December 31, 2011 and the effect we expect such obligations to have on our liquidity and cash flows in future periods (in thousands):

	Payments due by period				
Contractual Obligations	**Total**	**Less Than 1 Year**	**1-3 Years**	**3-5 Years**	**More Than 5 Years**
Operating lease obligations	$ 43,331	$ 20,068	$ 19,625	$ 3,639	$ —
Capital lease obligations	1,403	558	845	—	—
Purchase obligations (1)	22,471	20,151	2,320	—	—
Loans payable, including interest	131,537	95,838	35,698	—	—
Acquisition related obligations (2)	9,250	5,800	3,450	—	—
Total contractual cash obligations	$ 207,992	$ 142,415	$ 61,938	$ 3,639	$ —

(1) Our purchase obligations relate primarily to the construction of facilities to house our Business Operations and Advanced Technology Center in Cork, Ireland. We anticipate moving into our new building during the fourth quarter of 2012.

(2) This includes holdback amounts designated in relation to certain acquired companies. Also, this includes contingent consideration related to our acquisitions. We enter into earn-out agreements with the shareholders of certain companies we acquire. The amounts of earn-out contingency payments are typically based on the acquired company's products' total revenue or sales growth over a specified period after the acquisition date.

In addition to the cash commitments above, $56.9 million of unrecognized tax benefits, excluding penalties and interest of $5.2 million, have been recorded as long-term liabilities in accordance with FASB's interpretation of accounting for uncertainty in income taxes, and we are uncertain as to if or when such amounts may be settled and these unrecognized tax benefits are not included in the above table (please refer to Note 10 – Income Taxes of our Notes to Consolidated Financial Statements for additional details).

In connection with our acquisition of a 60 percent voting equity interest in Smarsh, Inc. in October 2011, the minority shareholder who holds the remaining 40 percent noncontrolling interest was granted the right to require us to purchase half of the 40 percent noncontrolling interest ("Put Right") from the first anniversary until the fifth anniversary of the acquisition date. The maximum redemption value payable by us in that case would be $22 million. This 20 percent noncontrolling interest is accounted for as redeemable noncontrolling interest because redemption is outside our control. As such, the redeemable noncontrolling interest is reported in the mezzanine section as temporary equity in our consolidated balance sheets. As of December 31, 2011, the carrying amount of the redeemable noncontrolling interest was increased to the redemption value of $22 million. The redemption value of $22 million is excluded from the table as the timing of such payment is contingent upon the exercise of the Put Right.

Recently Issued Accounting Pronouncements

Please refer to Note 1 – Summary of Significant Accounting Policies of our Notes to Consolidated Financial Statements for information regarding recently issued accounting pronouncements.

Critical Accounting Policies and Estimates

Our consolidated financial statements are based on the selection and application of generally accepted accounting principles in the United States of America ("GAAP"), which require us to make estimates and assumptions about future events that affect the amounts reported in our financial statements and the accompanying notes. Future events and their effects cannot be determined with certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results could differ from those estimates and any such differences may be material to our financial statements. We believe that the policies set forth below may involve a higher degree of judgment and complexity in their application than our other accounting policies and represent the critical accounting policies and estimates used in the preparation of our financial statements. If different assumptions or conditions were to prevail, the results could be materially different from our reported results. Historically, our assumptions, judgments and estimates relative to our critical accounting policies and estimates have not differed materially from actual results. Management has discussed the development and selection of these critical accounting policies and estimates with the Audit Committee of our Board of Directors and the Audit Committee has reviewed the related disclosures below and our significant accounting policies presented within Note 1 – Summary of Significant Accounting Policies of our Notes to Consolidated Financial Statements.

Revenue Recognition

Our revenue recognition policy is one of our critical accounting policies because revenue is a key component of our results of operations and is based on complex rules that require us to make significant judgments and estimates. In applying our revenue recognition policy we must determine which portions of our revenue are recognized currently (generally perpetual software licenses) and which portions must be deferred (generally maintenance, term-based software licenses and professional services). In addition, we analyze various factors including our pricing policies, the credit-worthiness of our customers, accounts receivable aging data and contractual terms and conditions in helping us make judgments about revenue recognition. Changes in judgments with respect to any of these factors could materially impact the timing and amount of revenue and cost recognized.

We recognize revenue pursuant to FASB's authoritative guidance on software revenue recognition. We cannot recognize any revenue before all of the following criteria are met: (1) there is persuasive evidence of an arrangement; (2) we deliver the products or services; (3) fees are fixed or determinable and license agreement terms are free of contingencies or uncertainties that may alter the agreement such that it may not be complete and final; and (4) collection is probable.

We initially capture value for our products by selling a software license to end customers. The fee for the first year of maintenance is included in, or bundled with, the perpetual software license at the time of initial sale. As such, the combination at initial sale of a perpetual software license and one year of maintenance represents a "multiple-element" arrangement for revenue recognition purposes.

When all four of our revenue recognition criteria are met, the multiple-element aspect of our arrangements means the only revenue recognized upfront, at the time of initial sale, is the residual revenue allocated to the perpetual software license. The revenue associated with the fair value of the undelivered maintenance and/or consulting and training services included in the initial sale is deferred and is subsequently recorded to revenue ratably over the support term and as such services are performed, respectively. The fair value of the undelivered elements is determined based on vendor-specific objective evidence ("VSOE") of fair value.

Revenue for our standalone sales of annual maintenance renewals in years two, three and beyond is recognized ratably over the support term. Sales of maintenance for multiple annual periods are treated similarly.

Revenue from our professional services is generally recognized as the services are performed in accordance with the underlying service contracts.

Our maintenance services VSOE of fair value is determined by reference to the prices our customers pay for this support when it is sold separately; that is, when we enter into an arms-length, annual renewal transaction with customers where the only offering sold is maintenance. These standalone maintenance renewal transactions are typically one year in duration and are priced as a targeted percentage of the initial purchase price which includes both the upfront license fee and the first year of maintenance. We bill maintenance renewal transactions in advance of the services provided. We also sometimes offer customers the right to purchase maintenance for multiple annual periods at discounted prices beyond the first year as they will be paying cash upfront, well in advance of the multi-year services performed.

Our professional services VSOE of fair value is determined by reference to our established pricing and discounting practices for these services when sold separately. Our professional services are typically sold as time-and-materials based contracts that average approximately fifteen days in duration. We sell professional services both standalone and as part of multiple-element arrangements.

Our VSOE of fair value is impacted by estimates and judgments that, if significantly different, could materially impact the timing and amount of revenue recognized in current and future periods. These estimates and judgments include, among other items:

- the ability to identify and validate VSOE of fair value for undelivered elements via the use of sampling techniques;
- the impact on sampling results of customer negotiating pressure on maintenance renewal rates;
- the impact on sampling results of maintenance renewals for licenses originally sold via indirect channels;
- the fair value of the undelivered element resulting from sampled transactions; and
- the economic impact of combining multiple renewal rate negotiations relative to varying products with varying purchase dates, into a single, coterminous maintenance renewal.

Historically, we have been able to establish VSOE of fair value for maintenance, and professional services but we may modify our pricing and discounting practices in the future. This could result in changes to our VSOE of fair value for these undelivered elements. If this were to occur, our future revenue recognition for multiple-element arrangements would differ significantly from our historical results. If we were unable to support through VSOE the fair value of our maintenance, and professional services, the entire amount of revenue from our initial, upfront sale of both a perpetual software license bundled with one year of maintenance and any professional services would be deferred and recognized ratably over the applicable time period, generally one year or less.

If we cannot objectively determine the fair value of any undelivered element (hardware, software, specific upgrade rights, etc.) in a bundled software and services arrangement, we defer revenue until all elements are delivered and services are performed, or until fair value can be objectively determined for any remaining undelivered elements.

In addition to perpetual software licenses, we sell a small amount of time-based software licenses (or term licenses) each year wherein customers pay a single fee for the right to use the software and receive maintenance for a defined period of time. Approximately 6% of 2011 license revenue was generated by these time-based software licenses. All license and support revenues on these term licenses are recognized ratably over the license term.

We license our products primarily through our direct sales force, our telesales force and indirect channels including value added resellers and distributors. For our direct sales, we utilize written contracts as the means to establish the terms and conditions upon which our products and services are sold to our end customers. For our indirect sales transactions, we accept orders from our resellers and distributors when they have existing orders from an end customer. Indirect sales through resellers are a growing proportion of our transaction volume. These transactions are generally handled via processes and policies that are similar to an end customer sale. We utilize written contracts coupled with purchase orders as the means to establish the terms and conditions of these indirect sales transactions. We recognize revenue from reseller and distributor transactions upon invoicing the order provided all other revenue recognition criteria have been met.

For those customers that have established a history of consistent, timely cash collection with us, we accept orders and simultaneously recognize revenue. For those customers that have not established a history of consistent, timely cash collection with us, we accept orders and defer revenue until cash collection occurs. The probability of collection criteria per GAAP is applied to each individual customer rather than to all direct sales or indirect sales in aggregate.

Substantially all of our software license arrangements do not include acceptance provisions. Since such acceptance provisions are not contained in our software license arrangements as standard provisions and the incidence of returns in accordance with such acceptance provisions cannot be reasonably estimated, if a contract does include such a provision we recognize revenue upon the earlier of receipt of written customer acceptance or expiration of the acceptance period.

We evaluate arrangements with governmental entities containing "fiscal funding" or "termination for convenience" provisions, when such provisions are required by law, to determine the probability of possible cancellation. We consider multiple factors, including the history with the customer in similar transactions, and the planning, budgeting and approval processes undertaken by the governmental entity. If we determine upon execution of these arrangements that cancellation is not likely, we then recognize revenue once all of the criteria described above have been met. If such a determination cannot be made, revenue is recognized upon the earlier of cash receipt or approval of the applicable funding provision by the governmental entity.

We assess whether fees are fixed or determinable at the time of sale and recognize revenue if all other requirements have been met. Our standard payment terms require payment within 30 days but may vary based on the country in which the agreement is executed. We generally deem payments that are due within 6 months to be fixed and determinable based on collections history and thereby satisfy the required revenue recognition criteria.

A small portion of our revenues are derived from sales of hardware that is part of a multiple-element arrangement including hardware and a combination of software, maintenance or professional services. We recognize revenue related to the nonessential software elements in accordance with the FASB's software revenue guidance. The remaining elements are excluded from the scope of software revenue guidance and revenue is recognized in accordance with the applicable guidance from the FASB.

For additional information regarding our revenue recognition accounting policies, please refer to Note 1 – Summary of Significant Accounting Policies of our Notes to Consolidated Financial Statements.

Asset Valuation

Asset valuation includes assessing the recorded value of certain assets, including accounts receivable, goodwill, other intangible assets and investments in non-consolidated companies. We use a variety of factors to assess valuation, depending upon the asset.

- Accounts Receivable – We maintain an allowance for sales returns and cancellations as well as an allowance for bad debt. Regarding our allowance for sales returns and cancellations, our standard form license and maintenance and/or service agreements do not typically or expressly provide for product returns or cancellations as a matter of right unless we have breached the product warranty and are unable to cure the breach. Our product warranties are typical industry warranties that a product will perform in accordance with established written specifications. However, we maintain the sales returns and cancellations allowance to cover the circumstances where the company accepts returns or cancellations on a discretionary basis even though not contractually obligated to do so. This allowance also covers estimated losses for our customer's unwillingness to make required payments. The allowance for bad debt is for estimated losses resulting from our customer's inability to make required payments related to enforceable contracts. To support both these allowances, we are required to make significant estimates of future software license returns, of cancellations for both maintenance and professional services, and of write-offs of customer accounts as bad debts – all related to current period revenues. The amount of our reserves is based on these estimates, the contractual terms and conditions of our contracts, our accounts receivable aging and our historical collection experience with a customer base. If significant product performance issues were to arise resulting in our accepting sales returns, additional allowances may be required which would result in a reduction of revenue in the period such determination was made. While such return, cancellation and bad debt write-off amounts have historically been within our planned expectations and the allowances established, we cannot guarantee that our sales returns and allowances will be adequate to cover future performance issues of our customer base and allowances may be required which would result in less revenues and additional general and administrative expense in the period such determination was made.
- Goodwill – We evaluate goodwill for impairment at the reporting unit level on an annual basis in the fourth quarter or more frequently if we believe indicators of impairment exist. Goodwill impairment is deemed to exist if the net book value of a reporting unit exceeds its estimated fair value. We performed our annual impairment review in the fourth quarter of 2011 and determined that the carrying value of each reporting unit was less than the estimated fair value of the reporting units. In calculating the fair value of the reporting units, the market approach and income approach were the methodologies deemed the most reliable and were the primary methods used for our impairment analysis. Based on our most recent annual impairment review, the estimated fair values of our reporting units were substantially in excess of their carrying value. We will continue to perform annual impairment reviews during the fourth quarter of each year or earlier if indicators of potential impairment exist. Future impairment reviews could result in significant charges against earnings to write down the value of goodwill.
- Amortizing Intangible Assets – These assets are recorded at their estimated fair value and include acquired technology, in-process research and development ("IPR&D"), customer relationships, non-compete agreements, trademarks and trade names acquired and are being amortized using the straight-line method over estimated useful lives ranging from two to fifteen years.

  We make estimates of fair value based upon assumptions believed to be reasonable. These estimates are based on historical experience and information obtained from the management of the acquired companies and are inherently uncertain. Critical estimates in valuing certain of the intangible assets include but are not limited to: future expected cash flows from license sales, maintenance agreements, consulting contracts, customer contracts and acquired developed technologies and patents; expected costs to develop the IPR&D into commercially viable products and estimated cash flows from the projects when completed; the acquired company's brand and market position, as well as assumptions about the period of time the acquired brand will continue to be used in the combined company's product portfolio; acquired company key personnel's willingness and ability to compete; and discount rates. Unanticipated events and circumstances may occur which may affect the accuracy or validity of such assumptions, estimates or actual results.

  The net carrying amount of amortizing intangible assets at December 31, 2011 was considered recoverable. In accordance with FASB's authoritative guidance on accounting for the impairment or disposal of long-lived assets, these intangible assets are reviewed for events or changes in circumstances which indicate that their carrying value may not be recoverable. We periodically review the carrying value of these assets to determine whether or not impairment to such value has occurred. In the event that in the future it is determined that the other intangible assets value has been impaired, an adjustment will be made in that corresponding period resulting in a charge against earnings for the write-down.

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- Investments in Non-Consolidated Companies – Most of our investments in non-consolidated companies are currently accounted for under the cost method, as we do not have the ability to exercise significant influence over these companies' operations. Significant influence is generally deemed to exist when we have an ownership interest in the voting stock of the investee of between 20% and 50%, although other factors, such as representation on the investee's board of directors, voting rights, and the impact of commercial arrangements, are also typically considered in determining the appropriate accounting treatment. The equity method of accounting is used for investment in companies where we have a voting interest of 20% to 50%. Investments of more than 3% to 5% in limited partnership are accounted for using the equity method. The fair value of our cost method investments is not estimated if there are no identified events or changes in circumstances that may have a significant adverse effect on the fair value of the investment. We determined that it is not practicable to estimate the fair value of our cost method investments since these investments were made in privately-held companies that are not subject to the same disclosure regulations as U.S. public companies, and, as such, the basis for an estimated fair value is subject to the completeness, quality, timing and accuracy of data received from these private companies. We periodically monitor our investments for impairment and will record reductions in carrying values if and when necessary. As part of this evaluation process, our review includes but is not limited to a review of each company's cash position, recent financing activities, financing needs, earnings and revenue outlook, operational performance, management or ownership changes, and impacts from competitive pressures, all to the extent we have access to such information. If we determine that the carrying value of our investment in a company is at an amount above fair value, an adjustment will be made in that corresponding period resulting in a charge against earnings for the write-down to fair value.

Accounting for Income Taxes

As part of the process of preparing our financial statements, we are required to estimate our obligation for income taxes in each of the jurisdictions in which we operate. This process requires a significant amount of judgment, estimation and uncertainty and our estimate of income taxes can be highly sensitive to shifts of taxable income reported between such tax jurisdictions. Additionally, our U.S. and foreign tax returns are subject to routine compliance reviews by the various tax authorities. Although we believe we have appropriate support for the positions taken on our tax returns, our income tax expense includes amounts intended to satisfy income tax assessments that could result from the examination of our tax returns. Determining the income tax expense for such contingencies requires a significant amount of judgment and estimation.

We recognize liabilities for uncertain tax positions based on a two-step process. Both steps presume that the tax position will be examined by the appropriate taxing authority that has full knowledge of all relevant information. The first step is to evaluate the tax position for recognition by determining if, based on the weight of available evidence, it is more likely than not that the position will be sustained on examination. The second step requires us to estimate and measure the tax benefit as the largest amount that is more than 50% likely of being realized upon ultimate settlement with a taxing authority. It is inherently difficult and subjective to estimate such amounts, as this may require us to determine the probability of various possible outcomes. We reevaluate these uncertain tax positions on a periodic basis. This evaluation is based on factors including, but not limited to, current year tax positions, expiration of statutes of limitations, litigation, legislative activity, or other changes in facts and circumstances. Such a change in recognition or measurement would result in the recognition of a tax benefit or an additional charge to the tax provision in that period. The amounts ultimately paid upon resolution of such uncertain tax positions could be materially different from the amounts previously included in our income tax expense and therefore could have a material impact on our consolidated results of operations. The tax liabilities for uncertain tax positions are recorded as a separate component in our long-term income taxes payable/ receivable balance. Please refer to Note 10 – Income Taxes of our Notes to Consolidated Financial Statements.

We recognize deferred income tax assets and liabilities based upon the differences between the financial statement carrying amounts and the tax bases of assets and liabilities. Such deferred income taxes primarily relate to the timing of the recognition of certain revenue items and the timing of the deductibility of certain reserves and accruals for income tax purposes. We regularly review the deferred tax assets for recoverability and establish a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized. If we are unable to generate sufficient future taxable income, or if there is a material change in the actual effective tax rates or time periods within which the underlying timing differences become taxable or deductible, we could be required to establish an additional valuation allowance against the deferred tax assets, which could result in a substantial increase in our effective tax rate and have a materially adverse impact on our operating results. U.S. income taxes were not provided for on undistributed earnings from certain non-U.S. subsidiaries because those earnings are considered permanently reinvested. Should that judgment change, U.S. income taxes would have to be recognized on those undistributed earnings no longer considered to be permanently invested.

Accounting for Stock-based Compensation

We account for stock-based compensation in accordance with the fair value recognition provisions per GAAP. Stock-based compensation expense is measured at the grant date based on the value of the award and is recognized as expense over the vesting period. We use the Black-Scholes option-pricing model to determine the fair value of stock options. The Black-Scholes option-pricing model incorporates various subjective assumptions including expected volatility, expected term and the risk-free interest rates. We estimate the expected volatility based upon historical volatilities of our common stock. We determine the expected term of our stock-based awards based on historical exercise patterns across two different groups of employees. In addition, judgment is also required in estimating the forfeiture rate on stock-based awards. We calculate the expected forfeiture rate based on average historical trends. These input factors are subjective and are determined using management's judgment. If a difference arises between the assumptions used in determining stock-based compensation cost and the actual factors which become known over time, we may change the input factors used in determining future stock-based compensation costs. Any such changes could materially impact our results of operations in the period in which the changes are made and in periods thereafter.

Determining Functional Currencies for Purpose of the Consolidation of Non-U.S. Subsidiaries

In preparing our consolidated financial statements, we are required to re-measure the financial statements of our foreign subsidiaries from their local currency into U.S. dollar. This process results in foreign currency re-measurement gains and losses included in Other (expense) income, net in the consolidated income statements.

Under the relevant accounting guidance, the treatment of these re-measurement gains or losses is dependent upon our determination of the functional currency of each subsidiary. The functional currency is determined based on the judgment of management and involves consideration of all relevant economic facts and circumstances affecting the subsidiary. The currency in which the subsidiary transacts a majority of its transactions (including transfer pricing arrangements, billings, financing, payroll and other expenditures) is one consideration of determining the functional currency; however, any dependency upon the parent and the nature of the subsidiary's operations are also considered.

Other (expense) income, net includes any gain or loss associated with the re-measurement of a subsidiary's financial statements when the functional currency of a subsidiary is the United States dollar. However, if the functional currency is deemed to be the local currency, any gain or loss associated with the translation of these financial statements into the United States dollar would be included within Accumulated other comprehensive income on our consolidated balance sheets. If we determine that there has been a change in the functional currency of a subsidiary to the local currency, any translation gains or losses arising after the date of change would be included within stockholders' equity as a component of Accumulated other comprehensive income.

Based on our assessment of the factors discussed above, we consider the U.S. dollar to be the functional currency for each of our international subsidiaries. As a result of this determination, assets and liabilities in these subsidiaries are re-measured at current period-end exchange rates, except for property and equipment, intangible assets, goodwill, and deferred revenue, which are re-measured at historical exchange rates. Revenues and expenses are re-measured at average exchange rates in effect during the reporting period except for revenues and costs related to the above mentioned balance sheet items which are re-measured at historical exchange rates. Accordingly, we had a net foreign currency re-measurement (loss) gain of $(4.3) million, $(3.2) million and $3.6 million for the years ended December 31, 2011, 2010 and 2009, respectively, recorded to Other (expense) income, net in the respective periods. Had we determined that the functional currency of our subsidiaries was the local currency, these translation gains and losses would have been included in our statement of stockholders' equity as a component of comprehensive income for each of the years presented, and would not have the impacts on our net income that are currently reflected in our consolidated financial statements.

