QUADRAMED CORP
Form 10-K
March 16, 2007
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the Fiscal Year Ended December 31, 2006

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Transition period from to

Commission File Number: 0-21031

QUADRAMED CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

DELAWARE	52-1992861
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)
12110 SUNSET HILLS ROAD, SUITE 600	
RESTON, VIRGINIA	20190
(Address of Principal Executive Offices)	(Zip Code)

(703) 709-2300

(Registrant s Telephone Number, Including Area Code)

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

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

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

NONE

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

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

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

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

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

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

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

The aggregate market value of voting and non-voting stock held by non-affiliates of the Registrant as of June 30, 2006, the last business day of the Registrant s most recently completed second quarter was approximately $59,830,382 (based upon the price at which the common stock was last sold as reported by the American Stock Exchange on June 30, 2006). Shares of common stock held by each officer, director and holder of 10% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

On March 7, 2007, 43,663,718 shares of the Registrant s common stock, $0.01 par value per share, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company s Proxy Statement to be filed subsequently for the 2007 Annual Meeting of Stockholders are incorporated herein by reference in Part III.

Table of Contents

QUADRAMED CORPORATION

FORM 10-K

ANNUAL REPORT

FOR THE YEAR ENDED DECEMBER 31, 2006

TABLE OF CONTENTS

Table of Contents

Cautionary Statement on Risks Associated With Forward-Looking Statements

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

We advise investors that we discuss other risks and uncertainties that could cause our actual results to differ from these forward-looking statements in *Item 1A. Risk Factors* of this Annual Report on Form 10-K.

PART I

Item 1. Business

Overview

The business mission of QuadraMed Corporation along with our subsidiaries (QuadraMed or the Company) is to advance the success of healthcare organizations through IT solutions that leverage quality care into positive financial outcomes. QuadraMed s driving principles include: maintaining long-term client relationships, building a culture of customer care, focusing on innovation as the key to success, and striving to always deliver value. QuadraMed offers innovative, user-friendly software applications designed and developed by the healthcare professionals and software specialists we employ.

In the healthcare market, clinical information and quality measurements are becoming drivers of revenue management. Access management, financial decision support, health information management (HIM) processes and systems combined with patient accounting systems are driving revenue management improvements and the movement to new quality-based reimbursement models. As evolving reimbursement scenarios will challenge hospitals to leverage quality of care into appropriate payment, we believe that clients committing to QuadraMed s Care-Based Revenue Cycle solutions will realize improved financial performance. QuadraMed s goal is to assist our clients in attaining significant improvement in financial success by leveraging quality of care into positive financial outcomes through performance-based IT solutions. We seek to accomplish this goal by delivering healthcare information technology products and services that support the healthcare organizations efforts to improve the quality of the care they provide and the efficiency with which it is delivered.

Using QuadraMed s solutions that are designed to optimize the patient experience and leverage quality of care into payment, our clients seek to receive the proper reimbursement, in the shortest time, at the lowest administrative cost. Our products are designed to eliminate paper, improve processes, streamline efficiencies and decrease error through the efficient management of patient clinical and financial records, resulting in better patient safety. Healthcare organizations of varying size, from small single entity hospitals to large multi-facility care delivery organizations, acute care hospitals, specialty hospitals, Veterans Health Administration facilities and associated/affiliated businesses such as outpatient clinics, long-term care facilities, and rehabilitation hospitals gain value from our solutions. Our products are sold as standalone, bundled or fully integrated software packages.

We do business directly and through our subsidiaries, all of which are wholly owned and operated under common management. In December 2004, we announced the shutdown of our Financial Services Division; operations ceased in February 2005. Accordingly, beginning in 2005, the Company considers itself to be a single reporting segment, specifically the software segment. The prior year financial results of these operating

Table of Contents

segments have been reclassified to conform to the current year presentation. The prior year consolidated financial statements and notes are included herein on Page F-1 of this Annual Report on Form 10-K.

Our corporate headquarters are located at 12110 Sunset Hills Road, Reston, Virginia in the Washington, D.C. metropolitan area. The Company was incorporated in 1993 and reincorporated in Delaware in 1996. Our telephone number is 703-709-2300. We file quarterly and annual reports, proxy statements and other information with the Securities and Exchange Commission (SEC). You may read and copy any document that we file at the SEC s Public Reference Room at 100 F Street, N.E.,, Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference rooms. Our SEC filings are also available to the public from the SEC s website at http://www.sec.gov and on our website, http://www.quadramed.com, which features all of our current SEC filings free of charge as soon as reasonably practicable after they are filed with the SEC. Our SEC filings are also available at the office of the American Stock Exchange. For further information on obtaining copies of our public filings from the American Stock Exchange, please call 212-306-1331.