The magnitude of these gains or losses is dependent upon fluctuations within the exchange rates of the foreign currencies in which we transact business against the U.S. dollar, the significance of the assets, liabilities, revenues and expenses denominated in foreign currencies, and the effect of any foreign currency hedging activities that we have entered into (please refer to Note 15 – Derivative Instruments of our Notes to Consolidated Financial Statements for details). We operate in a number of currencies worldwide, most notably in the Euro, the British Pound, Canadian Dollar, Australian Dollar and Russian Ruble. Any future re-measurement gains or losses could differ significantly from those we have experienced in recent years. In addition, if we determine that a change in the functional currency of one of our subsidiaries has occurred at any point in time, we would be required to include any translation gains or losses from the date of change in Accumulated other comprehensive income on our consolidated balance sheets.

Item 7A. ***Quantitative and Qualitative Disclosures About Market Risk***

Foreign Exchange Risk

We are a U.S. dollar functional company and transact business in a number of different foreign countries around the world. In most instances, revenues are collected and operating expenses are paid in the local currency of the country in which we are transacting. Accordingly, we are exposed to both transaction and translation risk relating to changes in foreign exchange rates.

Our exposure to foreign exchange risk originates both from our foreign operations net profits and losses denominated in currencies other than the U.S. dollar, as well as our net balances of monetary assets and liabilities in our foreign subsidiaries. These exposures have the potential to produce either gains or losses depending on the directional movement of the foreign currencies versus the U.S. dollar and our operational profile in foreign subsidiaries. Our cumulative currency gains or losses in any given period may be lessened by the economic benefits of diversification and the correlative relationships of different currencies, but there can be no assurance that this pattern will continue to be true in future periods. During the twelve months ended December 31, 2011, we had a positive effect, or an increase, of $8.4 million on total revenues and a negative effect in the form of an increase to total expenses by $14.5 million related to foreign currency fluctuation when comparing average monthly 2011 rates to 2010. In addition, for the twelve months ended December 31, 2011, within other (expense) income, net we had foreign currency losses of $4.3 million compared to $3.2 million in 2010.

The foreign currencies to which we currently have the most significant exposure are the Euro, the Canadian Dollar, the British Pound, the Australian Dollar and the Russian Ruble. We enter into hedges in the form of foreign currency contracts to reduce the range of outcomes foreign currency rate changes can have on non-functional currency denominated forecasted transactions and balance sheet positions, which include certain monetary assets and liabilities denominated in foreign currencies. The foreign currency contracts are carried at fair value and denominated in various currencies as listed in the tables below. The duration of these contracts ranges from less than one month to twelve months. A description of our accounting for foreign currency contracts is included in Note 1 – Summary of Significant Accounting Policies and Note 15 – Derivative Instruments of our Notes to Consolidated Financial Statements.

The magnitude of success of our hedging activities depends upon the accuracy of our estimates of various balances and transactions denominated in non-functional currencies. To the extent our estimates are correct, gains and losses on our forward foreign currency contracts will be offset by corresponding losses and gains on the underlying transactions. In order to monitor the financial impact of our foreign currency hedges, we subject our hedges to a stress test. This test is intended to quantify the impact to our financial statements of an abnormal change in the foreign currency rates in which we do business. We performed this test assuming the currencies in which we do business correlate with the Euro as they did during the fourth quarter of 2011. When subjected to a 10% and 20% adverse change, we estimated that the fair value of our contracts would decline by $8.6 million and $17.2 million, respectively.

We do not use foreign currency contracts for speculative or trading purposes. We enter into foreign currency contracts with reputable financial institutional counterparties whose financial health we monitor. To date, we have not experienced nonperformance by any of these counterparties and anticipate performance by all counterparties.

The following table summarizes the notional amounts of our outstanding foreign currency contracts at December 31, 2011 and 2010. All contracts have maturities of twelve months or less. (in U.S. Dollars in thousands):

	December 31	
Currency	2011	2010
Australian Dollar	$ 12,216	$ 6,634
Canadian Dollar	14,158	7,694
Chinese Yuan	2,776	1,167
Danish Krone	891	1,073
Euro	40,398	45,961
British Pound	7,950	14,988
Israeli Shekel	3,773	2,105
Brazil Real	3,826	2,381
Swedish Krona	446	743
Japanese Yen	6,439	—
South Korean Won	2,193	—
Norwegian Krone	1,073	1,028
Russian Ruble	8,433	6,206
Total	$ 104,572	$ 89,980

Interest Rate Risk

Our exposure to market interest-rate risk relates primarily to our investment portfolio. We traditionally do not use derivative financial instruments to hedge the market risks of our investments. We place our investments with high-quality issuers and money market funds and articulate allocation limits in our investment policy to any one issuer other than the United States government. Our investment portfolio as of December 31, 2011 consisted of money market funds, U.S. Treasuries, US agency securities, certificates of deposit and corporate bonds. Investments purchased with an original maturity of three months or less are considered to be cash equivalents. We classify our investments as available-for-sale securities. Available-for-sale securities are carried at fair value, with unrealized gains and losses, net of tax, reported in a separate component of stockholders' equity. Trading securities are carried at fair value, with changes in fair value reported in earnings.

Information about our investment portfolio is presented in the table below, which states the amortized book value and related weighted-average interest rates by year of maturity (in thousands):

	Amortized Book Value	Weighted Average Rate
Investments maturing by December 31, 2012 [(1)]	$ 132,383	0.48%
2013	17,568	1.31%
2014	5,449	1.82%
2015	—	—
2016	1,947	3.22%
Total portfolio	$ 157,347	0.64%

(1) Includes $95.7 million in cash equivalents.

Please refer to Note 4 – Cash and Cash Equivalents and Investments of our Notes to Consolidated Financial Statements for additional information regarding our investment portfolio.

In February 2011, our line of credit agreement with Wells Fargo Capital Finance, LLC (formerly known as Wells Fargo Foothill, LLC), as arranger, administrative agent and lender, was amended and renewed for a subsequent five-year term (the "Amended Credit Agreement"). Accordingly, we could be exposed to market risk from changes to interest rates on our loans payable. This exposure relates to our $100 million line of credit. Borrowings under the Amended Credit Agreement currently bear interest at variable rates based on, at the Company's election, (i) LIBOR (subject to reserve requirements) or (ii) the greater of (a) the Federal Funds Rate plus $^{1}/_{2}$% or (b) Wells Fargo's prime rate, in each case, plus an applicable margin. As of December 31, 2011, we have a $91 million balance outstanding under this line of credit recorded as current loans payable in our consolidated balance sheets. A hypothetical increase in interest rates of 1% as compared to the rates we experienced during 2011 would not have a material impact on the Company's financial position or cash flows.

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Item 8. ***Financial Statements and Supplementary Data***

The financial statements required by this item are included in Part IV, Item 15 of this Form 10-K and are presented beginning on page F-1.

The following tables set forth selected unaudited consolidated quarterly financial data for the eight quarters ended December 31, 2011:

	Quarters Ended							
	Dec. 31, 2011	Sept. 30, 2011	June 30, 2011	March 31, 2011	Dec. 31, 2010 (1)	Sept. 30, 2010	June 30, 2010	March 31, 2010
	(in thousands, except per share data)							
Revenues	$245,888	$220,400	$202,970	$188,157	$216,782	$193,042	$186,102	$171,171
Gross profit	212,016	188,986	172,537	160,758	190,577	169,565	164,608	150,133
Income before income tax provision	43,962	24,392	10,734	6,635	31,257	34,306	29,155	20,202
Net income	20,641	21,466	6,330	3,629	37,064	28,501	17,391	15,613
Net loss attributable to noncontrolling interest (including $8,237 increase of redeemable noncontrolling interest to redemption value) (2)	(8,091)	—	—	—	—	—	—	—
Net income attributable to Quest Software, Inc.	$ 12,550	$ 21,466	$ 6,330	$ 3,629	$ 37,064	$ 28,501	$ 17,391	$ 15,613
Net income per share attributable to Quest Software, Inc. stockholders:								
Basic	$ 0.15	$ 0.25	$ 0.07	$ 0.04	$ 0.40	$ 0.31	$ 0.19	$ 0.17
Diluted	$ 0.15	$ 0.25	$ 0.07	$ 0.04	$ 0.39	$ 0.31	$ 0.19	$ 0.17

(1) In 2010, we recorded a year-end adjustment of $6.8 million relating to tax reserves that should have been released in prior periods. Management has concluded that this correction is not material to any periods affected. Please refer to Note 1 – Summary of Significant Accounting Policies of our Notes to Consolidated Financial Statements for details of our tax adjustment related to prior periods.

(2) During the fourth quarter of 2011, we acquired a 60 percent voting equity interest in Smarsh, Inc. The minority shareholder who holds the remaining 40 percent noncontrolling interest was granted the right to require us to purchase half of the 40 percent non-controlling interest. This 20 percent noncontrolling interest is accounted for as redeemable noncontrolling interest because redemption is outside our control. As such, the redeemable noncontrolling interest is reported in the mezzanine section as temporary equity in our consolidated balance sheets. The remaining 20 percent noncontrolling interest is presented within total equity in our consolidated balance sheets. We present the consolidated net income that is attributable to Quest Software, Inc. and the noncontrolling interest in our consolidated income statements. Net income per share is calculated based on net income attributable to Quest Software, Inc. stockholders. Please refer to Note 11 – Noncontrolling Interest of our Notes to Consolidated Financial Statements for additional details.

Item 9. ***Changes In and Disagreements with Accountants on Accounting and Financial Disclosure***

None.

Item 9A. ***Controls and Procedures***

Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures designed to provide reasonable assurance that information required to be disclosed in reports filed under the Securities Exchange Act of 1934, as amended (the "Exchange Act") is recorded, processed, summarized and reported within the specified time periods and accumulated and communicated to management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2011 as required by paragraph (b) of Rule 13a-15 or Rule 15d-15 of the Exchange Act. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of that date, the Company's disclosure controls and procedures as defined in Rules 13a-15(e) or 15d-15(e) under the Exchange Act were not effective at the reasonable assurance level because of the identification of a material weakness in its internal control over financial reporting, described below, which the Company views as an integral part of its disclosure controls and procedures.

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 Exchange Act). Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2011.

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis by the Company's internal controls. Management performed an assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2011, utilizing the criteria described in the "Internal Control — Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. The objective of this assessment was to determine whether the Company's internal control over financial reporting was effective as of December 31, 2011. Based on this evaluation and those criteria, our management, with the participation of our Chief Executive Officer and Chief Financial Officer, concluded that, as of December 31, 2011, there were internal control deficiencies that constituted a material weakness, as described below.

Because of the material weakness noted below, management has concluded that internal control over financial reporting was not effective as of December 31, 2011, based on the criteria set forth in *Internal Control-Integrated Framework* issued by COSO.

The effectiveness of the Company's internal control over financial reporting has been audited by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in their report which is included herein.

Additional Information Regarding the Material Weakness

Our management identified a material weakness in the Company's internal control over financial reporting related to the income tax provision process as of December 31, 2011. During the preparation of the income tax provision, there were current period and prior period errors identified by both the external auditors and management. Management believes that the Company did not deploy or utilize sufficient internal or external resources, systems, and timely process changes to support our reporting needs in accordance with the growth and complexity of our overall business and the enhanced internal controls that were put in place during the fourth quarter of 2011. The level of resources deployed was insufficient to reduce the likelihood of detecting material adjustments to the Company's books and records. This material weakness resulted in the need to record immaterial adjustments. However, as a result of these errors we determined that there was a reasonable possibility that a material misstatement to the annual or interim financial statements would not have been prevented or detected.

Changes in Internal Control over Financial Reporting

There was no change in internal control over financial reporting that occurred during the fourth quarter of 2011 that has materially affected or is reasonably likely to materially affect our internal control over financial reporting, except as described below:

- During the fourth quarter of 2011, we undertook efforts to redesign and enhance our internal controls related to the accounting and reporting for income taxes. Specifically, we replaced a singular key control related to the income tax provision and created multiple key controls that address several high impact areas of the tax provision. Management believes that these multiple key internal controls have been adequately designed to address areas of risk. However, due to their recent implementation, we were unable to determine operating effectiveness within the current period.

Plan for Remediation of Material Weakness

We are also undertaking further efforts to remediate the material weakness identified above. The identified material weakness was caused, in part, by the insufficient deployment or utilization of resources. Therefore, our remediation plans include an evaluation of the sufficiency of our internal personnel and the use of external resources, including systems and processes.

Thus, we plan to take the following steps to improve our internal control over the tax aspects of financial reporting and to remediate the identified material weakness:

- We are evaluating the staffing level and qualifications of tax department personnel and will make changes as deemed appropriate.
- We will evaluate and may modify utilization of external resources, to provide greater assurance that these resources are effectively managed, and deployed.
- We plan to deploy additional software systems to assist in automating and controlling certain processes within the tax function.
- We will enhance our tax compliance and provision processes and procedures through expanded use of checklists for key tasks to improve effectiveness and efficiency.

We believe that the actions described above in addition to the improved internal controls added during the fourth quarter of 2011 will strengthen our internal control over financial reporting related to the income tax provision process, and will, over time, address the material weakness that we identified in our internal control over financial reporting as of December 31, 2011.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Quest Software, Inc.
Aliso Viejo, California

We have audited the internal control over financial reporting of Quest Software, Inc. and subsidiaries (the "Company") as of December 31, 2011, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company'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, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on 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, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on that risk, 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 by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel 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 of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. The following material weakness has been identified and included in management's assessment: The Company did not maintain effective controls over the income tax provision process. The Company did not deploy or utilize sufficient internal or external resources, systems, and timely process changes to support the Company's reporting needs. The level of resources deployed was insufficient to reduce the likelihood of detecting material adjustments to the Company's books and records. This material weakness resulted in the need to record immaterial adjustments. However, as a result of these errors there was a reasonable possibility that a material misstatement to the annual or interim financial statements would not have been prevented or detected. This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the consolidated financial statements and financial statement schedule as of and for the year ended December 31, 2011, of the Company and this report does not affect our report on such financial statements and financial statement schedule.

In our opinion, because of the effect of the material weakness identified above on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 31, 2011, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedule as of and for the year ended December 31, 2011, of the Company and our report dated February 28, 2012 expressed an unqualified opinion on those financial statements and financial statement schedule.

/s/ DELOITTE & TOUCHE LLP

Costa Mesa, California
February 28, 2012

Item 9B. ***Other Information***

Not applicable.

PART III

Item 10. ***Directors, Executive Officers and Corporate Governance***

Information required by this item will be included in the sections captioned *"Directors," "Executive Officers," "Code of Ethics," "Corporate Governance," "Board of Directors and Committees"* and *"Section 16(a) Beneficial Ownership Reporting Compliance"* of our definitive proxy statement, to be delivered to stockholders in connection with our 2012 Annual Meeting of Stockholders. Such information is incorporated herein by reference.

Item 11. ***Executive Compensation***

Information regarding compensation of certain named executive officers will be included in the sections captioned *"Executive Compensation and Related Information"*, "*Compensation Committee Interlocks and Insider Participation*," and "*Compensation Committee Report*" appearing in our definitive proxy statement, to be delivered to stockholders in connection with our 2012 Annual Meeting of Stockholders. Such information is incorporated herein by reference.

Item 12. ***Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

Information required by this item will be included in the sections captioned *"Security Ownership of Certain Beneficial Owners and Management"* and "*Equity Compensation Plan Information*" appearing in our definitive proxy statement, to be delivered to stockholders in connection with our 2012 Annual Meeting of Stockholders. Such information is incorporated herein by reference.

Item 13. ***Certain Relationships and Related Transactions, and Director Independence***

Information required by this item will be included in the section captioned *"Certain Relationships and Related Transactions,"* and *"Corporate Governance"* appearing in our definitive proxy statement, to be delivered to stockholders in connection with our 2012 Annual Meeting of Stockholders. Such information is incorporated herein by reference.

Item 14. ***Principal Accounting Fees and Services***

Information required by this item will be included in the section captioned *"Fees Paid to the Independent Registered Public Accounting Firm"* in our definitive proxy statement, to be delivered to stockholders in connection with our 2012 Annual Meeting of Stockholders. Such information is incorporated herein by reference.

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PART IV

Item 15. ***Exhibits, Financial Statement Schedules***

The following documents are filed as part of this Form 10-K.

(1) Financial Statements

(2) Financial Statement Schedule

The following financial statement schedule should be read in conjunction with the consolidated financial statements of Quest Software, Inc. filed as part of this Report:

- Schedule II — Valuation and Qualifying Accounts

Schedules other than that listed above have been omitted since they are either not required or not applicable or because the information required is included in the consolidated financial statements included elsewhere herein or the notes thereto.

(3) Exhibits

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Exhibit Number	Exhibit Title
3.1*	Certificate of Incorporation of Quest Software, Inc. (incorporated by reference to our Current Report on Form 8-K filed on April 30, 2009)
3.2*	Bylaws of Quest Software, Inc. (incorporated by reference to our Current Report on Form 8-K filed on April 30, 2009)
4.1*	Form of Registrant's Specimen Common Stock Certificate (incorporated by reference to our Registration Statement on Form S-1 and all amendments thereto filed on June 11, 1999 (File No. 333-80543))
10.1*	Form of Directors' and Officers' Indemnification Agreement (incorporated by reference to our Registration Statement on Form S-1 and all amendments thereto filed on June 11, 1999 (File No. 333-80543))
10.2*++	Quest Software, Inc. 1999 Stock Incentive Plan, as amended (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2008)
10.3*++	Form of Stock Option Agreement used under the Quest Software, Inc. 1999 Stock Incentive Plan (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended September 30, 2004)
10.4*++	Form of Restricted Stock Unit Award Agreement used under the Quest Software, Inc. 1999 Stock Incentive Plan, as amended (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2008)
10.5*++	Quest Software, Inc. 2001 Stock Incentive Plan, as amended (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2008)
10.6*++	Form of Stock Option Agreement used under the Quest Software, Inc. 2001 Stock Incentive Plan (incorporated by reference to our Registration Statement on Form S-8 (File No. 333-82784) filed on February 14, 2002)
10.7*++	Quest Software, Inc. 2008 Stock Incentive Plan (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2008)
10.8*++	Form of Stock Option Agreement used under the Quest Software, Inc. 2008 Stock Incentive Plan (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2008)
10.9*++	Form of Restricted Stock Unit Award Agreement used under the Quest Software, Inc. 2008 Stock Incentive Plan (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2008)
10.10*++	Quest Software, Inc. Executive Incentive Plan (incorporated by reference to our Annual Report on Form 10-K for the year ended December 31, 2007)
10.11*	Credit Agreement dated as of February 17, 2009 between Quest Software, Inc. and Wells Fargo Foothill, LLC (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2009)
10.12*	Amendment Number Three to Credit Agreement dated as of February 17, 2011 between Quest Software, Inc., the Lenders part thereto, and Wells Fargo Capital Finance LLC (formerly known as Wells Fargo Foothill, LLC) as the arranger and administrative agent for the Lenders (incorporated by reference to our Current Report on Form 8-K filed on February 23, 2011)
10.13*	Security Agreement dated as of February 17, 2009 among Quest Software, Inc., Aelita Software Corporation, ScriptLogic Corporation, Vizioncore, Inc., NetPro Computing, Inc. and those additional entities that hereafter become parties hereto, and Wells Fargo Foothill, LLC (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2009)
10.14*++	Voting Agreement dated June 1, 2009 by and between Quest Software, Inc. and Vincent C. Smith (incorporated by reference to our Current Report on Form 8-K filed on June 1, 2009)
10.15*	Loan and Security Agreement, dated as of August 3, 2009, between Quest Software, Inc. as Borrower and Mutual of Omaha Bank as Lender (incorporated by reference to our Current Report on Form 8-K filed on August 7, 2009)
10.16*	Secured Promissory Note, dated as of August 3, 2009, from Quest Software, Inc. as Maker to Mutual of Omaha Bank as Payee (incorporated by reference to our Current Report on Form 8-K filed on August 7, 2009)
10.17*	Deed of Trust, Security Agreement, Assignment of Rents and Leases, and Fixture Filing, dated as of August 3, 2009, by and among Quest Software, Inc. as Trustor, Mutual of Omaha Bank as Beneficiary, and Fidelity National Title Company as Trustee (incorporated by reference to our Current Report on Form 8-K filed on August 7, 2009)

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Exhibit Number	Exhibit Title
10.18*	Environmental Certification and Indemnity Agreement, dated as of August 3, 2009, by Quest Software, Inc. as Obligor in favor of Mutual of Omaha Bank as Lender (incorporated by reference to our Current Report on Form 8-K filed on August 7, 2009)
14.1*	Code of Conduct and Ethics (incorporated by reference to our Annual Report on Form 10-K for the period ended December 31, 2009)
21.1	Subsidiaries of the Registrant
23.1	Consent of Deloitte & Touche LLP
31.1	Certification of the Principal Executive Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
31.2	Certification of the Principal Financial Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
32.1	Certification of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

* Incorporated by reference

++ Indicates a management contract or compensatory arrangement.

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.

	QUEST SOFTWARE, INC.
Dated: February 29, 2012	By: /s/ Vincent C. Smith
	Vincent C. Smith
	President and Chief Executive Officer

Pursuant to the requirements of the Securities 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/ Vincent C. Smith **Vincent C. Smith**	President, Chief Executive Officer (Principal Executive Officer) and Chairman of the Board of Directors	February 29, 2012
/s/ Scott J. Davidson **Scott J. Davidson**	Senior Vice President and Chief Financial Officer (Principal Financial Officer)	February 29, 2012
/s/ Scott H. Reasoner **Scott H. Reasoner**	Vice President, Corporate Controller (Principal Accounting Officer)	February 29, 2012
/s/ Douglas F. Garn **Douglas F. Garn**	Vice Chairman and Director	February 29, 2012
/s/ Kevin M. Klausmeyer **Kevin M. Klausmeyer**	Director	February 29, 2012
/s/ Augustine L. Nieto II **Augustine L. Nieto II**	Director	February 29, 2012
/s/ Paul A. Sallaberry **Paul A. Sallaberry**	Director	February 29, 2012
/s/ H. John Dirks **H. John Dirks**	Director	February 29, 2012

**CONSOLIDATED FINANCIAL STATEMENTS AND
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

QUEST SOFTWARE, INC. AND SUBSIDIARIES

December 31, 2011, 2010 and 2009

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QUEST SOFTWARE, INC. AND SUBSIDIARIES

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Quest Software, Inc.
Aliso Viejo, California

We have audited the accompanying consolidated balance sheets of Quest Software, Inc. and subsidiaries (the "Company") as of December 31, 2011 and 2010, and the related consolidated statements of income, equity and comprehensive income (loss), and cash flows for each of the three years in the period ended December 31, 2011. Our audits also included the financial statement schedule listed in the Index at Item 15. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the consolidated financial statements and financial statement 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. 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 audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2011 and 2010, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such 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 have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2011, based on the criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 28, 2012, expressed an adverse opinion on the effectiveness of the Company's internal control over financial reporting because of a material weakness.

/s/ DELOITTE & TOUCHE LLP

Costa Mesa, California
February 28, 2012

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QUEST SOFTWARE, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except par value)

	December 31 2011	December 31 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 192,165	$ 356,533
Short-term investments	36,774	90,284
Accounts receivable, net of allowances of $6,369 and $5,367 at December 31, 2011 and 2010, respectively	201,636	179,621
Prepaid expenses and other current assets	45,846	48,312
Deferred income taxes, net	19,780	6,677
Total current assets	496,201	681,427
Property and equipment, net	94,602	70,854
Long-term investments	24,832	45,466
Intangible assets, net	150,386	62,785
Goodwill	858,444	706,224
Deferred income taxes, net	17,559	46,985
Other assets	55,627	21,843
Total assets	$1,697,651	$1,635,584
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$ 11,723	$ 5,512
Accrued compensation	56,148	55,185
Other accrued expenses	42,845	32,600
Loans payable	91,597	521
Deferred revenue	388,788	324,121
Total current liabilities	591,101	417,939
Long-term liabilities:		
Deferred revenue	111,050	100,264
Income taxes payable	51,276	41,385
Loans payable	32,133	32,730
Other long-term liabilities	9,942	11,000
Total long-term liabilities	204,401	185,379
Total liabilities	795,502	603,318
Commitments and contingencies (Notes 2 and 17)		
Redeemable noncontrolling interest	22,000	—
Equity:		
Quest Software, Inc. stockholders' equity:		
Preferred stock, $0.001 par value, 10,000 shares authorized; no shares issued or outstanding	—	—
Common stock, $0.001 par value, 200,000 shares authorized; 83,148 and 92,893 shares issued and outstanding at December 31, 2011 and 2010, respectively	83	93
Additional paid-in-capital	521,653	729,640
Retained earnings	345,672	301,697
Accumulated other comprehensive (loss) income	(208)	836
Total Quest Software Inc. stockholders' equity	867,200	1,032,266
Noncontrolling interest	12,949	—
Total equity	880,149	1,032,266
Total liabilities and equity	$1,697,651	$1,635,584

The accompanying notes are an integral part of these consolidated financial statements.

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QUEST SOFTWARE, INC. AND SUBSIDIARIES
CONSOLIDATED INCOME STATEMENTS
(In thousands, except per share data)

	Year Ended December 31		
	2011	**2010**	**2009**
Revenues:			
Licenses	$337,889	$320,683	$279,238
Services	519,526	446,414	415,998
Total revenues	857,415	767,097	695,236
Cost of revenues:			
Licenses	10,913	8,303	7,581
Services	88,431	67,809	58,528
Amortization of purchased technology	23,774	16,101	19,393
Total cost of revenues	123,118	92,213	85,502
Gross profit	734,297	674,884	609,734
Operating expenses:			
Sales and marketing	343,411	304,934	272,944
Research and development	166,191	151,896	144,370
General and administrative	110,198	84,808	76,748
Amortization of other purchased intangible assets	23,972	12,670	13,159
Litigation loss provision, net	—	—	19,025
Total operating expenses	643,772	554,308	526,246
Income from operations	90,525	120,576	83,488
Other (expense) income, net	(4,802)	(5,657)	2,549
Income before income tax provision	85,723	114,919	86,037
Income tax provision	33,657	16,352	15,678
Net income	52,066	98,567	70,359
Net loss attributable to noncontrolling interest (including $8,237 increase of redeemable noncontrolling interest to redemption value)	(8,091)	—	—
Net income attributable to Quest Software, Inc.	$ 43,975	$ 98,567	$ 70,359
Net income per share attributable to Quest Software, Inc. stockholders:			
Basic	$ 0.50	$ 1.09	$ 0.77
Diluted	$ 0.49	$ 1.06	$ 0.75
Weighted–average common shares outstanding:			
Basic	87,104	90,411	91,926
Diluted	88,992	93,282	94,066

The accompanying notes are an integral part of these consolidated financial statements.

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QUEST SOFTWARE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EQUITY AND COMPREHENSIVE INCOME (LOSS)
(In thousands)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Quest Software, Inc. Stockholders' Equity	Noncontrolling Interest	Total Equity	Redeemable Noncontrolling Interest
	Shares	Amount							
BALANCE, December 31, 2008	94,298	$ 94	$ 740,887	$ 132,771	$ —	$ 873,752	$ —	$ 873,752	$ —
Common stock issued under stock-based compensation plans	3,752	4	43,260	—	—	43,264	—	43,264	—
Net tax benefit related to stock-based compensation	—	—	4,867	—	—	4,867	—	4,867	—
Repurchase of common stock	(7,848)	(8)	(111,009)	—	—	(111,017)	—	(111,017)	—
Fees related to the repurchase of common stock	—	—	(1,431)	—	—	(1,431)	—	(1,431)	—
Cash settlement of equity based awards	—	—	(1,268)	—	—	(1,268)	—	(1,268)	—
Compensation expense associated with stock-based payments	—	—	14,079	—	—	14,079	—	14,079	—
Comprehensive Income:									—
Unrealized loss on available-for-sale securities, net of tax	—	—	—	—	(9)	(9)	—	(9)	—
Unrealized gain on foreign currency hedges, net of tax	—	—	—	—	196	196	—	196	—
Net income	—	—	—	70,359	—	70,359	—	70,359	—
Comprehensive income	—	—	—	—	—	70,546	—	70,546	—
BALANCE, December 31, 2009	90,202	90	689,385	203,130	187	892,792	—	892,792	—
Common stock issued under stock-based compensation plans	4,954	5	62,499	—	—	62,504	—	62,504	—
Net tax deficiency related to stock-based compensation	—	—	(3,071)	—	—	(3,071)	—	(3,071)	—
Repurchase of common stock	(2,263)	(2)	(37,361)	—	—	(37,363)	—	(37,363)	—
Fees related to the repurchase of common stock	—	—	(9)	—	—	(9)	—	(9)	—
Cash settlement of equity based awards	—	—	(3,421)	—	—	(3,421)	—	(3,421)	—
Compensation expense associated with stock-based payments	—	—	21,618	—	—	21,618	—	21,618	—
Comprehensive Income:							—		—
Unrealized gain on available-for-sale securities, net of tax	—	—	—	—	290	290	—	290	—
Unrealized gain on foreign currency hedges, net of tax	—	—	—	—	359	359	—	359	—
Net income	—	—	—	98,567	—	98,567	—	98,567	—
Comprehensive income	—	—	—	—	—	99,216	—	99,216	—
BALANCE, December 31, 2010	92,893	93	729,640	301,697	836	1,032,266	—	1,032,266	—
Common stock issued under stock-based compensation plans	2,183	2	32,305	—	—	32,307	—	32,307	—
Repurchase of common stock	(11,928)	(12)	(261,516)	—	—	(261,528)	—	(261,528)	—
Fees related to the repurchase of common stock	—	—	(239)	—	—	(239)	—	(239)	—
Cash settlement of equity based awards	—	—	(3,161)	—	—	(3,161)	—	(3,161)	—
Compensation expense associated with stock-based payments	—	—	24,624	—	—	24,624	—	24,624	—
Noncontrolling interest assumed related to acquisition	—	—	—	—	—	—	13,022	13,022	13,836
Comprehensive Income:									
Unrealized loss on available-for-sale securities, net of tax	—	—	—	—	(315)	(315)	—	(315)	—
Unrealized loss on foreign currency hedges, net of tax	—	—	—	—	(729)	(729)	—	(729)	—
Net loss attributable to noncontrolling interest	—	—	—	—	—	—	(73)	(73)	8,164
Net income attributable to Quest Software, Inc.	—	—	—	43,975	—	43,975	—	43,975	—
Comprehensive income (loss)	—	—	—	—	—	42,931	(73)	42,858	8,164
BALANCE, December 31, 2011	83,148	$ 83	$ 521,653	$345,672	$ (208)	$ 867,200	$ 12,949	$ 880,149	$ 22,000

The accompanying notes are an integral part of these consolidated financial statements.

QUEST SOFTWARE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended December 31 2011	2010	2009
Cash flows from operating activities:			
Net income	$ 52,066	$ 98,567	$ 70,359
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	54,279	43,031	47,973
Compensation expense associated with stock-based payments	25,269	23,101	15,178
Unrealized foreign currency losses (gains), net	4,217	1,963	2,282
Change in fair value of contingent consideration	(7,819)	2,500	—
Deferred income taxes	4,426	6,286	2,376
Impairment losses on intangible assets	8,951	—	—
Excess tax benefit related to stock-based compensation	(2,108)	(1,582)	(1,825)
Other non-cash adjustments, net	2,080	1,566	(310)
Changes in operating assets and liabilities, net of effects of acquisitions:			
Accounts receivable	(6,231)	(21,467)	5,484
Prepaid expenses and other current assets	(4,865)	4,429	(1,033)
Other assets	1,817	2,038	(682)
Accounts payable	1,545	1,183	(375)
Accrued compensation	(12,255)	4,267	(3,724)
Other accrued expenses	6,076	(902)	(11,164)
Income taxes payable	24,169	(23,692)	(3,118)
Deferred revenue	50,065	48,520	33,426
Other liabilities	(6,647)	(2,130)	2,825
Net cash provided by operating activities	195,035	187,678	157,672
Cash flows from investing activities:			
Purchases of property and equipment	(29,718)	(13,731)	(11,286)
Cash paid for acquisitions, net of cash acquired	(220,002)	(58,734)	(12,253)
Change in restricted cash	(4,940)	587	1,494
Cash paid for software rights	—	(2,229)	—
Notes receivable from a cost method investee	—	(2,000)	—
Change in notes receivable	(4,250)	(300)	—
Cash paid for intellectual property	(1,559)	—	—
Contributions on equity method investment	(920)	—	—
Purchases of cost method investments	(31,523)	—	(3,000)
Purchases of investment securities	(28,346)	(226,201)	(47,853)
Sales and maturities of investment securities	101,389	186,157	2,814
Net cash used in investing activities	(219,869)	(116,451)	(70,084)
Cash flows from financing activities:			
Proceeds from loans payable	91,000	—	68,428
Repayment of loans payable	(521)	(32,653)	(2,534)
Repurchase of common stock	(261,767)	(37,363)	(112,447)
Repayment of capital lease obligations	(326)	(245)	(263)
Cash paid for line of credit fees	(500)	—	(1,979)
Proceeds from the exercise of stock options	32,435	62,504	43,264
Excess tax benefit related to stock-based compensation	2,108	1,582	1,825
Net cash used in financing activities	(137,571)	(6,175)	(3,706)
Effect of exchange rate changes on cash and cash equivalents	(1,963)	(1,459)	(6,837)
Net increase (decrease) in cash and cash equivalents	(164,368)	63,593	77,045
Cash and cash equivalents, beginning of period	356,533	292,940	215,895
Cash and cash equivalents, end of period	$ 192,165	$ 356,533	$ 292,940
Supplemental disclosures of consolidated cash flow information:			
Cash paid for interest	$ 3,056	$ 3,305	$ 3,746
Cash paid for income taxes	$ 1,096	$ 32,988	$ 15,077
Supplemental schedule of non-cash investing and financing activities:			
Unrealized (loss) gain on available-for-sale securities, net of tax	$ (315)	$ 290	$ (9)
Unrealized (loss) gain on foreign currency contracts	$ (729)	$ 359	$ 196
Contingent consideration related to acquisitions	$ 3,086	$ 2,015	$ 4,000
Unpaid purchases of property and equipment	$ 3,180	$ 1,382	$ 1,081

The accompanying notes are an integral part of these consolidated financial statements.

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QUEST SOFTWARE, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Financial Statement Presentation

Quest Software, Inc. was incorporated in California in 1987 and reincorporated in Delaware in 2009. We are a leading developer and vendor of enterprise systems management software products. We also provide consulting, training, and support services to our customers. We have wholly-owned research and development subsidiaries and sales subsidiaries for marketing, distribution, and support of our products and services in the United States and abroad. References to "Quest," "Quest Software," the "Company," "we," "us," or "our" refer to Quest Software, Inc. and its consolidated subsidiaries.

The accompanying consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") and include our accounts and those of our majority owned subsidiaries. Intercompany transactions are eliminated. We present noncontrolling interest within the equity section in our consolidated balance sheets. Noncontrolling interest that is redeemable at the option of the minority shareholder is presented outside of permanent equity. As such, the redeemable noncontrolling interest is reported in the mezzanine section as temporary equity in our consolidated balance sheets. We present the amount of consolidated net income that is attributable to Quest Software, Inc. and the noncontrolling interest in our consolidated income statements. Furthermore, we disclose the amount of comprehensive income that is attributable to Quest Software, Inc. and the noncontrolling interest in our consolidated statements of equity and comprehensive income.

Impact of Change in Statement of Cash Flows Presentation to Prior Periods

We maintain positions in certain foreign currencies which may at times create unrealized gains or losses. Unrealized foreign currency gains/losses should be presented as an adjustment to reconcile net income to net cash provided by operating activities in our consolidated statement of cash flows. Effective during the third quarter of 2011, we presented such unrealized foreign currency gains/losses in our consolidated statement of cash flows. This change impacts our cash flow presentation and does not impact earnings or cash balances. Management has concluded that this change of presentation is not material to any periods affected. The following represents the details of the impact to previously reported statement of cash flows to conform to the current year presentation.

	Year Ended December 31, 2010			Year Ended December 31, 2009		
	As Previously Reported	As Adjusted	Impact	As Previously Reported	As Adjusted	Impact
Unrealized foreign currency losses, net	$ —	$ 1,963	$ 1,963	$ —	$ 2,282	$ 2,282
Changes in operating assets and liabilities, net of effects of acquisitions	11,840	12,246	406	19,535	21,639	2,104
Net cash provided by operating activities	185,309	187,678	2,369	153,286	157,672	4,386
Effect of exchange rate changes in cash and cash equivalents	910	(1,459)	(2,369)	(2,451)	(6,837)	(4,386)
Net impact to cash and cash equivalents			$ —			$ —

The adjusted consolidated statement of cash flows for the periods ended March 31, 2011 and June 30, 2011 will be presented as comparative financial statements in our filing of Form 10-Q for the quarterly period ended March 31, 2012 and June 30, 2012.

Tax Adjustment Related to Prior Periods

During the 2010 year-end close process, we discovered that approximately $6.8 million in tax reserves should have been released in prior periods upon the lapsing of statutes of limitations in federal taxing jurisdictions. The release of these tax reserves would have resulted in higher net income and earnings per share than previously reported for the prior interim periods and the year ended December 31, 2009. In 2010, we recorded a year-end adjustment of $6.8 million and management has concluded that this correction is not material to any periods affected. The impact of the year-end adjustment for the three months and twelve months ended December 31, 2010 was an increase in net income of $6.8 million and an increase in diluted earnings per share of $0.07. The impact to prior interim periods for the income statement would have been an increase in net income of $2.1 million, $0.1 million and $4.6 million for the three months ended September 30, 2010, December 31, 2009 and September 30, 2009, respectively and an increase in diluted earnings per share of $0.02, $— and $0.05 for the three months ended September 30, 2010, December 31, 2009 and September 30, 2009, respectively. The impact to fiscal year 2009 would have been an increase in net income of $4.7 million and an increase in diluted earnings per share of $0.05 for the twelve months ended December 31, 2009. The impact to prior periods for the balance sheet would have been a decrease in non-current deferred income taxes of $1.0 million and a decrease in long-term income taxes payable of $7.8 million as of September 30, 2010, a decrease in non-current deferred income taxes of $0.7 million and a decrease in long-term income taxes payable of $5.4 million as of December 31, 2009, and a decrease in non-current deferred income taxes of $0.7 million and a decrease in long-term income taxes payable of $5.3 million as of September 30, 2009, respectively.

QUEST SOFTWARE, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Use of Estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

New Accounting Pronouncements

In January 2010, the FASB issued an amendment regarding improving disclosures about fair value measurements. This new guidance requires some new disclosures and clarifies some existing disclosure requirements about fair value measurement. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. There was no impact from the adoption of this guidance to our consolidated financial position or results of operations as the amendment only addresses disclosures.

In December 2010, the FASB issued an amendment to goodwill impairment testing. The amendment modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that impairment may exist. The qualitative factors are consistent with the existing guidance and examples, which require that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. Early adoption was not permitted. There was no impact from our adoption of this guidance since we do not have any reporting units with zero or negative carrying amounts.

In December 2010, the FASB issued an amendment to the disclosure of supplementary pro forma information for business combinations. The amendments in this ASU specify that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The amendments also expand the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The amendments are effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. Early adoption is permitted; but was not elected. There was no impact from our adoption of this guidance since the acquisitions in 2011 individually, or in the aggregate, were not material, and therefore supplementary pro forma information are not presented for the years ended December 31, 2011 and 2010.

In May 2011, the FASB issued amendments to its accounting guidance on fair value measurement. The amendments provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. The amendments change certain fair value measurement principles and enhance the disclosure requirements about fair value measurements. This guidance is effective during interim and annual periods beginning after December 15, 2011 and should be applied prospectively. We do not anticipate a material impact to our consolidated financial statements upon adoption of this guidance.

QUEST SOFTWARE, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

In June 2011, the FASB issued amendments to its accounting guidance on comprehensive income. The amendments require an entity to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The amendments eliminate the option to present the components of other comprehensive income as part of the statement of equity. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. We do not anticipate a material impact to our consolidated financial statements upon adoption of this guidance. In December 2011, the FASB issued amendments to defer the presentation on the face of the financial statements the reclassification adjustments out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented.

In September 2011, the FASB issued amendments to its accounting guidance on testing goodwill for impairment. The amendments allow entities to use a qualitative approach to test goodwill for impairment. This permits an entity to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that it is more likely than not that the fair value of a reporting unit is less than its carrying value, it is necessary to perform the currently prescribed two-step goodwill impairment test. Otherwise, the two-step goodwill impairment test is not required. This guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011 and early adoption is permitted. We have not determined if we will perform this qualitative assessment in 2012.

Cash Equivalents and Investments

We consider highly liquid investments with original maturities of three months or less at the date of purchase to be cash equivalents. Cash equivalents consist primarily of AAA-rated money market funds in all periods presented. Investments consist of available-for-sale or trading securities as defined in *Accounting for Certain Investments in Debt and Equity Securities*. These investments are recorded at fair value and are classified as investments in the accompanying consolidated balance sheets. The changes in fair values on trading securities are recorded as a component of Other (expense) income, net. The changes in fair values, net of applicable taxes, on available-for-sale investment securities are recorded as unrealized gains (losses) as a component of accumulated other comprehensive income in stockholders' equity. Realized gains and losses and declines in value judged to be other-than-temporary on available-for-sale securities are included in Other (expense) income, net. The cost basis for realized gains and losses on available-for-sale securities is determined on a specific identification basis. Investments are made based on our investment policy which restricts the types of investments that can be made. We have classified available-for-sale and trading securities as short-term or long-term based primarily on the maturity date of the related securities.