Market for Healthcare Information Technology

The healthcare industry is the largest industry in the United States economy. The Centers for Medicare and Medicaid Services (CMS) estimate that 2007 total healthcare expenditures in the United States will be approximately $2.3 trillion, or approximately 16.8% of the U.S. gross domestic product. CMS estimates that by 2015, total U.S. healthcare spending will reach $4.0 trillion, or 20% of the estimated U.S. gross domestic product. Hospital services represent one of the largest categories of total healthcare expenditures. According to CMS, in 2007, spending on hospital services will amount to approximately $709.1 billion, or 30.5% of total healthcare expenditures. According to the American Hospital Association, there are approximately 4,900 community hospitals in the United States. The healthcare industry is under increasing pressure from the government, consumers, employers and third-party payers to increase the use of technology to improve efficiency, eliminate errors and enhance the quality of care. This fact is demonstrated by the number of government, private industry and consumer-driven initiatives that are acting as catalysts and driving the business decisions made by healthcare executives.

The need to increase the use of technology to improve patient safety became evident in 2000 when the Institute of Medicine of the National Academy of Sciences (IOM) published a report entitled To Err is Human: Building a Safer Health System. This report detailed the extent of preventable medical errors in today s hospitals errors which were estimated to cause between 44,000 and 98,000 deaths each year. Another IOM report, published in 2001, Crossing the Quality Chasm: A New Health System for the 21st Century, led to the development of initiatives for public reporting on performance, pay for performance and quality improvement. In September 2004, the IOM launched the Redesigning Health Insurance Performance Measures, Payment, and Performance Improvement Programs project in response to the Medicare Prescription Drug Improvement and Modernization Act of 2003. This project resulted in a series of three reports released in 2005 and 2006 with a focus on improving the quality of care. The first report focused on the selection of measures to support quality improvement efforts and on the creation of a common infrastructure for managing a consistent set of measures nationally and regionally. The second report suggests that Medicare s Quality Improvement Program be restructured so it can become an important national resource integral to strategies of performance measurement, public reporting, and payment incentives. The third report analyzes the promise and risks of instituting a pay for performance program within Medicare to encourage a more effective health care system.

Other federal government agencies are key players in driving the need for information technology. As one of the largest payers of healthcare in the United States, CMS has an important role to play in supporting states in their efforts to implement quality improvement strategies including pay for performance programs, care coordination, patient safety initiatives, e-prescribing, electronic medical records, public reporting, evidence-based guidelines and performance measurement. CMS initiated a three-year pay for performance demonstration project in October 2003 in which hospitals were rewarded financially for providing higher levels of quality care. In January 2007, CMS announced that the second year results from this project resulted in a substantial

4

Table of Contents

improvement in patient care. Following this announcement, CMS approved a three-year extension of the pay for performance demonstration project in order to test new incentive models and ways to measure quality. We believe this is additional evidence that pay for performance works.

Congress has also passed various laws that were designed to facilitate the use of technology in the healthcare industry. First, the Health Insurance Portability and Accountability Act of 1996 (HIPAA) and the regulations implementing its administrative simplification provisions have had a significant impact on healthcare organizations and their need for technology. HIPAA s scope is very broad; it applies to health plans, most healthcare providers and healthcare clearinghouses. These covered entities must comply with a variety of administrative simplification regulations issued per HIPAA, including the Privacy Rule, the Transactions Rule and the Security Rule. The Privacy and Security Rules require covered entities to protect the privacy and security of individually identifiable patient health information called protected health information. The Transactions Rule requires covered entities to conduct certain specified transactions (for example, health plan enrollment) using specific electronic formats and codes. These rules may increase healthcare entities need for technology solutions. For example, prior to the Privacy Rule, there was no federal requirement that healthcare entities track and account for all non-routine disclosures of protected health information and provide a summary of the same at the patient s request. The complexity of tracking all such disclosures per the Privacy Rule s requirements, as well as providing the patient with a record of what has been disclosed, places both a burden and a risk on the organization. As such, healthcare information technology companies, particularly healthcare information system vendors, often partner with healthcare organizations to help them meet the significant regulatory requirements mandated by the HIPAA Rules.