Concentration of Credit Risk

Financial instruments that potentially subject us to credit risk include cash and cash equivalents, investments and accounts receivable. We believe that credit risks related to our investment portfolio are moderated by limitations we place on our exposure to any one issuer and credit risks on accounts receivable are moderated by the diversity of our products, customers and geographic sales areas. We monitor extensions of credit and have not experienced significant credit losses in the past. We maintain an allowance both for bad debts and for sales returns and cancellations and such losses and returns have historically been within management's expectations. No single customer accounted for 10% or more of our total revenues or accounts receivable for the years ended December 31, 2011, 2010 or 2009.

Allowances for Doubtful Accounts and Returns

We record allowances for doubtful accounts based upon a specific review of significant outstanding invoices and/or our historical write-off experience. We also record an allowance for estimated sales returns and cancellations on product and service-related sales in accordance with GAAP. These estimates are based on historical sales returns and other known factors.

Other Assets

The following table summarizes our other assets by asset type at the dates indicated (in thousands):

	December 31	
Asset Type	2011	2010
Cost method investments	$ 46,072	$ 14,304
Income taxes receivable	828	2,092
Lease security deposits	3,223	2,678
Non-current restricted cash (1)	2,477	1,040
Other	3,027	1,729
Total Other Assets	$ 55,627	$ 21,843

(1) As of December 31, 2011, this relates primarily to holdback arrangements designated in relation to certain acquired companies during the year. As of December 31, 2010, this is primarily cash restricted as a condition to certain non-US facility leases.

QUEST SOFTWARE, INC. AND SUBSIDIARIES
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Cost method investments are investments made in non-consolidated companies accounted for under the cost method given that we do not have the ability to exercise significant influence over these companies' operations. These investments were made in early stage private companies and private equity funds for business and strategic purposes. We may make additional investments of this nature in the future. We periodically monitor our investments for impairment and will record reductions in carrying values if and when necessary. The evaluation process is based on information that we request from these privately-held companies. This information is not subject to the same disclosure regulations as U.S. public companies and, as such, the basis for these evaluations is subject to the timing and the accuracy of the data received from these companies. As part of this evaluation process, our review includes but is not limited to a review of each company's cash position, recent financing activities, financing needs, earnings and revenue outlook, operational performance, management or ownership changes, and impacts from competitive pressures to the extent that we have access to such information. If we were to subsequently determine that the carrying value of our investment in a company is at an amount above fair value, an adjustment will be made in that corresponding period resulting in a charge against earnings for the write-down.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are provided using the straight-line method over the following estimated useful lives:

	Years
Building	30
Furniture and fixtures	7
Machinery and equipment	7
Computer equipment	3-5
Computer software	3-7

Leasehold improvements are amortized over the shorter of the estimated useful lives of the improvements or the term of the related lease. Repair and maintenance costs associated with property, equipment and leasehold improvements are expensed as incurred.

Software licenses are recorded at cost and are amortized over the shorter of the estimated useful lives of the related products or the term of the license, generally three years.

We capitalize external direct costs of materials and services used in developing or obtaining internal-use computer software and amortize these costs using the straight-line method over the estimated useful life of the software, which range from 3 to 7 years. Costs of significant upgrades and enhancements that result in additional functionality are also capitalized, whereas costs incurred for maintenance and minor upgrades and enhancements are expensed as incurred.

Business Acquisitions and Related Intangible Assets

For business acquisitions, we recognize separately from goodwill the identifiable assets acquired, the liabilities assumed, and any noncontrolling interests in an acquiree, which are measured at the acquisition date fair value. We use significant estimates and assumptions, including fair value estimates, as of the business combination date and refine those estimates that are provisional, as necessary, during the measurement period. The measurement period is the period after the acquisition date, not to exceed one year, in which we may gather new information about facts and circumstances that existed as of the acquisition date to adjust the provisional amounts recognized. Measurement period adjustments are applied retrospectively. All other adjustments are recorded to the income statement. Costs to effect an acquisition are recorded in general and administrative expenses on the consolidated income statements as the expenses are incurred.

Goodwill arising from acquisitions is measured as the excess of consideration transferred over the net amounts of the identifiable assets acquired and the liabilities assumed at the acquisition date. We test goodwill for impairment at the reporting unit level on an annual basis in the fourth quarter or more frequently if we believe indicators of impairment exist. The carrying amount of goodwill was considered recoverable at December 31, 2011, based on the results of our goodwill impairment evaluation performed in the fourth quarter of 2011. As of December 31, 2011, the fair values of goodwill were substantially in excess of the carrying amounts of goodwill for all our reporting units.

QUEST SOFTWARE, INC. AND SUBSIDIARIES
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Intangible assets are recorded at the estimated fair value of acquired technology, in-process research and development ("IPR&D"), customer relationships, non-compete agreements, trademarks and trade names acquired and amortized using the straight-line method over estimated useful lives. The estimated useful lives of the intangible assets being amortized range from two to fifteen years. The estimated fair values of trade names associated with ScriptLogic Corporation ("ScriptLogic") acquired in 2007 and PacketTrap Networks, Inc. acquired in 2009 were assigned indefinite useful lives and are not being amortized. During the fourth quarter of 2011, the trade name related to ScriptLogic became impaired due to the integration and branding of ScriptLogic products with Quest products (please refer to Note 6 – Goodwill and Intangibles Assets, Net for more details on impairment of intangible assets). Accumulated amortization of intangible assets was $251.9 million and $203.6 million at December 31, 2011 and 2010, respectively.

Noncontrolling Interest

The noncontrolling interest in a subsidiary is initially recognized at estimated fair value on acquisition date and is presented within total equity in our consolidated balance sheets. We track the carrying amount of noncontrolling interest at acquisition-date fair value plus an allocation of subsidiary earnings based on ownership interest. Noncontrolling interest that has redemption features outside our control is accounted for as redeemable noncontrolling interest and is recorded as temporary equity. Noncontrolling interest that is redeemable at other than fair value is recorded at the higher of its carrying amount or redemption value if the shareholders were to exercise their put right. The adjustment to the carrying amount of the redeemable noncontrolling interest to the redemption value is recorded in net income attributable to the noncontrolling interest, thereby directly affecting net income attributable to Quest Software, Inc. Net income per share is calculated based on net income attributable to Quest Software, Inc. stockholders. Acquisitions of redeemable noncontrolling interests are treated as equity transactions.

Long-Lived Assets

Long-lived assets to be held and used are reviewed for events or changes in circumstances, which indicate that their carrying value may not be recoverable. We periodically review the carrying value of long-lived assets to determine whether or not impairment to such value has occurred.

Derivative Instruments

Foreign Exchange Risk Management Policy

In 2009, our Board of Directors approved our Foreign Exchange Risk Management Policy. The policy identifies target exposures such as balance sheet, cash flow and income statement risks, program objectives, approved financial instruments and counterparties, accounting and tax treatment, as well as oversight, reporting and controls. The functional currency of all our subsidiaries is the U.S. Dollar. Our exposure to foreign exchange risk is composed of the combination of our foreign operations' revenues and cash expenses denominated in currencies other than the U.S. Dollar, as well as our net balances of monetary assets and liabilities within our foreign subsidiaries. These exposures have the potential to produce either gains or losses depending on the directional movement of the foreign currencies versus the U.S. Dollar and our operational profile in foreign subsidiaries. Certain balance sheet items are re-measured each period and the changes in value are recorded within Other (expense) income, net.

FASB's authoritative guidance on derivative instruments and hedging activities requires that we recognize all derivative instruments on the balance sheet at fair value. If certain conditions are met, hedge accounting may be applied and the derivative instrument may be specifically designated as: (a) a hedge of the exposure to changes in the fair value of a recognized asset or liability or unrecognized firm commitment, referred to as a *fair value hedge*, or (b) a hedge of the exposure to the variability of cash flows of a recognized asset, liability or forecasted transaction, referred to as a *cash flow hedge*, or (c) a hedge of the foreign currency exposure of an unrecognized firm commitment, a recognized asset or liability, a forecasted transaction or a net investment in a foreign operation, referred to as a *foreign currency hedge.*

In the case of a qualifying cash flow hedge, changes in the value of the derivative instruments that are highly effective are recognized in Accumulated other comprehensive income ("AOCI") on the consolidated balance sheets, until the hedged item is recognized in the consolidated income statements. The ineffective portion of a derivative's change in fair value is recognized through the consolidated income statements. Upon the occasional termination of a cash flow hedge, the remaining cost of that hedge is amortized over the remaining life of the hedged item in proportion to the change in the hedged forecasted transaction. We have derivatives in place to hedge the exposure to the variability in future cash flows for revenues and forecasted research and development cash expenses. We formally document all qualifying hedge relationships, as well as our risk management objective and strategy for undertaking each hedge transaction. Derivatives that are non-designated hedges are adjusted to fair value through the consolidated income statements. Quest does not use derivative instruments for speculative purposes. Please refer to Note 15 – Derivative Instruments for a full description of our derivative activities.

Fair Value of Financial Instruments

The carrying amounts of our financial instruments including cash and cash equivalents, investments in available-for-sale and trading securities, accounts receivable, derivatives, accounts payable, accrued liabilities and loans payable approximate their respective fair values because of the relatively short period of time between origination of the instruments and their expected realization or liquidation, or because they are carried at fair value. We measure fair value based on applicable accounting guidance. The guidance defines fair value measurements, establishes a framework for measuring fair value and outlines a fair value hierarchy based on the inputs to valuation techniques used to measure fair value. The standard categorizes the inputs to valuation techniques into a three-level hierarchy based on the extent to which the measurement relies on observable market inputs in measuring fair value. Assets and liabilities are classified within this hierarchy in their entirety based on the lowest level of any input that is significant to the fair value measurement. Financial instruments carried at fair value under Level 1 include inputs based on unadjusted quoted prices in active markets for those identical financial instruments. The financial instruments recorded under Level 2 are valued primarily utilizing inputs or prices that are observable in the marketplace, can be derived from observable market data or corroborated by observable levels at which transactions are executed. Because financial instruments classified as Level 3 are generally based on unobservable inputs, the process to determine fair value is generally more subjective and involves management judgment and assumptions. These assumptions may have a significant effect on our estimates of fair value, and the use of different assumptions as well as changes in market conditions could have a material effect on our results of operations or financial condition.

Please refer to Note 16 – Fair Value Measurements for further information, including the classification within the three-level hierarchy of all of our assets and liabilities carried in our consolidated balance sheets at fair value.

Revenue Recognition

We derive revenues from three primary sources: (1) software licenses, (2) maintenance and support services and (3) professional services. We recognize revenue in accordance with FASB's authoritative guidance on software revenue recognition.

Before revenue can be recognized all of the following criteria must be satisfied:

(1) Persuasive evidence of an arrangement exists – including a written contract signed by both the end customer and Quest.

(2) Delivery has occurred – when all product and/or service that is essential to the functionality is delivered to the end customer.

(3) The fee is fixed or determinable – when we have a signed contract that states the agreed upon fee for our product and/or service and specifies the related terms and conditions that govern that arrangement, and is free of material contingencies or significant uncertainty.

(4) Collection is probable – assessed based on the probability of collection on a customer-by-customer basis based on payment history and our evaluation of the customer's financial position.

We license our products primarily through our direct sales force, our telesales force and indirect channels including value added resellers and distributors. For our direct sales, we utilize written contracts as the means to establish the terms and conditions upon which our products and services are sold to our end customers. For our indirect sales transactions, we accept orders from our resellers and distributors when they have existing orders from an end customer. Indirect sales through resellers are a growing proportion of our transaction volume. These transactions are generally handled via processes and policies that are similar to an end customer sale. We utilize written contracts coupled with purchase orders as the means to establish the terms and conditions of these indirect sales transactions. We recognize revenue from reseller and distributor transactions upon invoicing the order provided all other revenue recognition criteria have been met.

For those customers that have established a history of consistent, timely cash collection with us, we accept orders and simultaneously recognize revenue. For those customers that have not established a history of consistent, timely cash collection with us, we accept orders and defer revenue until cash collection occurs. The probability of collection criteria per GAAP is applied to each individual customer rather than to all direct sales or indirect sales in aggregate.

Most of our software products are "off the shelf" products that do not require customization. We initially capture value for our products by selling a software license to end customers. The fee for the first year of maintenance is included in, or bundled with, the perpetual software license at the time of initial sale. As such, the combination at initial sale of a perpetual software license and one year of maintenance services represents a "multiple-element" arrangement for revenue recognition purposes.

QUEST SOFTWARE, INC. AND SUBSIDIARIES
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We account for the perpetual software license component of these multiple-element arrangements using the residual method, which requires recognition of the perpetual software license revenue once all software products have been delivered to the end customer and the only undelivered element is maintenance and professional services, if applicable. The value of the undelivered elements is determined based on vendor-specific objective evidence ("VSOE") of fair value and is deferred. The residual value, after allocation of the fee to the undelivered elements based on VSOE of fair value, is then allocated to the perpetual software license for the software products being sold.

Our maintenance services VSOE of fair value is determined by reference to the prices our customers pay for this support when it is sold separately; that is, when we enter into an arms-length, annual renewal transaction with customers where the only offering sold is maintenance. These standalone maintenance renewal transactions are typically for one year in duration and are priced as a targeted percentage of the initial, discounted purchase price. We bill these renewal transactions in advance of the services provided. We also sometimes offer customers the right to purchase maintenance for multiple annual periods beyond the first year. Revenue for our standalone sale of annual maintenance renewals in years two, three and beyond is recognized ratably over the support term. Sales of maintenance for multiple annual periods are treated similarly.

Our professional services VSOE of fair value is determined by reference to our established pricing and discounting practices for these services when sold separately. Our professional services are typically sold as time-and-materials based contracts that average approximately fifteen days in duration. Revenue from professional services is generally recognized as the services are performed in accordance with the underlying service contracts.

If we cannot objectively determine the fair value of any undelivered element (hardware, software, specific upgrade rights, etc.) in a bundled software and services arrangement, we defer revenue until all elements are delivered and services are performed, or until fair value can be objectively determined based on VSOE of fair value for any remaining undelivered elements.

In addition to perpetual software licenses, we sell a small amount of time-based software licenses (or term licenses) each year wherein customers pay a single fee for the right to use the software and receive maintenance for a defined period of time. Approximately 6% of our 2011 license revenue was generated by these time-based software licenses. All license and maintenance revenues on these term licenses are recognized ratably over the license term.

There are numerous factors that can affect our assessment of whether the revenue recognition criteria are satisfied. For example:

- An arrangement with governing terms and conditions that extend payment terms beyond our customary and historical practices may indicate that collection is not probable. We assess whether fees are fixed or determinable at the time of sale and recognize revenue if all other requirements have been met. Our standard payment terms are 30 days but may vary based on the country in which the agreement is executed. We generally deem payments that are due within 6 months to be fixed and determinable based on collections history and thereby satisfy the required revenue recognition criterion.
- An arrangement with a contractual clause indicating the transaction is contingent on the end customer's "satisfaction with and acceptance of" the product may yield a conclusion that the fee is not yet fixed or determinable. Substantially all of our software license arrangements do not include acceptance provisions. Since such acceptance provisions are not contained in our software license arrangements as standard provisions and the incidence of returns in accordance with such acceptance provisions cannot be reasonably estimated, if a contract does include such a provision we recognize revenue upon the earlier of receipt of written customer acceptance or expiration of the acceptance period.
- We evaluate arrangements with governmental entities containing "fiscal funding" or "termination for convenience" provisions, when such provisions are required by law, to determine the probability of possible cancellation. We consider multiple factors, including the history with the customer in similar transactions, and the planning, budgeting and approval processes undertaken by the governmental entity. If we determine upon execution of these arrangements that the likelihood of cancellation is not likely, we then recognize revenue once all of the criteria described above have been met. If such a determination cannot be made, revenue is recognized upon the earlier of cash receipt or approval of the applicable funding provision by the governmental entity.

Our product return policy is reflected in our standard form license, maintenance and/or service agreements for end customers as well as for resellers and distributors. These agreements do not typically or expressly provide for product returns and cancellations as a matter of right. Quest maintains an allowance for sales returns and cancellations to cover the circumstances where the company accepts returns or cancellations on a discretionary basis even though not contractually obligated to do so. This allowance is intended only as an estimate of customer payment obligations associated with enforceable contracts for the delivery of products or services, which based on our history, we do not expect to collect.

QUEST SOFTWARE, INC. AND SUBSIDIARIES
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We analyze various factors including our historical experience, the credit-worthiness of our customers, accounts receivable aging data, contractual terms and conditions and our current analysis of the collectability of accounts receivable in helping us make judgments about the level of allowances to hold for sales returns and cancellations. Changes in judgments on any of these factors could materially impact the timing and amount of revenue and costs recognized.

We recognize channel rebates in accordance with GAAP. The rebates provided to those who distribute our products are recorded as an offset to revenue as they are considered adjustments of the selling price of our products during the period of the corresponding order.

We also recognize some revenue on sales of multiple-element arrangements that include hardware and a combination of software, maintenance and professional services. We recognize revenue related to the nonessential software elements in accordance with the FASB's software revenue guidance. The remaining elements are excluded from the scope of software revenue guidance and revenue is recognized in accordance with the applicable guidance from the FASB.

Uncollected Deferred Revenue

Because of our revenue recognition policies, there are circumstances for which we are unable to recognize revenue relating to sales transactions that have been billed to customers where uncertainty exists regarding their ability to pay, and the related account receivable has not been collected. While the receivable represents an enforceable obligation, for balance sheet presentation purposes we have offset the deferred revenue with the related account receivable and no amounts appear in our consolidated balance sheets for such transactions. The aggregate amount of unrecognized accounts receivable and deferred revenue was $29.0 million and $33.0 million at December 31, 2011 and 2010, respectively.

Software Development Costs

Costs incurred in the research and development of new software products and enhancements to existing software products are expensed as incurred until technological feasibility has been established. After technological feasibility is established, any additional costs are capitalized in accordance with FASB's authoritative guidance on *Accounting for the Costs of Computer Software to Be Sold, Leased or Otherwise Marketed* until the product is available for general release. Because our current process for developing software is essentially completed concurrently with the establishment of technological feasibility, no software development costs have been capitalized as of December 31, 2011 and 2010.

Advertising Expenses

We expense all advertising costs as incurred, and such costs were $9.4 million, $5.9 million and $4.5 million for the years ended December 31, 2011, 2010 and 2009, respectively. Advertising expenses are recorded within our operating expenses in our consolidated income statements.

Foreign Currency Translation

In accordance with FASB's authoritative guidance on *Foreign Currency Translation,* the U.S. Dollar is considered to be the functional currency for each of our foreign subsidiaries, as such subsidiaries act primarily as an extension of our parent company's operations. The determination of functional currency is primarily based on the subsidiaries' relative financial and operational dependence on the parent company. Assets and liabilities in these subsidiaries are re-measured at current exchange rates, except for property and equipment, intangible assets, goodwill and deferred revenue, which are translated at historical exchange rates. Revenues and expenses are re-measured at average exchange rates in effect during the year except for revenues and costs related to the above mentioned balance sheet items which are translated at historical rates. Foreign currency gains and losses are included in Other (expense) income, net in the consolidated income statements. There was a net foreign currency (loss) gain of $(4.3) million, $(3.2) million and $3.6 million for the years ended December 31, 2011, 2010 and 2009, respectively.

Income Taxes

Income taxes are accounted for under the asset and liability method in accordance with FASB's authoritative guidance on *Accounting for Income Taxes.* Deferred tax assets and liabilities are recognized for 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 carry-forwards. 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. We provide valuation allowances against the net deferred tax asset for amounts that are not considered more likely than not to be realized (Please refer to Note 10 – Income Taxes for disclosure of amounts related to deferred taxes and associated valuation allowances).

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In accordance with FASBs guidance on *Accounting for Uncertainty in Income Taxes*, we perform a comprehensive review of our portfolio of uncertain tax positions regularly. In this regard, an uncertain tax position represents our expected treatment of a tax position taken in a filed tax return, or planned to be taken in a future tax return or claim, which has not been reflected in measuring income tax expense for financial reporting purposes. Until these positions are sustained by the taxing authorities, we have not recognized the tax benefits resulting from such positions and report the tax effects as a liability for uncertain tax positions in our consolidated balance sheets.

Taxes Collected from Customers and Remitted to Governmental Authorities

We present taxes collected from customers and remitted to governmental authorities in accordance with the guidance on *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation),* on a net basis.

Net Income Per Share Attributable to Quest Software, Inc. Stockholders

Basic net income per share is computed by dividing net income attributable to Quest Software Inc. stockholders by the weighted-average number of common shares outstanding for the period. Diluted net income per share reflects the potential dilution of securities by including other common stock equivalents, including stock options and restricted stock units, in the weighted–average number of common shares outstanding for a period, if dilutive.

The table below sets forth the reconciliation of the denominator of the net income per share attributable to Quest Software, inc. stockholders (in thousands):

	Year Ended December 31		
	2011	2010	2009
Shares used in computing basic net income per share	87,104	90,411	91,926
Dilutive effect of stock options and restricted stock units [1]	1,888	2,871	2,140
Shares used in computing diluted net income per share	88,992	93,282	94,066

(1) Options to purchase 6,741, 6,524 and 6,314 shares of common stock were outstanding during 2011, 2010 and 2009, respectively, but were not included in the computation of diluted net income per share as inclusion would have been anti-dilutive.

Stock-Based Compensation

We account for stock-based compensation using the fair value recognition provisions under GAAP. We estimate the fair value of stock options granted using a Black Scholes option valuation model and a single option award approach. We use historical data to estimate pre-vesting option forfeitures and record stock-based compensation expense only for those awards that are expected to vest. We amortize the fair value of stock options on a straight-line basis over the requisite service periods of the awards, which are generally the vesting periods. We value restricted stock units granted based on the market price of our common stock on the date of the grant. We amortize the value of restricted stock units on a straight-line basis over the restriction period. Please refer to Note 14 – Stock Based Compensation and Employee Benefit Plans for a description of our stock-based employee compensation plans and the assumptions we use to calculate the fair value of stock-based employee compensation.

NOTE 2 — ACQUISITIONS

2011 Acquisitions

BakBone Software Incorporated – In January 2011, we acquired 100 percent of the voting equity interest of BakBone Software Incorporated ("BakBone"), a publicly-held provider of data protection software, for cash consideration of approximately $56 million. BakBone provides us with additional technologies and products to provide data protection solutions across heterogeneous physical, virtual and application-level environments.

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The acquisition has been accounted for as a business combination and the purchase price was allocated primarily to goodwill and other intangible assets. Actual results of operations of BakBone are included in our consolidated financial statements from the date of acquisition. Our final allocation of the purchase price to assets and liabilities based upon fair value determinations was as follows (in thousands):

Current assets	$	12,479
Acquired technologies with a weighted average useful life of 5.2 years		24,500
In-process research and development		400
Customer relationships with a useful life of 4.0 years		11,300
Trademarks and trade names with a useful life of 10.0 years		1,800
Goodwill		18,690
Deferred income tax assets – non-current		9,872
Other non-current assets		2,419
Current liabilities		(6,328)
Deferred revenue – current		(9,383)
Deferred revenue – non-current		(9,491)
Other long-term liabilities		(278)
Total purchase price	$	55,980

The intangible assets will be amortized over the pattern in which the expected economic benefits of the intangible assets are realized, which in general is correlated with the cash flows generated from such assets. We acquired an in-process research and development ("IPR&D") project and the value assigned to the IPR&D was determined utilizing the income approach by determining cash flow projections relating to the project. We applied a discount rate of 28% to derive the value of the IPR&D project. The IPR&D project will be assessed for impairment until completed. Upon completion, the project will be amortized over its estimated useful life, as described above. The goodwill associated with this acquisition is reported within our Licenses, Maintenance Services and Professional Services segments of our business, and is not expected to be deductible for tax purposes. The goodwill allocation of 45% to Licenses, 52% to Maintenance Services and 3% to Professional Services is based on both historical and projected relative contribution from Licenses, Maintenance Services and Professional Services revenues. Goodwill results from expected synergies from the transaction, including complementary products that will enhance our overall product portfolio, and opportunities within new markets, which we believe will result in incremental revenue and profitability.

Smarsh, Inc. – In October 2011, we acquired a 60 percent voting equity interest in Smarsh, Inc. ("Smarsh"), a privately-held provider of secure and reliable email archiving solutions for message compliance and records retention, proactive litigation readiness, and mail server data management, for cash consideration of approximately $56 million. This acquisition was funded through our Wells Fargo line of credit. In connection with this acquisition, we obtained a right to purchase half of the 40 percent noncontrolling interest from the date of acquisition for a maximum redemption value of $26 million, and the minority shareholder was granted the right to require us to purchase half of the 40 percent noncontrolling interest, provided that we have not purchased any additional shares, from the first anniversary until the fifth anniversary of the acquisition date for a maximum redemption value of $22 million. This 20 percent noncontrolling interest is accounted for as redeemable noncontrolling interest because redemption is outside our control. As such, the redeemable noncontrolling interest is reported in the mezzanine section as temporary equity in our consolidated balance sheets. Furthermore, we have a right to acquire the remaining 20 percent noncontrolling interest for a purchase price to be determined by mutual agreement or by use of a third party valuation firm from the later of (1) the purchase of 20 percent noncontrolling interest per above and (2) the third anniversary of the acquisition date.

QUEST SOFTWARE, INC. AND SUBSIDIARIES
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The acquisition has been accounted for as a business combination and the purchase price was allocated primarily to goodwill, other intangible assets and noncontrolling interest. Actual results of operations of Smarsh are included in our consolidated financial statements from the date of acquisition. Our preliminary allocation of the purchase price to assets and liabilities based upon fair value determinations was as follows (in thousands):

Current assets	$ 6,974
Acquired technologies with a useful life of 5 years	12,000
In-process research and development	1,900
Customer relationships with a useful life of 15 years	26,000
Trade names with a useful life of 10 years	2,400
Goodwill	48,281
Other non-current assets	4,958
Current liabilities	(2,017)
Deferred income tax liabilities – non-current	18,040
Other long-term liabilities	(36)
Redeemable noncontrolling interest	(13,836)
Noncontrolling interest	(13,022)
Total purchase price	$55,562

The preliminary allocation of purchase price for Smarsh was based upon valuation information and estimates and assumptions available at the time of filing. Our estimates and assumptions are subject to change and preliminary valuations are often finalized after a reporting period. The areas of the purchase price allocation that are still not finalized and are subject to change within the measurement period relate to the valuation of certain intangible assets, income taxes and the resulting goodwill.

The intangible assets will be amortized over the pattern in which the expected economic benefits of the intangible assets are realized, which in general is correlated with the cash flows generated from such assets. We acquired an in-process research and development ("IPR&D") project and the value assigned to the IPR&D was determined utilizing the income approach by determining cash flow projections relating to the project. We applied a discount rate of 13% to derive the value of the IPR&D project. The IPR&D project will be assessed for impairment until completed. Upon completion, the project will be amortized over its estimated useful life, as described above. The goodwill associated with this acquisition is reported within our Maintenance Services segment of our business, and is not expected to be deductible for tax purposes. Goodwill results from expected synergies from the transaction, including complementary products that will enhance our overall product portfolio, and opportunities within new markets, which we believe will result in incremental revenue and profitability.

The fair value of the redeemable noncontrolling interest and noncontrolling interest at acquisition date of approximately $14 million and $13 million, respectively, were estimated by applying the market approach. This fair value measurement is based on significant inputs that are not observable in the market and thus represents a Level 3 inputs under accounting guidance for measuring fair value. Key assumptions include a discount rate of 13 percent because of the lack of control and adjustments because of the lack of marketability that market participants would consider when estimating the fair value of the noncontrolling interest.

Other Acquisitions – We completed six other acquisitions during the year ended December 31, 2011. These acquisitions have been accounted for as business combinations. The aggregate purchase price for these transactions was approximately $130 million. The allocation of purchase price was primarily to goodwill and other intangible assets for approximately $80 million and $50 million, respectively. Actual results of operations of these acquisitions are included in our consolidated financial statements from the effective dates of the acquisitions.

The 2011 acquisitions individually, or in the aggregate, are not material, and therefore supplemental pro forma information is not presented for the years ended December 31, 2011 and 2010.

2010 Acquisitions

Völcker Informatik AG – In July 2010, we acquired 100 percent of the voting equity interest of Germany-based Völcker Informatik AG ("Völcker"), a privately held identity management solutions provider, for cash consideration of approximately $20.2 million. The acquisition further extends the Quest® One Identity Solution product portfolio. In connection with the acquisition, Quest also agreed to certain post-closing payments with a maximum potential payout of approximately $5.0 million paid over three years, of which $2.5 million relates to an earn-out contingent upon achieving certain sales targets and the remainder to retention bonuses tied to continued employment. The estimated fair value of the earn-out contingency of $2.0 million has been recorded as an accrual, making the total purchase price approximately $22.2 million.

QUEST SOFTWARE, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The earn-out contingency requires payments of up to $2.5 million that will be due and payable if certain levels of revenues for Völcker products are met during the three-year period subsequent to the close of the acquisition. The fair value of the earn-out contingency was determined using the income approach with significant inputs that are not observable in the market. A key assumption is a discount rate consistent with our estimated pre-tax cost of debt. The expected outcomes were recorded at net present value. Subsequent changes in the fair value of the earn-out contingency will be recorded in earnings.

The acquisition has been accounted for as a business combination and the purchase price was allocated primarily to goodwill and other intangible assets. Actual results of operations of Völcker are included in our consolidated financial statements from the date of acquisition. Our final allocation of the purchase price to assets and liabilities based upon fair value determinations was as follows (in thousands).

Current assets	$	2,823
Acquired technologies with a useful life of 4.5 years		5,416
Customer relationships with a useful life of 4.5 years		3,401
Goodwill		13,930
Other non-current assets		490
Current liabilities		(1,246)
Deferred income tax liabilities – non-current		(2,645)
Total purchase price	$	22,169

The intangible assets will be amortized over the pattern in which the economic benefits of the intangible assets are being utilized, which in general reflects the cash flows generated from such assets. The goodwill associated with this acquisition is reported within our Licenses, Maintenance Services and Professional Services segments of our business, and is not expected to be deductible for tax purposes. The goodwill allocation of 50% to Licenses, 36% to Maintenance Services and 14% to Professional Services is based on both historical and projected relative contribution from Licenses, Maintenance Services and Professional Services revenues. Goodwill results from expected synergies from the transaction, including complementary products that will enhance our overall product portfolio, and opportunities within new markets, which we believe will result in incremental revenue and profitability.

Surgient, Inc. – In August 2010, we acquired 100 percent of the voting equity interest of Surgient, Inc. ("Surgient"), a privately held cloud management company for cash consideration of $35.0 million. The acquisition has been accounted for as a business combination and the purchase price was allocated primarily to goodwill and other intangible assets. Actual results of operations of Surgient are included in our consolidated financial statements from the date of acquisition. During the third quarter of 2011, as a result of finalizing our analysis of the Surgient pre-acquisition U.S. net operating loss carryovers and other deferred tax items, we recorded a purchase price adjustment that resulted in an increase of $6.1 million in goodwill and a decrease of $6.1 million in non-current deferred income tax assets. Management has concluded that this purchase price adjustment is not material and we did not revise comparative prior period information to reflect this adjustment. Our final allocation of the purchase price to assets and liabilities based upon fair value determinations was as follows (in thousands):

Current assets	$	789
Acquired technologies with a useful life of 3.5 years		1,030
In-process research and development		120
Customer relationships with a useful life of 3.5 years		1,240
Goodwill		26,011
Deferred income tax assets – non-current		9,178
Other non-current assets		1,271
Deferred revenue – current		(2,943)
Other current liabilities		(1,124)
Deferred revenue – non-current		(572)
Total purchase price	$	35,000

QUEST SOFTWARE, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The intangible assets are amortized over the pattern in which the economic benefits of the intangible assets are being utilized, which in general reflects the cash flows generated from such assets. We acquired one in-process research and development ("IPR&D") project. The value assigned to the IPR&D project was determined utilizing the income approach by determining cash flow projections relating to the project. We applied a discount rate of 12% to determine the value of the IPR&D project. During the third quarter of 2011, certain intangible assets became impaired due to change of plans for certain products that were to include these technology assets. The impairment losses of $1.6 million were recorded in Cost of revenues and Amortization of other purchased intangible assets for $0.8 million each.

The goodwill associated with this acquisition is reported within our Licenses, Maintenance Services and Professional Services segments of our business, and is not expected to be deductible for tax purposes. The goodwill allocation of 55% to Licenses, 37% to Maintenance Services and 8% to Professional Services was determined based on both historical and projected relative contribution from Licenses, Maintenance Services and Professional Services revenues. Goodwill results from expected synergies from the transaction, including complementary products that were expected to enhance our overall product portfolio, and provide us with opportunities within new markets, which at the time of our acquisition we believed would result in incremental revenue and profitability.

The pro forma effects of all 2010 acquisitions individually, or in the aggregate, would not have been material to our results of operations for the years ended December 31, 2010 and 2009, and therefore are not presented.

2009 Acquisition

PacketTrap Networks, Inc. – In December 2009, we acquired all of the outstanding shares of PacketTrap Networks, Inc. ("PacketTrap"), a provider of enterprise class network and application management software, for purchase consideration of approximately $11.0 million. The acquisition of PacketTrap allows us to fill a technical gap in our existing product lines for the network management space and to bolster our focus and product offerings in the mid-market. The PacketTrap purchase agreement provides for earn-out contingency payments totaling up to $10.8 million contingent upon the achievement of certain PacketTrap sales targets. The fair value of the earn-out contingency at acquisition date of $4.0 million has been accrued for a total purchase price of $15.0 million.

The PacketTrap contingent consideration arrangement requires payments of up to $10.8 million that will be due and payable if certain criteria in relation to amounts billed to customers for PacketTrap products are met during the three-year period subsequent to the close of the acquisition. The fair value of the contingent consideration arrangement was determined using the income approach with significant inputs that are not observable in the market. Key assumptions include a discount rate consistent with the level of risk of achievement and probability of meeting those sales targets. The expected outcomes were recorded at net present value. Subsequent changes in the fair value of the liability were recorded in earnings. As of December, 31, 2011, and 2010, the estimated fair value of the earn-out contingency was $— million and $6.5 million, respectively (please refer to Note 16 – Fair Value Measurement for details).

The acquisition has been accounted for as a business combination and the purchase price was allocated primarily to other intangible assets and to the residual asset, goodwill. Actual results of operations of PacketTrap are included in our consolidated financial statements from the date of acquisition. Our final allocation of the purchase price to assets and liabilities based upon the fair value determinations was as follows (in thousands):

Current assets	$	51
Acquired technologies with a useful life of 3.0 years		1,500
In-process research and development		1,100
Trade name with an indefinite useful life		800
Customer relationships		100
Non-compete agreements with a useful life of 3.0 years		650
Goodwill		9,985
Other non-current assets		875
Current liabilities		(61)
Total purchase price	$	15,000

The intangible assets will be amortized over the pattern in which the economic benefits of the intangible assets are being utilized, which in general reflects the cash flows generated from such assets. We acquired one in-process research and development ("IPR&D") project. The value assigned to the IPR&D project was determined utilizing the income approach by determining cash flow projections relating to the project. We applied a discount rate of 21% to determine the value of the IPR&D project. During the fourth quarter of 2011, we identified the IPR&D as impaired due to change of plans for certain products that were to include these technology assets. The impairment losses of $1.1 million were recorded in Cost of revenues in our consolidated income statements.

QUEST SOFTWARE, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The goodwill associated with this acquisition is reported within our Licenses, Maintenance Services and Professional Services segments of our business, and is not expected to be deductible for tax purposes. The goodwill allocation of 50% to Licenses, 47% to Maintenance Services and 3% to Professional Services is based on both historical and projected relative contribution from Licenses, Maintenance Services and Professional Services revenues. The goodwill results from expected synergies from the acquired business, including complementary products that will enhance our overall product portfolio, and opportunities within new markets, which we believe will result in incremental revenue and profitability.

The pro forma effects of PacketTrap would not have been material to our results of operations for the year ended December 31, 2009, and therefore are not presented.

NOTE 3 — GEOGRAPHIC AND SEGMENT REPORTING

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by our chief operating decision maker, or decision-making group, in assessing performance and deciding how to allocate resources. Our reportable operating segments are Licenses, Maintenance Services and Professional Services. The Licenses segment develops and markets licenses to use our software products. The Maintenance Services segment provides after-sale support for software products. The Professional Services segment provides consulting and fee-based training related to our software products.

Previously, we had two reportable operating segments, Licenses and Services. During the first quarter of 2011, we revised our reportable operating segments by separating our Services segment into our Professional Services segment and our Maintenance Services segment. We separated these two previously aggregated segments because the Professional Services component has experienced significant growth and has become more distinct and robust relative to all Services, and also has become more separately managed and analyzed. Previously reported segment data have been reclassified to conform to the 2011 presentation. Goodwill previously allocated to the Services segment has been reallocated between the Maintenance Services and Professional Services segments using a relative fair value approach.

We do not separately allocate operating expenses to these segments, nor do we allocate specific assets to these segments. Therefore, segment information reported includes only revenues, cost of revenues, and gross profit.

Reportable segment data for the three years ended December 31, 2011, is as follows (in thousands):

	Licenses	Maintenance Services	Professional Services	Total
Year ended December 31, 2011:				
Revenues	$ 337,889	$ 461,793	$ 57,733	$ 857,415
Cost of revenues	34,687	42,183	46,248	123,118
Gross profit	$ 303,202	$ 419,610	$ 11,485	$ 734,297
Year ended December 31, 2010:				
Revenues	$ 320,683	$ 399,901	$ 46,513	$ 767,097
Cost of revenues	24,404	31,370	36,439	92,213
Gross profit	$ 296,279	$ 368,531	$ 10,074	$ 674,884
Year ended December 31, 2009:				
Revenues	$ 279,238	$ 377,955	$ 38,043	$ 695,236
Cost of revenues	26,974	28,599	29,929	85,502
Gross profit	$ 252,264	$ 349,356	$ 8,114	$ 609,734

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Revenues are attributed to geographic areas based on the location of the entity from which the products or services were invoiced. Revenues and long-lived assets concerning principal geographic areas in which we operate are as follows (in thousands):

	United States	Ireland	Other International (2)	Total
Year ended/As of December 31, 2011:				
Revenues	$ 503,919	$ 156,860	$ 196,636	$ 857,415
Long-lived assets (1)	120,929	13,747	15,553	150,229
Year ended/As of December 31, 2010:				
Revenues	$ 477,255	$ 104,075	$ 185,767	$ 767,097
Long-lived assets (1)	79,422	5	13,270	92,697
Year ended/As of December 31, 2009:				
Revenues	$ 434,213	$ 66,103	$ 194,920	$ 695,236
Long-lived assets (1)	81,627	10	15,021	96,658

(1) Includes property and equipment, net and other assets.
(2) No single location within Other International accounts for greater than 10% of total revenues.

NOTE 4 — CASH AND CASH EQUIVALENTS AND INVESTMENTS

The following table summarizes our cash and cash equivalents and investments by balance sheet classification at the dates indicated (in thousands):

	December 31			
	2011		2010	
Classification on balance sheet	Amortized Cost	Fair Value (1)	Amortized Cost	Fair Value (1)
Cash and cash equivalents	$ 192,165	$ 192,165	$ 356,533	$ 356,533
Short-term investments	36,688	36,774	90,159	90,284
Long-term investments	24,964	24,832	45,271	45,466
Total cash and cash equivalents and investments	$ 253,817	$ 253,771	$ 491,963	$ 492,283

(1) Please refer to Note 16 – Fair Value Measurements for details regarding fair value measurements.

The following table summarizes our investments by investment category at the dates indicated (in thousands):

	December 31, 2011			
Investment category:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
US treasury securities	$ 6,920	$ 1	$ —	$ 6,921
US agency securities	5,526	25	—	5,551
Corporate notes/bonds	47,600	124	(196)	47,528
Certificates/term deposits	1,606	—	—	1,606
Total investments	$ 61,652	$ 150	$ (196)	$ 61,606

	December 31, 2010			
Investment category:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
US treasury securities	$ 24,463	$ 48	$ —	$ 24,511
US agency securities	35,331	61	(5)	35,387
Commercial paper	14,980	6	(2)	14,984
Corporate notes/bonds	50,969	214	(2)	51,181
Certificates/term deposits	9,687	—	—	9,687
Total investments	$ 135,430	$ 329	$ (9)	$ 135,750

QUEST SOFTWARE, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The average remaining maturities of the Company's short-term and long-term available-for-sale investments at December 31, 2011 were approximately 6 months and 20 months, respectively.

Interest income, included in Other (expense) income, net in the accompanying consolidated income statements, was $2.1 million, $2.4 million and $1.9 million for the years ended December 31, 2011, 2010 and 2009, respectively.

NOTE 5 — PROPERTY AND EQUIPMENT, NET

Net property and equipment consisted of the following (in thousands):

	December 31	
	2011	2010
Building	$ 39,297	$ 39,003
Furniture and fixtures	17,249	15,846
Machinery and equipment	9,163	7,181
Computer equipment	65,331	54,940
Computer software	51,541	43,822
Leasehold improvements	18,615	15,438
Land	16,317	11,154
Construction in progress - building	6,427	—
	223,940	187,384
Less accumulated depreciation and amortization	(129,338)	(116,530)
Property and equipment, net	$ 94,602	$ 70,854

Total depreciation and amortization expense related to property and equipment was $15.4 million, $14.2 million and $15.4 million in 2011, 2010 and 2009, respectively.