Second, the Medicare Prescription Drug Improvement and Modernization Act of 2003 (MMA) contained a number of different provisions designed to increase the use of technology in the healthcare industry. For example, the MMA contains provisions that aim to increase the use of electronic prescribing in order to reduce medical errors. The MMA also authorizes a chronic care improvement program designed to improve chronic care for Medicare beneficiaries through, among other things, the use of information technology.

QuadraMed s Strategy

New financially oriented incentives based on quality, adherence to evidenced-based medicine and improvements in clinical outcomes are being explored in the healthcare sector and these efforts are likely to result in new quality-based reimbursement and pay for performance programs. Market dynamics are also creating the connected healthcare community which requires interconnectivity across hospitals, physician, pharmacy, laboratory, outpatient, long-term care, home health, payer sites and the community. Certain management functions will remain hospital-centered; however, systems must now cover a spectrum of patient activities within the ambulatory and inpatient arena to ensure adherence to quality standards and improve efficiency of care. As interconnectivity and ultimately interoperability become essential, patient identification and record locator services become critical to success; to empower patients and consumers through the development of personal health records and to support patient safety efforts, anticipated public health monitoring and reporting, and epidemiologic and bio-terror surveillance initiatives.

Our goal is to increase market share by offering innovative and user-friendly clinical, administrative, financial and health information management solutions to meet the demand among hospitals and other healthcare providers looking to achieve improvements in financial success by leveraging quality of care into positive financial outcomes using performance-based IT solutions. To achieve this goal, we have combined the considerable healthcare expertise of our product managers with the technological skill of our development engineers in an effort to assure that our products are designed and supported by professionals who understand healthcare requirements, health trends and healthcare providers.

Table of Contents

Industry analysts have recently written reports that we believe validate our strategy.

The industry s major technology challenge is integration of all kinds data integration, device integration, network integration and process integration. Better integration of information systems, as well as process improvements that provide more efficient ways to collect, use, and communicate information, can go far toward improving patient safety and increasing efficiency, two key goals of forward-thinking healthcare providers. Marc Holland IDC Analyst Connection, Clinical and Financial Information Integration: A Critical Component of IT Effectiveness, November 2006

Next generation clinical and financial information systems must address RCM from a care-based perspective in order for organizations to fully realize their revenue potential as the paradigm of reimbursement shifts to payment based on quality and performance. 2007 Health Information Management Systems Society Analytics Report: Care-Based Revenue Cycle Management Report.

QuadraMed continues to focus our strategy around our core software business and seeks to achieve industry leadership by:

- Building upon our value proposition that QuadraMed solutions can optimize the patient experience and leverage quality of care into payment for hospitals to achieve the proper reimbursement in the shortest amount of time, at the lowest administrative cost;
- Aligning our resources and efforts around a vision that quality measurements and clinical outcomes improvements are likely to result in new quality-based reimbursement and pay for performance programs that will impact approaches to revenue management;
- Continuing to enhance functionality and scope of our existing solutions to meet market driven demands;
- Improving consistency of the underlying technology and our support services across our solutions to meet emerging trends related to interoperability and quality-based reimbursement;
- Providing through development, partnership or acquisition, additional software applications to complement our product line consistent with our mission and value proposition;
- Increasing our footprint in the current customer base and growing sales volume by selling new and enhanced applications to our existing customer base;
- Acquiring new customers for our integrated solution set, as well as in stand-alone sales opportunities through expanded professional sales, marketing and industry activities; and
- Maintaining expense discipline.

QuadraMed s Products and Solutions

QuadraMed provides comprehensive software and service solutions that help our customers achieve clinical and financial efficiency across the continuum of patient care through our Care-Based Revenue Cycle solutions. A significant portion of our software license arrangements also require us to provide product maintenance and implementation services to customers. These services include installations, maintenance, consulting and training.

QuadraMed s Care-Based Revenue Cycle solutions begin with Access Management, the entry point for the patient experience. Through these solutions, patients and resources are identified accurately at entry points throughout a healthcare enterprise. Our Care Management solutions are patient-centric and facilitate the delivery of safe, accurate and timely care as clinicians focus on patient care. QuadraMed HIM solutions provide a powerful link between access, care and patient revenue. With patient information a key element of quality care, our HIM solutions enable healthcare organizations to efficiently manage information critical to all processes within their facility. QuadraMed s Patient Revenue Management solutions are designed to facilitate timely, accurate and complete billing. At the core of the Care-Based Revenue Cycle solutions are embedded HIPAA electronic data interchange (EDI) transaction sets which drive our workflow-oriented solutions. These solutions

Table of Contents

offer the flexibility of sending transactions to a clearinghouse or directly to payers. They also provide smarter technology such as exception-driven workflow and rules-based logic that are designed to ensure that healthcare organizations have the right tools available to work the right account at the right time. In addition, we have solutions that fulfill additional needs including decision support, pharmacy, radiology and laboratory.