NOTE 6 — GOODWILL AND INTANGIBLE ASSETS, NET

The changes in the carrying amount of goodwill by reportable operating segment (please refer to Note 3 – Geographic and Segment Reporting for discussion of our reportable operating segments) for the year ended December 31, 2010 and 2011, are as follows (in thousands):

	Licenses	Maintenance Services	Professional Services	Total
Balance as of December 31, 2009	$ 470,934	$ 198,895	$ 652	$ 670,481
Acquisitions (1)	17,837	12,196	3,664	33,697
Adjustments (2)	1,324	715	7	2,046
Balance as of December 31, 2010	490,095	211,806	4,323	706,224
Acquisitions (1)	49,591	94,783	3,517	147,891
Adjustments (3)	2,557	1,292	480	4,329
Balance as of December 31, 2011	$ 542,243	$ 307,881	$ 8,320	$ 858,444

(1) Please refer to Note 2 – Acquisitions for additional details.
(2) Primarily from post-acquisition payment obligations to former shareholders of acquisitions we made in 2007 pursuant to accounting principles applicable to acquisitions in that year.
(3) Adjustments relate to finalization of purchase price allocations, primarily from Surgient (please refer to Note 2 – Acquisitions for details of this adjustment).

QUEST SOFTWARE, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Intangible assets, net are comprised of the following (in thousands):

	December 31					
	2011			2010		
	Gross Carrying Amount	Accumulated Amortization and Impairments	Net	Gross Carrying Amount	Accumulated Amortization and Impairments	Net
Acquired technology and IPR&D (1)	$ 244,680	$ (157,944)	$ 86,736	$ 164,816	$ (133,591)	$ 31,225
Customer relationships	122,918	(67,193)	55,725	74,318	(50,639)	23,679
Non-compete agreements	15,068	(13,896)	1,172	13,919	(13,201)	718
Trademarks and trade names (2)	19,596	(12,843)	6,753	13,302	(6,139)	7,163
	$ 402,262	$ (251,876)	$ 150,386	$ 266,355	$ (203,570)	$ 62,785

(1) IPR&D projects were identified and valued related to our acquisitions. These projects are continually assessed for impairment. Upon completion, these projects will be amortized over their estimated useful life.

(2) Trademarks and trade names include $6.2 million and $0.8 million in trade names related to our acquisition of ScriptLogic and PacketTrap, respectively, that each have an indefinite useful life, and as such are not being amortized. In 2011, the $6.2 million trade name related to ScriptLogic became impaired.

During the year ended December 31, 2011, we recognized impairment losses of approximately $9 million. During the third quarter of 2011, certain intangible assets related to Surgient were impaired due to changed plans for certain products that were to include these technology assets. The impairment loss of $1.6 million was recorded in Cost of revenues and Amortization of other purchased intangible assets for $0.8 million each in our consolidated income statements. During the fourth quarter of 2011, the trade name of $6.2 million related to ScriptLogic and the IPR&D of $1.1 million related to PacketTrap became impaired. The trade name related to ScriptLogic became impaired due to the integration and branding of ScriptLogic products with Quest products. The IPR&D related to PacketTrap became impaired due to changed plans for certain products that were to include these technology assets. The impairment loss of $6.2 million was recorded in Amortization of other purchased intangible assets and $1.1 million was recorded in Cost of revenues in our consolidated income statements.

Amortization expense for intangible assets was $39.4 million, $28.8 million and $32.6 million for the year ended December 31, 2011, 2010 and 2009, respectively. Estimated annual amortization expense related to intangible assets reflected on our December 31, 2011 balance sheet is as follows (in thousands):

	Estimated Annual Amortization Expense
2012	$ 43,612
2013	29,863
2014	27,285
2015	18,185
2016 and thereafter	30,641
Total accumulated amortization	$ 149,586

NOTE 7 — COST METHOD INVESTMENTS

We invested $31.8 million and $2.1 million in early stage private companies and private equity funds during the year ended December 31, 2011 and 2010, respectively. These investments are accounted for under the cost method given that we do not have the ability to exercise significant influence over these companies. The fair value of our cost method investments is not estimated if there are no identified events or changes in circumstances that may have a significant adverse effect on the fair value of the investment. We determined that it is not practicable to estimate the fair value of our cost method investments since these investments were made in privately-held companies that are not subject to the same disclosure regulations as U.S. public companies, and, as such, the basis for an estimated fair value is subject to the completeness, quality, timing and accuracy of data received from these private companies. Our cost method investments are carried at $46.1 million and $14.3 million as part of Other assets in our consolidated balance sheets at December 31, 2011 and 2010, respectively.

QUEST SOFTWARE, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 8 — LOANS PAYABLE

In February 2011, our line of credit agreement with Wells Fargo Capital Finance, LLC (formerly known as Wells Fargo Foothill, LLC), as arranger, administrative agent and lender, was amended and renewed for a subsequent five-year term (the "Amended Credit Agreement"). The Amended Credit Agreement allows for cash borrowings and letters of credit under a secured revolving credit facility of up to a maximum of $100.0 million. Interest will accrue based on a floating rate based on, at the Company's election, (i) LIBOR (subject to reserve requirements) or (ii) the greater of (a) the Federal Funds Rate plus $^1/_2$% or (b) Wells Fargo's prime rate, in each case, plus an applicable margin. The Amended Credit Agreement includes limitations on the Company's ability to, among other things, incur debt, grant liens, make acquisitions and other investments, make certain restricted payments such as dividend payments, and dispose of assets. The Amended Credit Agreement is secured by substantially all of the Company's assets, subject to certain exceptions. Fees associated with this amended line of credit were approximately $0.5 million and will be amortized over the life of the credit agreement as interest expense. As of December 31, 2011, we have a $91 million balance outstanding under this line of credit recorded as current loans payable in our consolidated balance sheets.

In August 2009, we entered into a loan agreement with Mutual of Omaha Bank whereby we borrowed an aggregate principal amount of $34 million. The loan is secured by our real property at our headquarters in Aliso Viejo, California. We have used the proceeds from the loan for working capital and other general corporate purposes. The loan matures in five years, during which time we will make equal monthly principal and interest payments at a 7.03% interest rate on a fixed rate, 25-year amortization schedule. Events of default include, among other things, payment defaults, breaches of covenants and bankruptcy events. In the case of a continuing event of default, the lender may, among other things, accelerate the payment of any unpaid principal and interest amounts, increase the then-current interest rate by 5% and foreclose on the real estate collateral. As of December 31, 2011, we have a $32.7 million balance outstanding with $0.6 million recorded as current and $32.1 million recorded as long-term portion of loans payable in our consolidated balance sheets.

Scheduled maturities of current and long-term loans payable are as follows (in thousands):

	Year Ending December 31
2012	$ 91,597
2013	648
2014	31,485
Total loans payable	$ 123,730

We were in compliance with all debt-related covenants as of December 31, 2011.

NOTE 9 — OTHER (EXPENSE) INCOME, NET

Other (expense) income, net consists of the following (in thousands):

	Year Ended December 31		
	2011	2010	2009
Interest income	$ 2,056	$ 2,393	$ 1,863
Interest expense	(3,957)	(4,445)	(2,827)
Foreign currency (losses) gains, net (1)	(4,300)	(3,211)	3,640
Forward foreign currency contracts gains (losses), net (2)	1,952	(459)	(893)
Other (expense) income, net	(553)	65	766
Total other (expense) income, net	$ (4,802)	$ (5,657)	$ 2,549

(1) Our foreign currency (losses) gains, net are predominantly attributable to the re-measurement gains or losses on our net balances of monetary assets and liabilities in our foreign subsidiaries which were primarily denominated in the Euro, and to a lesser extent, the British Pound and Canadian Dollar. The foreign currency re-measurement adjustments to these balance sheet items are calculated by comparing the currency spot rates at the end of a month to the spot rates at the end of the previous month.

(2) Relates to changes in fair value of our forward foreign currency contracts not designated as hedging instruments. Please refer to Note 15 — Derivative Instruments for further details.

QUEST SOFTWARE, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 10 — INCOME TAXES

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

	Year Ended December 31		
	2011	2010	2009
Current:			
Federal	$ 17,494	$ 2,664	$ 3,509
State	5,251	2,427	1,674
Foreign	6,486	4,975	12,871
Deferred:			
Federal	1,302	7,579	1,791
State	176	15	1,284
Foreign	2,948	(1,308)	(5,451)
Total income tax provision	$ 33,657	$ 16,352	$ 15,678

The reconciliations of the U.S. federal statutory rate to the effective income tax rate are as follows:

	Year Ended December 31		
	2011	2010	2009
Tax provision at U.S. federal statutory rates	35.0%	35.0%	35.0%
State taxes	4.0	1.3	2.0
Foreign taxes and foreign losses with tax benefit	(1.9)	(14.8)	(19.8)
Change in U.S. valuation allowance	0.4	(0.2)	(0.3)
Research and development credits	(4.3)	(3.4)	(2.1)
Section 199 benefit (1)	(2.7)	—	—
Stock-based compensation expense (1)	6.7	—	—
Other	2.1	(3.7)	3.4
	39.3%	14.2%	18.2%

(1) For 2010 and 2009, the impact of Section 199 benefit and stock-based compensation expense were not separately disclosed as these were not material to the overall effective tax rate.

Our effective income tax rate increased to 39.3% compared to the previous year primarily as a result of the mix of pre-tax income between high and low tax jurisdictions, and other discrete items impacting the year ended December 31, 2011. Discrete items primarily include additional valuation allowances recorded against foreign deferred tax assets for Brazil, Mexico and China, excess shortfalls associated with the exercise, cancellation and expiration of stock options, and decreases due to release of reserves from the expiration of the U.S. federal income tax statute for the fiscal year 2007 and closure of the Canada Revenue Agency income tax audit for the fiscal years 2006 through 2007.

QUEST SOFTWARE, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Deferred income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of our deferred taxes are as follows (in thousands):

	December 31	
	2011	2010
Deferred tax assets:		
Accounts receivable and sales returns reserves	$ 255	$ 170
Accrued liabilities	7,225	7,353
Deferred revenue	9,972	4,256
Foreign net operating loss carry-forwards	20,267	18,292
U.S. net operating loss carry-forwards	29,315	17,827
Stock compensation	13,146	16,549
Tax credits	13,999	14,303
Other	11,295	11,831
Total gross deferred tax assets	105,474	90,581
Deferred tax liability - Intangibles	(42,243)	(16,518)
Deferred tax liability - Fixed Assets	(2,724)	(92)
Valuation allowance	(23,168)	(20,309)
Net deferred income taxes	37,339	53,662
Less current portion	(19,780)	(6,677)
Non-current portion	$ 17,559	$ 46,985

As of December 31, 2011, our valuation allowance was approximately $23.2 million on certain of our deferred tax assets. The change of $2.9 million in our valuation allowance primarily relates to a net increase in allowances related to foreign net operating losses in Brazil, Mexico and China. Based on the weight of available evidence, we believe that it is more likely than not that these deferred tax assets will not be realized.

As of December 31, 2011, we have estimated federal and state net operating loss carry-forwards of approximately $110.7 million from acquired subsidiaries which begin to expire in 2011. Additionally, we have certain federal net operating losses of approximately $5.4 million related to an acquired subsidiary that, as a result of federal consolidation rules, are not available to offset current or future income of our other U.S. entities. At December 31, 2011, we also have foreign net operating loss carry-forwards of approximately $85.1 million, which began to expire in 2011. Approximately $25.1 million of the foreign net operating loss carry-forwards were incurred by subsidiaries prior to the date of our acquisition of such subsidiaries. We established a valuation allowance of approximately $3.7 million at the dates of acquisition related to these subsidiaries.

As of December 31, 2011, we have state tax credit carry-forwards of $7.5 million, which will carry forward indefinitely until utilized. Also, we have $1.5 million of acquired state tax credits that are subject to ownership change limitations and will begin to expire in 2018.

During the current year, we realized net tax benefits of $6.9 million from the stock-based compensation. That amount was allocated and debited (credited) to the following items (in thousands):

Goodwill	(10)
Deferred income tax asset	(11,064)
Income tax provision	4,100
Total	$ (6,974)

Income before income taxes consists of the following components (in thousands):

	Year Ended December 31		
	2011	2010	2009
United States	$ 54,618	$ 55,856	$ 14,953
Foreign	31,105	59,063	71,084
Total	$ 85,723	$ 114,919	$ 86,037

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

As of December 31, 2011, gross undistributed earnings of our foreign subsidiaries were approximately $333.1 million and are considered permanently reinvested outside the United States. It is not practicable to estimate the amount of U.S. income taxes or foreign withholding taxes that may be payable upon distribution of such earnings.

As of December 31, 2011, the estimated liability for our uncertain tax positions was approximately $56.9 million. The change in unrecognized tax benefits, excluding interest and penalties, is as follows (in thousands):

	Year Ended December 31		
	2011	2010	2009
Unrecognized tax benefit at the beginning of the year	$ 46,846	$ 51,332	$ 47,477
Additions from tax positions taken in the current year	11,889	7,366	9,129
Additions from tax positions taken in prior years	4,339	151	7,467
Reductions from tax positions taken in prior years	—	(2,974)	(10,665)
Settlements of tax audits	(1,324)	—	(2,076)
Decrease related to lapse of statute of limitations	(4,816)	(9,029)	—
Unrecognized tax benefit at the end of the year	$ 56,934	$ 46,846	$ 51,332

Included in the unrecognized tax benefit at December 31, 2011 is $39.3 million of tax benefits that, if recognized, would affect the effective tax rate. Also included in the unrecognized tax benefits at December 31, 2011 is $17.6 million of tax benefits that, if recognized would result in adjustments to deferred tax assets and long term income taxes payable/receivable or valuation allowances.

During the years ended December 31, 2011 and 2010, we recorded on a cumulative basis approximately $5.2 million and $4.3 million for tax-related interest and penalties within the income tax provision, respectively. Penalties and tax-related interest expense are reported as a component of our income tax provision.

As of December 31, 2011, we are no longer subject to U.S. federal audits for years through December 31, 2007 and California state audits for years through December 31, 2006. We continue to be subject to examination in the U.S. federal jurisdiction for years from 2008 through 2011, as well as various state and foreign jurisdictions for the tax years from 2006 through 2011.

During the first quarter of 2011, we received examination notices from the Internal Revenue Service and the California Franchise Tax Board to audit income tax returns filed for calendar years 2008 through 2009, and 2007 through 2008, respectively. Both of these examinations are currently in the information gathering stage and no assessments have been made at this point.

During 2009, we filed requests with Irish Inland Revenue and the French Tax Authority to enter into the Mutual Agreement Procedure pursuant to Article 24 of the Ireland-France Income Tax Treaty. This request attempts to resolve the adjustments proposed by the French Tax Authority during their audit of our French subsidiary for the period April 1, 2003 through December 31, 2004. This request continues to be outstanding as of December 31, 2011.

Additionally, we are currently under examination by the French Tax Authority for the years ended December 31, 2005 – 2008, the German Tax Authority for the years ended December 31, 2005 – 2007 and Her Majesty's Revenue & Customs (UK) for the years ended December 31, 2006 – 2007. In December 2009 we received a tax assessment from the French Tax Authority for the years ended December 31, 2005 – 2006. In November 2010, we received a tax assessment from the French Tax Authority for the years ended December 31, 2007 – 2008. We continue to pursue resolution of these assessments through the various appeals processes within France. Neither assessment from the French Tax Authority has been incorporated into the current Mutual Agreement Procedure pursuant to Article 24 of the Ireland-France Income Tax Treaty.

During the quarter ended September 30, 2011, we received notice from the Canadian Revenue Agency informing us they have closed the audit period with no proposed adjustments.

We believe appropriate provisions for all outstanding issues have been made for all jurisdictions and all open years. However, due to the risk that audit outcomes and the timing of audit settlements are subject to significant uncertainty and as we continue to evaluate such uncertainties in light of current facts and circumstances, our current estimate of the total amounts of unrecognized tax benefits could increase or decrease for all open tax years. As of the date of this report, we do not anticipate that there will be any significant change in the unrecognized tax benefits within the next twelve months.

QUEST SOFTWARE, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 11 — NONCONTROLLING INTEREST

In October 2011, we acquired a 60 percent voting equity interest in Smarsh, Inc., a privately-held company. The minority shareholder who holds the remaining 40 percent noncontrolling interest was granted the right to require us to purchase half of the 40 percent noncontrolling interest from the first anniversary until the fifth anniversary of the acquisition date. The maximum redemption value payable by us in that case would be $22 million. The put right is embedded in the shares owned by the minority shareholder and is not freestanding. This 20 percent noncontrolling interest is accounted for as redeemable noncontrolling interest because redemption is outside our control. As such, the redeemable noncontrolling interest is reported in the mezzanine section as temporary equity in our consolidated balance sheets. The remaining 20 percent noncontrolling interest is presented within total equity in our consolidated balance sheets. Noncontrolling interest that is redeemable at other than fair value is recorded at the higher of its carrying amount or redemption value as if the end of the reporting period was the redemption date. As of December 31, 2011, the carrying amount of the redeemable noncontrolling interest was increased to the redemption value of $22 million. The increase of $8.2 million was recorded in net loss attributable to noncontrolling interest, thereby directly affecting net income attributable to Quest Software, Inc. Net income per share is calculated based on net income attributable to Quest Software, Inc. stockholders.

NOTE 12 — STOCKHOLDERS' EQUITY

In May 2011, our Board of Directors authorized a new stock repurchase program covering up to $200 million of our common stock. This program replaced the $150 million stock repurchase program previously authorized in February 2011. Any stock repurchases may be made through open market and privately negotiated transactions, at times and in such amounts as management deems appropriate, including pursuant to one or more Rule 10b5-1 trading plans. Rule 10b5-1 permits Quest to establish, while not in possession of material nonpublic information, prearranged plans to buy stock at a specific price in the future, regardless of any subsequent possession of material nonpublic information. The timing and actual number of shares repurchased will depend on a variety of factors including market conditions, corporate and regulatory requirements, and capital availability. The stock repurchase program does not have an expiration date and may be limited or terminated at any time without prior notice. During the year ended December 31, 2011, we repurchased 11.9 million shares at a weighted-average price per share of $21.95, for a total cost of $261.8 million pursuant to the two authorizations above. As of December 31, 2011, a total of $68.0 million remains available pursuant to our stock repurchase authorization.

Previously, in August 2009, the Board of Directors authorized a plan to repurchase up to $100 million of our common stock. Any stock repurchases could be made through open market and privately negotiated transactions, at times and in such amounts as management deemed appropriate, including pursuant to one or more Rule 10b5-1 trading plans. Rule 10b5-1 permits Quest to establish, while not in possession of material nonpublic information, prearranged plans to buy stock at a specific price in the future, regardless of any subsequent possession of material nonpublic information. The timing and actual number of shares repurchased depended on a variety of factors including market conditions, corporate and regulatory requirements, and capital availability. The stock repurchase program did not have an expiration date and could be limited or terminated at any time without prior notice. During the twelve months ended December 31, 2010, we repurchased 2.3 million shares under this stock repurchase authorization at a weighted-average price per share of $16.50, for a total cost of $37.4 million. In February 2011, the Board of Directors increased the authorization under this stock repurchase program previously authorized in 2009 to an aggregate of $150 million.

In June 2009, we commenced a modified "Dutch Auction" tender offer to purchase up to 10,715,000 shares of our common stock. In July 2009, we accepted for purchase 6,850,871 shares in the tender offer, at a price of $14.00 per share, for a total cost of $95.9 million excluding approximately $1.3 million in fees and expenses related to the tender offer.

In March 2009, our Board of Directors authorized a stock repurchase of up to $100 million of our common stock. This stock repurchase authorization was terminated in connection with the commencement of the June 2009 tender offer as discussed above. During the year ended December 31, 2009, we repurchased 341,639 shares under this stock repurchase authorization at a weighted-average price per share of $11.37, for a total cost of $3.9 million.

NOTE 13 — RELATED PARTY TRANSACTIONS

In 2000, we received a note receivable with a face amount of $15.8 million from one of our then executive officers for the purchase of 339,200 shares of our common stock at a purchase price of $46.50 per share. The note receivable bears interest at 6.33% per annum. The officer granted Quest a security interest in the shares and also assigned, transferred, and pledged the shares to Quest to secure his obligations under the note. The Company maintains physical possession of the certificates representing the shares purchased as collateral until payment of the principal and interest under the note is made. The former officer remained employed by Quest as of December 31, 2011. The note receivable is deemed to be a non-recourse obligation of the former officer for financial reporting purposes, and as such we recorded the note as a reduction to stockholders' equity and recorded a corresponding credit to common stock. The original maturity date of the note receivable was August 2007. In December 2009, the former executive officer and Quest signed a letter extending the due date of the note receivable until June 1, 2010. The note receivable is due and we are currently pursuing methods of collection or other means of recovery.

QUEST SOFTWARE, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

We believe that the transactions set forth above were made on terms no less favorable to us than could have been otherwise obtained from unaffiliated third parties.

NOTE 14 — STOCK-BASED COMPENSATION AND EMPLOYEE BENEFIT PLANS

Profit Sharing Plan

We adopted the Managing for Results ("MFR") Profit Sharing Plan in 2008, which is intended to reward and recognize key management and individual contributors capable of affecting the long-term growth, profitability, and major market successes of the global corporation. The participating employees are awarded performance plan unit(s) that are payable at the discretion of the Compensation Committee of our Board of Directors in either stock awards or cash. For the 2008 and 2009 Plan years, the performance plan units were converted into restricted stock units ("RSUs") and for the 2010 and 2011 Plan years, the performance plan units were converted to stock options. All awards are subject to the achievement of certain performance objectives and service requirements. The RSUs awarded are subject to a three-year quarterly vesting schedule while the 2010 and 2011 option awards vest over three years and six years, respectively. Eligible employees must maintain active employment status on each vesting date to maintain eligibility to receive the shares of stock. Any stock based awards granted under the profit sharing plan will be granted pursuant to the terms of our 2008 Stock Incentive Plan described below.

Stock-Based Compensation Plans

In March 2008, our Board of Directors adopted the Quest Software, Inc. 2008 Stock Incentive Plan (the "2008 Plan"). The 2008 Plan, which was approved by our stockholders in May 2008, is the successor to the Quest Software, Inc. 1999 Stock Incentive Plan, as amended (the "1999 Plan") and the Quest Software, Inc. 2001 Stock Incentive Plan (the "2001 Plan" and, together with the 1999 Plan, the "Prior Plans"). The 2008 Plan became effective and replaced the Prior Plans effective July 1, 2008. Our Board adopted the 2008 Plan to provide a means to secure and retain the services of our employees, directors, and consultants, to provide a means by which such eligible individuals may be given an opportunity to benefit from increases in the value of our Common Stock through the grant of stock awards, and thereby align the long-term compensation and interests of those individuals with our stockholders.

We had previously authorized for issuance an aggregate 38.5 million shares of common stock available to employees, directors and consultants under the Prior Plans. Any shares remaining available for issuance pursuant to the exercise of options or settlement of stock awards under the Prior Plans are available for issuance pursuant to stock awards granted under the 2008 Plan. Any shares subject to outstanding stock awards granted under the Prior Plans that expire or terminate for any reason prior to exercise or settlement shall become available for issuance pursuant to stock awards granted under the 2008 Plan.

The 2008 Plan provides for the discretionary grant of incentive stock options, non-statutory stock options, restricted stock awards, restricted stock unit awards, stock appreciation rights, and other forms of equity compensation (collectively, the "stock awards"). Incentive stock options granted under the 2008 Plan are intended to qualify as "incentive stock options" within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended, or the "Code." Non-statutory stock options granted under the 2008 Plan are not intended to qualify as incentive stock options under the Code. The 2008 Plan also provides for the automatic grant of stock options to non-employee Board members over their period of service on our Board, continuing the similar program for automatic stock option grants to non-employee directors under the 1999 Plan.

Non-qualified stock options granted under the 2008 Plan and Prior Plans generally have a 10-year life and vest ratably over a five year period, generally at the rate of 20% one year after the grant date and 10% semi-annually thereafter. In 2010 and 2011, we granted MFR option awards that vest over three years and six years, respectively. All outstanding stock awards granted under the Prior Plans will continue to remain subject to the terms and conditions of those predecessor plans. All stock awards granted after the July 1, 2008 effective date of the 2008 Plan will be subject to the terms of the 2008 Plan. The exercise price of all options granted under the 2008 Plan is to be established by the Plan Administrator; provided, however, that the exercise price of stock options shall not be less than the market value of our Common Stock on the date of grant. The Plan Administrator for the 2008 Plan is the Compensation Committee of the Board of Directors. Except as otherwise noted, the terms of stock awards granted under the 2008 Plan are substantially similar to those granted under the Prior Plans.

The number of shares of Common Stock available for issuance under the 2008 Plan is 20.3 million as of December 31, 2011. The number of shares of Common Stock reserved for issuance under the 2008 Plan will be reduced by 1 share for each share of Common Stock issued under the 2008 Plan pursuant to a stock option and by 1.94 shares for each share of Common Stock issued under the 2008 Plan pursuant to a restricted stock award, restricted stock unit award, or other stock award. There were approximately 137 thousand assumed options that were issued related to an acquisition in the fourth quarter of 2011 and such grants were outside of the 2008 Plan. As of December 31, 2011, there were 4.5 million shares available for grant under the 2008 Plan.

Our Board may amend or modify the 2008 Plan at any time, subject to any required stockholder approval. To the extent required by applicable law or regulation, stockholder approval will be required for any amendment that (a) materially increases the number of shares available for issuance under the 2008 Plan; (b) materially expands the class of individuals eligible to receive stock awards under the 2008 Plan; (c) materially increases the benefits accruing to the participants under the 2008 Plan or materially reduces the price at which shares of common stock may be issued or purchased under the 2008 Plan; (d) materially extends the term of the 2008 Plan; or (e) expands the types of awards available for issuance under the 2008 Plan.

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Stock Option Awards

A summary of the activity of employee stock options during the year ended December 31, 2011, and details regarding the options outstanding and exercisable at December 31, 2011, are provided below:

	Number of Shares (in thousands)	Weighted-Average Exercise Price (per share)	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands) (1)
Outstanding at December 31, 2010	13,130	$ 16.93		
Granted	6,425	$ 19.30		
Exercised	(1,875)	$ 17.24		
Canceled/forfeited/expired	(1,901)	$ 21.98		
Outstanding at December 31, 2011	15,779	$ 17.26	7.38	$ 42,593
Vested or expected to vest at December 31, 2011	14,423	$ 17.17	7.21	$ 39,946
Exercisable at December 31, 2011	5,213	$ 14.10	4.34	$ 25,746

(1) These amounts represent the difference between the exercise price and $18.60, the closing price of Quest Software, Inc. stock on December 31, 2011 as reported on the NASDAQ National Market, for all options outstanding that have an exercise price currently below the closing price.

The weighted-average fair value of options granted during the years ended December 31, 2011, 2010 and 2009 was $7.09, $7.11 and $6.54, respectively. The total intrinsic value of options exercised was $12.6 million, $37.6 million and $14.5 million for the years ended December 31, 2011, 2010 and 2009, respectively. The total fair value of options vested during the years ended December 31, 2011, 2010 and 2009 was $16.1 million, $8.9 million and $8.8 million, respectively.

Restricted Stock Unit Awards

RSUs have been granted to selected executives pursuant to our Executive Incentive Plan. We have also granted RSUs to key employees pursuant to the MFR Profit Sharing Plan described above. All of our outstanding RSUs vest over three years with vesting contingent upon continuous service and meeting certain company-wide performance goals, including sales, operating profit margin, and cash flow targets. We estimate the fair value of RSUs using the market price of our common stock on the date of the grant. The fair value of these awards is amortized on a straight-line basis over the vesting period. Additionally, a portion of each RSU award is settled in cash, only to the extent necessary to pay the minimum tax withholding or any government levies on the restricted stock unit.

A summary of our RSUs activity during the year ended December 31, 2011 is provided below:

	Number of Shares	Weighted-Average Grant Date Fair Value (per share)
Non-vested at January 1, 2011	787,798	$ 14.99
Granted	—	$ —
Vested	(474,679)	$ 14.44
Forfeited	(76,788)	$ 15.70
Non-vested at December 31, 2011[(1)]	236,331	$ 15.88

(1) 225,744 of these shares are expected to vest.

The total fair value of RSUs vested during the years ended December 31, 2011, 2010 and 2009 was $6.9 million, $8.4 million and $4.2 million, respectively. The weighted-average grant-date fair value of RSUs granted during the year ended December 31, 2009 was $12.49. There were no RSUs granted during fiscal years 2010 and 2011.

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Stock-Based Compensation Expense

The following table presents the income statement classification of all stock-based compensation expense for the years ended December 31, 2011, 2010 and 2009 (in thousands):

	Year Ended December 31,		
	2011	2010	2009
Cost of licenses	$ —	$ 1	$ 1
Cost of services	1,042	1,114	737
Sales and marketing	7,150	6,861	4,997
Research and development	8,180	8,015	5,385
General and administrative	8,897	7,109	4,058
Total stock-based compensation	25,269	23,100	15,178
Tax benefit associated with stock-based compensation expense (1)	9,905	8,940	6,071
Reduction of net income	$ 15,364	$ 14,160	$ 9,107

(1) The recognized tax benefit related to stock-based compensation expense is estimated to be 39.2%, 38.7% and 40% in fiscal years 2011, 2010 and 2009, respectively. These rates approximate the blended Federal and State statutory tax rate after the benefit for state taxes which provides an accurate estimate of the current and deferred tax benefits ultimately received from stock-based compensation.

As of December 31, 2011, total unrecognized stock-based compensation cost related to non-vested stock option awards was $52.3 million, which is expected to be recognized over a weighted-average period of 4.1 years, and total unrecognized stock-based compensation expense related to non-vested RSUs was $2.9 million, which is expected to be recognized over a weighted-average period of 0.9 years.

Determining Fair Value

Valuation and Amortization Method. We estimate the fair value of stock options granted using the Black-Scholes option valuation model utilizing a single option approach. For equity awards that are expected to be settled with RSUs, but not yet granted (related to the MFR Profit Sharing Plan), we measure the value of these awards based on the market price of our common stock as of the date of the end of each reporting period. Once an RSU is granted (approved by the Compensation Committee of our Board of Directors and communicated to the participating employees) we estimate the fair value of RSUs using the market price of our common stock on the date of the grant. The fair value of all stock-based awards is generally amortized on a straight-line basis over the vesting period.

We have reviewed our historical pattern of option exercises and have determined that meaningful differences in option activity existed among employees. Therefore, we have categorized these awards into two separate groups of employees. The employees within each group have similar historical exercise behavior for valuation purposes.

Determining the fair value of stock option awards at the grant date requires judgment, including estimating the expected term, expected volatility, risk-free interest rate and dividend yield. We may use different assumptions under the Black-Scholes option valuation model in determining the fair value of any option grants in future years, which could materially affect the measurement of the fair value of those options.

Expected Term. The expected term of options granted represents the period of time such options are expected to be outstanding. We estimate the expected terms of options granted based on historical exercise patterns across two different groups of employees. We believe these estimates are reasonably representative of each group's likely future behavior.

Expected Volatility. Expected volatilities are based on historical volatilities of Quest's stock as we believe the historical volatilities to be a fair indicator of future volatility of our stock.

Risk-Free Interest Rate. We base the risk-free interest rate on the U.S. Treasury zero-coupon issues in effect at the time of option grant for equivalent remaining terms.

Dividend Yield. We do not expect to pay any dividends and, therefore, we use an expected dividend yield of zero.

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We used the following assumptions to estimate the fair value of options granted during the years ended December 31, 2011, 2010 and 2009:

	Year Ended December 31					
	2011		2010		2009	
	Range:	Weighted Average:	Range:	Weighted Average:	Range:	Weighted Average:
Risk-free interest rate	0.8% to 2.5%	1.4%	1.1% to 3.1%	2.1%	1.6% to 3.2%	2.6%
Expected term (in years)	5.2 to 6.8	5.7	5.3 to 8.0	5.9	5.4 to 5.9	5.9
Expected volatility	34% to 36%	34%	34% to 37%	35%	36% to 40%	38%
Expected dividend yield	None	None	None	None	None	None

Employee 401(k) Plan

We sponsor the Quest Software, Inc. 401(k) Plan ("401(k) Plan") covering substantially all of our employees. As allowed under Section 401(k) of the Internal Revenue Code, the 401(k) Plan provides tax-deferred salary deductions for eligible employees. Employees may contribute from 1% to 100% of their annual compensation to the 401(k) Plan, limited to a maximum annual amount as set periodically by the Internal Revenue Service. Participant contributions and discretionary matching contributions to employees with three years of service vest immediately, while discretionary matching contributions made to employees with less than three years of service have certain vesting requirements. Our discretionary matching contributions totaled $3.4 million and $2.9 million for the years ended December 31, 2011 and 2010, respectively.

NOTE 15 — DERIVATIVE INSTRUMENTS

We utilize a balance sheet hedging program with the stated objective of reducing volatility within Other (expense) income, net. Under this program, we use derivatives in the form of foreign currency contracts to hedge certain balance sheet exposures. We do not designate these contracts as hedging instruments and therefore do not qualify for hedge accounting. Accordingly, these outstanding non-designated derivatives are recognized in the consolidated balance sheets at fair value and the changes in fair value from these contracts are recorded in Other (expense) income, net, in the consolidated income statements. These derivative contracts typically have a one month term.

We have a cash flow hedging program primarily focused on reducing volatility in our forecasted research and development cash expenses and license revenues, some of which are denominated in non-U.S. Dollar currencies. Under this program, we use derivatives in the form of forward foreign currency contracts and foreign currency option contracts to hedge certain forecasted transactions. These derivatives, with durations ranging from less than one month to nine months, are designated as hedging instruments and qualify for hedge accounting. Accordingly, these outstanding designated derivatives are recognized in the consolidated balance sheets at fair value. Changes in value that are highly effective are recognized in Accumulated other comprehensive income ("AOCI") in the consolidated balance sheets, until the hedged item is recognized in the income statement. Any ineffective portion of a derivative's change in fair value is recorded in Other (expense) income, net, in the consolidated income statements. There was no material ineffectiveness in our cash flow hedging program for the twelve months ended December 31, 2011.

We had the following notional amounts for our foreign currency contracts included in our consolidated balance sheets (in U.S. Dollars in thousands):

Currency	December 31 2011	December 31 2010
Derivatives designated as hedging instruments		
Australian Dollar	$ 4,078	$ 2,788
Canadian Dollar	14,158	7,694
Chinese Yuan	2,777	1,167
Israeli Shekel	3,773	2,105
Russian Ruble	8,433	6,206
British Pound	—	7,188
Euro	—	22,029
Total	$ 33,219	$ 49,177

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Derivatives not designated as hedging instruments		
Danish Krone	$ 891	$ 2,126
Norwegian Krone	1,073	2,013
Swedish Krona	446	2,058
Euro	40,397	43,600
Australian Dollar	8,138	3,846
South Korean Won	2,193	—
Brazil Real	3,826	4,705
Japanese Yen	6,439	—
British Pound	7,950	18,724
Total	$ 71,353	$ 77,072

Fair Value of Derivative Instruments

The following table provides the fair value of our foreign currency contracts included in our consolidated balance sheets (in thousands):

	Derivative Assets				Derivative Liabilities			
	December 31, 2011		December 31, 2010		December 31, 2011		December 31, 2010	
Derivatives designated as hedging instruments	**Balance Sheet Location**	**Fair Value (1)**	**Balance Sheet Location**	**Fair Value (1)**	**Balance Sheet Location**	**Fair Value (1)**	**Balance Sheet Location**	**Fair Value (1)**
Foreign currency contracts	Prepaid expenses and other current assets	$ 351	Prepaid expenses and other current assets	$ 1,123	Other accrued expenses	$ 237	Other accrued expenses	$ 424

	Derivative Assets				Derivative Liabilities			
	December 31, 2011		December 31, 2010		December 31, 2011		December 31, 2010	
Derivatives not designated as hedging instruments	**Balance Sheet Location**	**Fair Value (1)**	**Balance Sheet Location**	**Fair Value (1)**	**Balance Sheet Location**	**Fair Value (1)**	**Balance Sheet Location**	**Fair Value (1)**
Foreign currency contracts	Prepaid expenses and other current assets	$ 2,512	Prepaid expenses and other current assets	$ —	Other accrued expenses	$ 63	Other accrued expenses	$ 956

(1) Please refer to Note 16 – Fair Value Measurements for additional details.

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The Effect of Derivative Instruments on Financial Performance

The following tables provide the effect derivative instruments had on our AOCI and results of operations (in thousands):

Derivatives designated as hedging instruments	Year Ended December 31 Amount of (loss) gain recognized in AOCI (effective portion)		Location of (loss) gain reclassified from accumulated AOCI into income statement (effective portion)	Amount of (loss) gain reclassified from accumulated AOCI (effective portion)	
	2011	2010		2011	2010
Foreign currency contracts	$ (729)	$ 359	Revenues	$ (753)	$ (973)
			Operating expenses	$ 668	$ 738

Derivatives not designated as hedging instruments	Year Ended December 31 Location of gain (loss) recognized on derivative instruments	Amount of gain (loss) recognized on derivative instruments	
		2011	2010
Foreign currency contracts	Other expense, net	$ 1,952	$ (459)

NOTE 16 — FAIR VALUE MEASUREMENTS

We perform fair value measurements in accordance with FASB's authoritative guidance on fair value measurements and disclosures. This standard defines fair value, provides guidance for measuring fair value and requires certain disclosures. This standard does not require any new fair value measurements, but rather applies under other accounting pronouncements that require or permit fair value measurements. The standard discusses valuation techniques, such as the market approach (comparable market prices), the income approach (present value of future income or cash flow) and the cost approach (cost to replace the service capacity of an asset or replacement cost). The statement establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The following is a brief description of those three levels:

- Level 1: Observable inputs such as quoted prices (unadjusted) in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
- Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.
- Level 3: Unobservable inputs that reflect the reporting entity's own assumptions when there is little or no market data.

We measure our financial assets and liabilities at fair value on a recurring basis using the following valuation techniques:

(a) Market Approach – uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.

(b) Income Approach – uses valuation techniques to convert future estimated cash flows to a single present amount based on current market expectations about those future amounts, using present value techniques.

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The following table represents our fair value hierarchy and the valuation techniques used for financial assets and financial liabilities measured at fair value on a recurring basis (in thousands):

	December 31, 2011				
	Total	Level 1	Level 2	Level 3	Valuation Techniques
Assets:					
Money market funds	$ 65,811	$ 65,811	$ —	$ —	(a)
U.S. treasury securities	6,921	3,499	3,422	—	(a)
U.S. agency securities	5,551	3,545	2,006	—	(a)
Corporate notes/bonds	47,528	—	47,528	—	(a)
Certificates/term deposits	2,922	—	2,922	—	(a)
Derivative assets [1]	2,863	—	2,863	—	(a)
Total	$ 131,596	$ 72,855	$ 58,741	$ —	
Liabilities:					
Derivative liabilities [1]	$ 300	$ —	$ 300	$ —	(a)
Contingent consideration	3,782	—	—	3,782	(b)
Total	$ 4,082	$ —	$ 300	$ 3,782	

	December 31, 2010				
	Total	Level 1	Level 2	Level 3	Valuation Techniques
Assets:					
Money market funds	$ 268,118	$ 268,118	$ —	$ —	(a)
U.S. treasury securities	24,511	24,511	—	—	(a)
U.S. agency securities	35,387	35,387	—	—	(a)
Corporate notes/bonds	51,181	—	51,181	—	(a)
Certificates/term deposits	10,777	—	10,777	—	(a)
Commercial paper	14,984	—	14,984	—	(a)
Derivative assets [1]	1,123	—	1,123	—	(a)
Total	$ 406,081	$ 328,016	$ 78,065	$ —	
Liabilities:					
Derivative liabilities [1]	$ 1,380	$ —	$ 1,380	$ —	(a)
Contingent consideration	8,515	—	—	8,515	(b)
Total	$ 9,895	$ —	$ 1,380	$ 8,515	

(1) Please refer to Note 15 – Derivative Instruments for details.

The following table presents our liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended December 31, 2011 and 2010 (in thousands):

	Year Ended December 31	
	2011	2010
Total, beginning of the period	$ 8,515	$ 4,000
Contingent consideration[1]	5,821	2,015
Change in fair value of contingent consideration [2]	(7,819)	2,500
Payment of contingent consideration	(2,735)	—
Total, end of the period	$ 3,782	$ 8,515

(1) We enter into earn-out agreements with the shareholders of certain companies we acquire. The earn-out contingent payments are typically based on the acquired company's products' total revenue or sales growth over a specified period after the acquisition date. This also includes contingent consideration relating to our purchase of intellectual property. During the second quarter of 2011, we separately purchased intellectual property and entered into an agreement whereby the former owner has the opportunity to earn an additional amount contingent upon achievement of certain technology milestones.

QUEST SOFTWARE, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(2) The estimated fair value decreased due to actual earn-out achievement for 2011 that was lower than expected and the resulting expected unattainable minimum thresholds required for earning a payout for the third and final earn-out period.

Other Financial Assets and Liabilities

The carrying amounts of our other financial assets and liabilities including accounts receivable, accounts payable and accrued liabilities approximate their respective fair values because of the relatively short period of time between their origination and their expected realization.

The book value and fair value of our current and long-term portion of loans payable as of December 31, 2011 are as follows (in thousands):

	Book Value	Fair Value [1]
Current portion of loans payable	$ 91,597	$ 91,597
Long-term portion of loans payable	32,133	32,133
	$ 123,730	$ 123,730

(1) Estimated fair value of long-term debt is based on quoted prices for similar liabilities for which significant inputs are observable.

NOTE 17 — COMMITMENTS AND CONTINGENCIES

Leases. We lease office facilities and certain equipment under various operating leases. A majority of these leases are non-cancelable and obligate us to pay costs of maintenance, utilities, and applicable taxes. The leases on most of the office facilities contain escalation clauses and renewal options. Rental expense is recorded on a straight-line basis over the life of the lease. Total rent expense was $21.0 million, $17.8 million and $17.8 million for the years ended December 31, 2011, 2010 and 2009, respectively.