Software Solutions

QuadraMed Access Management

QuadraMed Patient Access products include:

Enterprise Scheduling

Web Scheduling

Medical Necessity

Insurance Verification

Patient Kiosk

Surgery Management

QuadraMed s Care-Based Revenue Cycle solutions begin with Access Management, the entry point for the patient experience. Through these solutions, patients and resources are identified accurately across the healthcare enterprise. From setting physician orders in motion to maximizing how healthcare organizations use their resources, QuadraMed s advanced Access Management rules engine enables facilities to optimize the patient experience. QuadraMed Care-Based Revenue Cycle solutions streamline patient access and manage the scheduling needs of a customer s entire enterprise with QuadraMed Enterprise Scheduling. These solutions are designed to maximize a facility s resources by moving patients through a customer s organization efficiently, without costly delays and conflicts.

QuadraMed Smart Identity Management

QuadraMed Smart Identity Management products include:

Smart Identity Exchange®

MPI Cleanup

MPIspy®

SmartID®

SmartMerge®

SmartScan®

Accurate person identification and Master Patient or Person Index (MPI) data integrity are the foundation of patient safety, quality healthcare and accurate reimbursement. QuadraMed s Smart Identity Management Solutions leverage advanced technology, powerful workflow tools and proven methodologies to provide a comprehensive identity management program for today s healthcare enterprises.

QuadraMed Health Information Management

QuadraMed Health Information Management products include:

Abstracting

Facility Coding

Table of Contents

Physician Coding

Compliance

Record Management

Electronic Document Management

Workflow

QuadraMed HIM solutions provide powerful links between access, care and patient revenue. With patient information a key element of quality care, these HIM solutions enable healthcare organizations to efficiently manage information critical to processes within their facilities. QuadraMed HIM solutions offer a web-native, fully integrated health information management platform designed to improve healthcare providers compliance and reimbursement. Our HIM products integrate across the suite of Care-Based Revenue Cycle solutions. These solutions are designed with input from HIM professionals to ensure improvements in all key success metrics.

QuadraMed Care Management

QuadraMed Care Management products include:

Orders and Results

Reports/Notes Transcription

Charting

VS I/O Assessments

Medication Management

CPOE

Physician Access

Decision Support

Core Measures (Clinical Outcome Practice Evaluator (COPE)

Laboratory

Radiology

Pharmacy

Acuity Plus (Patient Care Resource Management)

Care delivery is at the heart of QuadraMed s Care-Based Revenue Cycle solutions. QuadraMed helps healthcare organizations reach the goal of an Electronic Health Record (EHR) with integrated, workflow-driven solutions that enable clinicians to organize and manage patient care activities, access patient information and document the care they provide. QuadraMed Care Management solutions are focused on the patient, facilitating the delivery of safe, accurate and timely care. Regulatory compliance, quality reporting and billing information are produced as clinicians care for their patients. QuadraMed Computerized Physician Order Entry (CPOE) brings innovation in clinical decision support to the industry using advanced knowledge management functionality with the goal of improving patient safety and outcomes.

QuadraMed Patient Revenue Management

QuadraMed Patient Revenue Management products include:

Patient Accounting

EDI

Table of Contents

Contract Management

Account Workflow

Central Business Office

General Ledger

Accounts Payable

Payroll/Personnel

InSight

Performance Measurement

QuadraMed s Patient Revenue Management solutions are designed to facilitate timely, accurate and complete billing. At the core of these Care-Based Revenue Cycle solutions are embedded HIPAA EDI transaction sets that drive our workflow-oriented solutions. These solutions offer the flexibility of sending transactions to a clearinghouse or directly to payers. They also provide smarter technology such as exception-driven workflow and rules-based logic, ensuring that healthcare organizations have the right tools available to work the right account at the right time. With these powerful advantages, QuadraMed Patient Revenue Management solutions effectively and efficiently manage the business of transforming patient care into revenue. QuadraMed s Patient Revenue Management includes comprehensive HIPAA-compliant EDI, integrated denial management and exception-driven workflow to help our customers reach financial success.