Minimum lease commitments under non-cancelable operating leases as of December 31, 2011 are as follows (in thousands):

Year ending December 31:	Minimum Lease Commitment
2012	$ 20,068
2013	12,964
2014	6,661
2015	3,210
2016	428
Thereafter	—
Total minimum lease commitments	$ 43,331

Patent Litigation. On August 27, 2010, we filed a complaint in the United States District Court for the District of Utah against Centrify Corporation and Likewise Software alleging that Centrify's DirectControl software and Likewise's Enterprise software infringe Quest's United States Patent No. 7,617,501 (the "501 Patent"). Our complaint seeks money damages, costs, attorneys' fees, and the entry of permanent injunctions against each defendant. On December 27, 2011, pursuant to an agreement between the parties, the Court issued an order staying the lawsuit until ninety days after the earlier of (a) the conclusion of all reexamination-related appeals by the Board of Patent Appeals and Interferences pertaining to the 501 Patent and the 005 Patent; (b) if appeals to the Board of Patent Appeals and Interferences are taken in one, but not both of the reexamination proceedings pertaining to the 501 Patent and the 005 Patent, the decision of all reexamination-related appeals by the Board of Patent Appeals and Interferences in the appealed case; or (c) the deadline for the parties to file appeals to the Board of Patent Appeals and Interferences passes in the reexamination proceedings pertaining to both the 501 Patent and the 005 Patent without an appeal being timely filed in either proceeding.

QUEST SOFTWARE, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

On August 30, 2010, Centrify filed a complaint in the United States District Court for the Northern District of California against Quest alleging that our Authentication Services software infringes Centrify's United States Patent No. 7,591,005 (the "005 Patent"). Centrify's complaint seeks an unspecified amount of money damages, costs, attorneys' fees, and a permanent injunction. On September 20, 2011, Centrify filed an additional complaint in the United States District Court for the Northern District of California against Quest alleging that our Authentication Services software infringes United States Patent No. 8,024,360 (the "360 Patent"). Centrify's complaint seeks an unspecified amount of money damages, costs, attorneys' fees, and a permanent injunction. On December 23, 2011, pursuant to an agreement between the parties, the Court issued an order staying both Centrify's infringement action concerning the 005 Patent and Centrify's infringement action concerning the 360 Patent until ninety days after the earlier of (a) the conclusion of all reexamination-related appeals by the Board of Patent Appeals and Interferences pertaining to the 501 Patent and the 005 Patent; (b) if appeals to the Board of Patent Appeals and Interferences are taken in one, but not both of the reexamination proceedings pertaining to the 501 Patent and the 005 Patent, the decision of all reexamination-related appeals by the Board of Patent Appeals and Interferences in the appealed case; or (c) the deadline for the parties to file appeals to the Board of Patent Appeals and Interferences passes in the reexamination proceedings pertaining to both the 501 Patent and the 005 Patent without an appeal being timely filed in either proceeding.

On August 31, 2010, we filed a petition with the United States Patent and Trademark Office alleging that Centrify's 005 Patent is invalid and requesting the United States Patent and Trademark Office to commence an *inter partes* reexamination of the patentability of Centrify's 005 Patent. On November 15, 2010, the United States Patent and Trademark Office granted our petition for *inter partes* reexamination of the patentability of Centrify's 005 Patent and issued a first office action rejecting all claims of Centrify's 005 Patent. On January 18, 2011, Centrify filed a response to the United States Patent and Trademark Office's first office action. On October 19, 2011, the United States Patent and Trademark Office issued an Action Closing Prosecution, rejecting all claims of Centrify's 005 Patent. On November 21, 2011, Centrify filed comments after the Action Closing Prosecution. On December 20, 2011, Quest filed a response to Centrify's comments. On January 24, 2012, the United States Patent and Trademark Office issued a Right of Appeal Notice.

On September 30, 2010, Centrify filed a petition with the United States Patent and Trademark Office alleging that our 501 Patent is invalid and requesting the United States Patent and Trademark Office to commence an *inter partes* reexamination of the patentability of our 501 Patent. On November 30, 2010, the United States Patent and Trademark Office granted Centrify's petition for *inter partes* reexamination of the patentability of our 501 Patent. On January 21, 2011, the United States Patent and Trademark Office issued a first office action rejecting all claims of our 501 Patent. Our response to the United States Patent and Trademark Office was filed on March 21, 2011. On October 20, 2011, the United States Patent and Trademark Office issued an Action Closing Prosecution, rejecting all claims of our 501 patent. On December 16, 2011, the United States Patent and Trademark Office issued a Right of Appeal Notice. On January 16, 2012 we filed a Notice of Appeal. We believe that our 501 patent is valid and enforceable and intend to vigorously defend the patentability of the 501 Patent.

On May 2, 2011, Quest and Likewise agreed to the terms of a Settlement Agreement under which Quest agreed to dismiss the lawsuit against Likewise in exchange for a permanent injunction preventing Likewise (and its subsidiaries, affiliates, successors and assigns) from making, using, selling, offering to sell, importing, exporting, or supporting products or services that constitute technology covered by Quest's 501 patent or that utilize or embody the method covered by Quest's 501 patent. On May 23, 2011, the Utah Court entered the mutually agreed upon permanent injunction against Likewise, ending the case against Likewise.

General. The Company and its subsidiaries are also involved in other legal proceedings, claims and litigation arising in the ordinary course of business. The foregoing discussion includes material developments that occurred during the year ended December 31, 2011 or thereafter in our material legal proceedings.

Redeemable Noncontrolling Interest. In connection with our acquisition of a 60 percent voting equity interest in Smarsh, Inc. in October 2011, the minority shareholder who holds the remaining 40 percent noncontrolling interest was granted the right to require us to purchase half of the 40 percent noncontrolling interest from the first anniversary until the fifth anniversary of the acquisition date. The maximum redemption value payable by us in that case would be $22 million. This 20 percent noncontrolling interest is accounted for as redeemable noncontrolling interest because redemption is outside our control. As such, the redeemable noncontrolling interest is reported in the mezzanine section as temporary equity in our consolidated balance sheets. As of December 31, 2011, the carrying amount of the redeemable noncontrolling interest was increased to the redemption value of $22 million. The increase of $8.2 million was recorded in net loss attributable to noncontrolling interest, thereby directly affecting net income attributable to Quest Software, Inc.

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Construction of Building. We entered into a development agreement for facilities to house our Business Operations and Advanced Technology Center in Cork, Ireland. As of December 31, 2011, we incurred $5.2 million for the land and $6.4 million for the construction of the building. Under the development agreement, we expect approximately $18 million of capital expenditures to complete the construction of the building in 2012.

In the normal course of our business, we enter into certain types of agreements that require us to indemnify or guarantee the obligations of other parties. These commitments include (i) intellectual property indemnities to licensees of our software products, (ii) indemnities to certain lessors under office space leases for certain claims arising from our use or occupancy of the related premises, or for the obligations of our subsidiaries under leasing arrangements, (iii) indemnities to customers, vendors and service providers for claims based on negligence or willful misconduct of our employees and agents, (iv) indemnities to our directors and officers to the maximum extent permitted under applicable law, and (v) letters of credit and similar obligations as a form of credit support for our international subsidiaries and certain resellers. The terms and duration of these commitments varies and, in some cases, may be indefinite, and certain of these commitments do not limit the maximum amount of future payments we could become obligated to make there under; accordingly, our actual aggregate maximum exposure related to these types of commitments cannot be reasonably estimated. Historically, we have not been obligated to make significant payments for obligations of this nature, and no liabilities have been recorded for these obligations in our financial statements included in this report.

NOTE 18 — SUBSEQUENT EVENTS

In February 2012, we paid $20 million of the outstanding balance of our Wells Fargo line of credit. The outstanding balance after this payment was $71 million. This line of credit was recorded as current loans payable in our consolidated balance sheets (please refer to Note 8 – Loans Payable for additional details).

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QUEST SOFTWARE, INC. AND SUBSIDIARIES
FINANCIAL STATEMENT SCHEDULE
SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS

Description	Balance at Beginning of Period	Acquired Balances	Charges, Costs and Expenses	Additions/ Deductions	Balance at End of Period
			(In Thousands)		
Year ended December 31, 2011:					
Allowance for bad debt	$ 509	$ 140	$ 131	$ (171)	$ 609
Allowance for sales returns and cancellations	$ 4,858	$ 516	$ 623	$ (237)	$ 5,760
Year ended December 31, 2010:					
Allowance for bad debt	$ 535	$ —	$ 458	$ (484)	$ 509
Allowance for sales returns and cancellations	$ 5,070	$ —	$ 2,112	$ (2,324)	$ 4,858
Year ended December 31, 2009:					
Allowance for bad debt	$ 847	$ —	$ 72	$ (384)	$ 535
Allowance for sales returns and cancellations	$ 7,537	$ 1	$ 1,062	$ (3,530)	$ 5,070

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2011 Form 10-K Exhibit List

Exhibit Number	Exhibit Title
3.1*	Certificate of Incorporation of Quest Software, Inc. (incorporated by reference to our Current Report on Form 8-K filed on April 30, 2009)
3.2*	Bylaws of Quest Software, Inc. (incorporated by reference to our Current Report on Form 8-K filed on April 30, 2009)
4.1*	Form of Registrant's Specimen Common Stock Certificate (incorporated by reference to our Registration Statement on Form S-1 and all amendments thereto filed on June 11, 1999 (File No. 333-80543))
10.1*	Form of Directors' and Officers' Indemnification Agreement (incorporated by reference to our Registration Statement on Form S-1 and all amendments thereto filed on June 11, 1999 (File No. 333-80543))
10.2* ++	Quest Software, Inc. 1999 Stock Incentive Plan, as amended (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2008)
10.3* ++	Form of Stock Option Agreement used under the Quest Software, Inc. 1999 Stock Incentive Plan (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended September 30, 2004)
10.4* ++	Form of Restricted Stock Unit Award Agreement used under the Quest Software, Inc. 1999 Stock Incentive Plan, as amended (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2008)
10.5* ++	Quest Software, Inc. 2001 Stock Incentive Plan, as amended (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2008)
10.6* ++	Form of Stock Option Agreement used under the Quest Software, Inc. 2001 Stock Incentive Plan (incorporated by reference to our Registration Statement on Form S-8 (File No. 333-82784) filed on February 14, 2002)
10.7* ++	Quest Software, Inc. 2008 Stock Incentive Plan (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2008)
10.8* ++	Form of Stock Option Agreement used under the Quest Software, Inc. 2008 Stock Incentive Plan (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2008)
10.9* ++	Form of Restricted Stock Unit Award Agreement used under the Quest Software, Inc. 2008 Stock Incentive Plan (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2008)
10.10* ++	Quest Software, Inc. Executive Incentive Plan (incorporated by reference to our Annual Report on Form 10-K for the year ended December 31, 2007)
10.11*	Credit Agreement dated as of February 17, 2009 between Quest Software, Inc. and Wells Fargo Foothill, LLC (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2009)
10.12*	Amendment Number Three to Credit Agreement dated as of February 17, 2011 between Quest Software, Inc., the Lenders part thereto, and Wells Fargo Capital Finance LLC (formerly known as Wells Fargo Foothill, LLC) as the arranger and administrative agent for the Lenders (incorporated by reference to our Current Report on Form 8-K filed on February 23, 2011)
10.13*	Security Agreement dated as of February 17, 2009 among Quest Software, Inc., Aelita Software Corporation, ScriptLogic Corporation, Vizioncore, Inc., NetPro Computing, Inc. and those additional entities that hereafter become parties hereto, and Wells Fargo Foothill, LLC (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2009)
10.14* ++	Voting Agreement dated June 1, 2009 by and between Quest Software, Inc. and Vincent C. Smith (incorporated by reference to our Current Report on Form 8-K filed on June 1, 2009)
10.15*	Loan and Security Agreement, dated as of August 3, 2009, between Quest Software, Inc. as Borrower and Mutual of Omaha Bank as Lender (incorporated by reference to our Current Report on Form 8-K filed on August 7, 2009)

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Exhibit Number	Exhibit Title
10.16*	Secured Promissory Note, dated as of August 3, 2009, from Quest Software, Inc. as Maker to Mutual of Omaha Bank as Payee (incorporated by reference to our Current Report on Form 8-K filed on August 7, 2009)
10.17*	Deed of Trust, Security Agreement, Assignment of Rents and Leases, and Fixture Filing, dated as of August 3, 2009, by and among Quest Software, Inc. as Trustor, Mutual of Omaha Bank as Beneficiary, and Fidelity National Title Company as Trustee (incorporated by reference to our Current Report on Form 8-K filed on August 7, 2009)
10.18*	Environmental Certification and Indemnity Agreement, dated as of August 3, 2009, by Quest Software, Inc. as Obligor in favor of Mutual of Omaha Bank as Lender (incorporated by reference to our Current Report on Form 8-K filed on August 7, 2009)
14.1*	Code of Conduct and Ethics (incorporated by reference to our Annual Report on Form 10-K for the period ended December 31, 2009)
21.1	Subsidiaries of the Registrant
23.1	Consent of Deloitte & Touche LLP
31.1	Certification of the Principal Executive Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
31.2	Certification of the Principal Financial Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
32.1	Certification of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

* Incorporated by reference

++ Indicates a management contract or compensatory arrangement

Exhibit 21.1

Subsidiaries of Quest Software, Inc.

Name	Jurisdiction of Organization
1397639 ONTARIO, LTD	Canada
881229 ALBERTA ULC	Canada
ACTIVE CONCEPTS INC.	California
ACTIVE CONCEPTS PTY LTD	Australia
AELITA SOFTWARE (UK) LTD	UK
AELITA SOFTWARE CORPORATION	Delaware
BAKBONE SOFTWARE GMBH	Germany
BAKBONE SOFTWARE INDIA PVT. LTD.	India
BAKBONE SOFTWARE SARL	France
BAKBONE SOFTWARE, INC.	California
BAKBONE SOFTWARE, LTD.	UK
BITKOO, LLC	California
BOLTS ACQUISITION CORPORATION	Canada
CHANGE BASE LIMITED	UK
CHARONWARE SRO	Czech Republic
COLDSPARK, INC.	Delaware
*CSCAN ACQUISITION CORP.	New York
FASTLANE TECHNOLGIES CORPORATION	Delaware
FASTLANE TECHNOLOGIES (UK) LTD	UK
FRESH DEW INVESTMENTS LTD.	British Virgin Islands
*FVISIONS ACQUISITION CORP.	Nevada
IMCEDA SOFTWARE AUSTRALIA PTY LTD	Australia
IMCEDA SOFTWARE, INC.	Delaware
IMCEDA TECHNOLOGIES, PTY, LTD.	Australia
INVIRTUS, INC.	Delaware
LECCO TECHNOLOGY (UK) LIMITED	UK
LECCO TECHNOLOGY INC.	Delaware
LECCO TECHNOLOGY INC., CANADA	Canada
MAGNUM TECHNOLOGIES, INC.	Minnesota
MESSAGEWISE, INC .	Canada
MURECIA INVESTMENTS LTD.	British Virgin Islands
NETPRO COMPUTING CANADA, INC.	Arizona
NETPRO COMPUTING FRANCE, INC.	Arizona
NETPRO COMPUTING GERMANY, INC.	Arizona
NETPRO COMPUTING INC.	Delaware
NETPRO COMPUTING UK, INC.	Arizona
NETPRO ENGINEERING, INC.	Arizona
NETPRO EUROPE, INC.	Arizona
OPTIGROWTH CAPITAL SARL	Luxembourg
PACKETTRAP NETWORKS, INC.	Delaware
PASSGO TECHNOLOGIES LIMITED	UK
PASSGO TECHNOLOGIES TRUSTEES LTD	UK
Q.S.I. QUEST SOFTWARE ISRAEL LIMITED	Israel
QSFT INDIA PRIVATE LIMITED	India
QSFT SVENSKA AB	Sweden
QUEST ACQUISITION CORPORATION	California
QUEST HOLDING COMPANY, LLC	California
QUEST HOLDINGS SARL	Luxembourg
QUEST SCANDINAVIA A/S	Denmark
QUEST SOFTWARE (UK) LIMITED	UK
QUEST SOFTWARE (ZHUHAI) LTD.	China
QUEST SOFTWARE BEIJING COMPANY LIMITED	China
QUEST SOFTWARE BELGIUM NV	Belgium
QUEST SOFTWARE CANADA, INC.	Canada
QUEST SOFTWARE COMPANY LIMITED	Ireland
QUEST SOFTWARE ESPANA, SL	Spain
QUEST SOFTWARE FRANCE SARL	France
QUEST SOFTWARE GMBH	Germany
QUEST SOFTWARE GREATER CHINA LTD	Hong Kong
QUEST SOFTWARE INC.	Delaware

Subsidiaries of Quest Software, Inc. (Continued)

Name	Jurisdiction of Organization
QUEST SOFTWARE INTERNATIONAL LIMITED	Ireland
QUEST SOFTWARE ITALIA -S.R.L. UNIPERSONALE	Italy
QUEST SOFTWARE JAPAN, LTD.	Japan
QUEST SOFTWARE JAVA SUPPORT CENTRE B.V.	Netherlands
QUEST SOFTWARE KOREA LTD.	Korea
QUEST SOFTWARE LIMITED	Hong Kong
QUEST SOFTWARE LTDA	Brazil
QUEST SOFTWARE MEXICO S DE RL DE CV	Mexico
QUEST SOFTWARE NEDERLAND B.V.	Netherlands
QUEST SOFTWARE NEW ZEALAND LTD	New Zealand
QUEST SOFTWARE NORGE AS	Norway
QUEST SOFTWARE PTY LTD	Australia
QUEST SOFTWARE PUBLIC SECTOR, INC.	Delaware
QUEST SOFTWARE SALES SDN BHD	Malaysia
QUEST SOFTWARE SINGAPORE PTY LIMITED	Singapore
QUEST SOFTWARE SWITZERLAND GMBH	Switzerland
SAFARI I INC.	Delaware
SAFARI II GENERAL PARTNER LLC	Delaware
SAFARI II INC.	Delaware
SAFARI II LIMITED PARTNERSHIP	Canada
SAFARI LIMITED PARTNERSHIP	Canada
SCRIPTLOGIC AUSTRALIA PTY LTD	Australia
SCRIPTLOGIC CORPORATION	Delaware
*SMARSH CRM SERVICES, INC.	Arizona
*SMARSH INC.	New York
SURGIENT LIMITED	UK
SURGIENT, INC.	Delaware
SYMLABS ESPANA S.L.	Spain
SYMLABS S.A.	Portugal
SYMLABS, INC.	Delaware
VINTELA AUSTRALIA PTY. LTD	Australia
VINTELA PTY. LTD.	Australia
VINTELA, INC.	Utah
VIRTUAL FABRIX, INC.	California
VIZIONCORE, INC.	Illinois
VKERNEL CORPORATION	Delaware
WEDGETAIL COMMUNICATIONS, INC.	Delaware

* Quest Software, Inc. owns a 60% voting equity interest in Smarsh, Inc. Smarsh, Inc. wholly owns the following subsidiaries: CSCAN Acquisition Corp., FVisions Acquisition Corp., and Smarsh CRM Services, Inc.

EXHIBIT 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement Nos. 333-49668, 333-96183, 333-113927, 333-125398, 333-126585, 333-152064, and 333-178033 on Form S-8 of our reports dated February 28, 2012, relating to the consolidated financial statements and financial statement schedule of Quest Software, Inc. and subsidiaries (the "Company") and the effectiveness of the Company's internal control over financial reporting (which report expressed an adverse opinion on the effectiveness of the Company's internal control over financial reporting because of a material weakness), appearing in this Annual Report on Form 10-K of the Company for the year ended December 31, 2011.

/s/ Deloitte & Touche LLP

Costa Mesa, California
February 28, 2012

Exhibit 31.1

CERTIFICATION

I, Vincent C. Smith, certify that:

1. I have reviewed this Annual Report on Form 10-K of Quest Software, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 29, 2012

/s/ Vincent C. Smith

Vincent C. Smith
President and Chief Executive Officer

Exhibit 31.2

CERTIFICATION

I, Scott J. Davidson, certify that:

1. I have reviewed this Annual Report on Form 10-K of Quest Software, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 29, 2012

/s/ Scott J. Davidson

Scott J. Davidson
Senior Vice President and Chief Financial Officer

Exhibit 32.1

Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Pursuant to the requirement set forth in Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. §1350), Vincent C. Smith, Chief Executive Officer of Quest Software, Inc. (the "Company"), and Scott J. Davidson, Chief Financial Officer of the Company, each hereby certifies that, to the best of his or her knowledge:

1. The Company's Annual Report on Form 10-K for the period ended December 31, 2011, to which this Certification is attached as Exhibit 32.1 (the "Annual Report") fully complies with the requirements of Section 13(a) or Section 15(d) of the Exchange Act, and

2. The information contained in the Annual Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

In Witness Whereof, the undersigned have set their hands hereto as of the 29th day of February, 2012.

/s/ Vincent C. Smith	/s/ Scott J. Davidson
Vincent C. Smith	Scott J. Davidson
President and Chief Executive Officer	Senior Vice President and Chief Financial Officer

This certification accompanies the Form 10-K to which it relates, is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of Quest Software, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of the Form 10-K), irrespective of any general incorporation language contained in such filing.