Other Products

QuadraMed *Decision Support* products include*:*

Contract Management

Performance Measurement

COPE (Clinical Outcome Practice Evaluator)

Contract Management is a managed care contract management system; *Performance Measurement* is a clinical and financial outcome analysis and decision support system.

QuadraMed *Government Solutions* include*:*

Encoder Product Suite (EPS)

VIP Compliance Suite (VIP)

VA Chart Complete (VACC)

Workflow Analysis & Product Utilization Enhancement Services (WFA-PUE)

Consulting Services

QuadraMed offers a full range of consulting services for today s healthcare challenges. These services include providing technical assistance to maximize healthcare organizations technology investments, comprehensive Smart Identity Management clean-up services to resolve costly patient identity errors and assisting in clinical transformation initiatives. Additionally, QuadraMed provides services to help organizations achieve true enterprise scheduling for improved efficiency, and patient and physician satisfaction. QuadraMed also meets the needs of today s government care providers with services improving the Department of Veterans Administration Medical Centers revenue cycle management and departmental communication for better care delivery.

Table of Contents

Product Development Strategy

The key drivers for our technology development are portability of information, flexibility of deployment, access anywhere and anytime, and data standardization. Our technology strategy is guided by the following technology trends:

- The Internet and distributed computing have had and will likely continue to have a significant impact on the way software is developed and delivered;
- Web-native applications with a modern Internet architecture will likely have a significant role in the future; and
- Computing power, storage capacity, and network bandwidth have, and may continue to, double every 18, 12, and 6 months, respectively.

We believe that the principles upon which our core products are being developed will enhance their ability to be easily accessed, scaled, extended and integrated with the customer s legacy systems. These principles include:

- **Standards Based:** Our products support industry standards, such as Health Level 7 (HL7), X12 EDI and XML. This standards-based approach enables QuadraMed customers to preserve their investments in previously installed departmental systems and to support a corporate-wide integration strategy. Increasingly, our products will make it possible to integrate information from different environments into a single, patient-centered database.
- **Platform Independent:** We intend to isolate the application business logic and user interface from the underlying hardware and operating system through an adaptive technology framework and core services. A QuadraMed customer will be able to pursue the most advantageous hardware route generally without affecting data portability.
- **Scalable and Reliable:** Our architecture is based upon the communications and networking facilities of UNIX and Windows. The adaptive architecture offers great scalability and reliability from small to large enterprise systems.
- **Flexible and Customizable:** Our architecture includes powerful tools that allow users to adapt the system to their specific needs. At the institution level, customers can design custom data entry screens, reports, and workflow without programming. At the user level, the framework supports end user authoring which allows physicians and clinicians to easily configure the system to provide the information that they need, in a format that they are comfortable with, and organized to support the way they work.
- **Ease of Installation and Implementation:** Our emerging architecture makes it easy to install and implement. The use of web-based thin clients eliminates the need for manual software installation and configuration on individual workstations. Our products are designed to support incremental installation, specializing in interfacing with legacy systems, thereby providing the customer with a rapid return on investment.
- **Web Accessible:** Our newer applications are fully web accessible, including a web-native and Java (J2EE)-based framework that is fully integrated with core enterprise-wide registration, clinical and financial systems. This architecture also allows integration with existing web portals to make enterprise wide information web-accessible.

We depend on licenses from a number of third-party vendors for certain technology, including the computer hardware, operating systems, database management systems, programming language and runtime environment upon which we develop and operate our products. We are materially reliant upon licenses with the following third-party vendors: InterSystems Corporation, Document Storage Systems, Inc., Megas Corporation, Unicor Medical, Oracle, Microsoft, Quovadx, the American Medical Association, and the American Hospital

Table of Contents

Association. Most of our licenses expire within three to five years. Such licenses can be renewed only by mutual consent. Most of our third-party licenses are non-exclusive and competitors may obtain the same or similar technology. Most application software companies, including QuadraMed and its competitors, are reliant on licensed technology and third-party components for the development and operation of their software products. Therefore, we believe that our reliance on licensed technology does not place us at a competitive disadvantage. Moreover, as discussed above, a key component of our product development strategy is to become platform-independent, which we believe will mitigate the risks of our reliance on third-party licenses.

Technical Architecture

To eliminate the disparity of technical architectures that has resulted from our many corporate acquisitions, we have established a technical architecture which guides the development and integration of our products. We have focused on integrating the functionality of our products through the development of web-native applications (designed to run in a web browser) built on n-tiered architecture (developed in discrete layers separating the user interface from the business rules and data storage to provide maximum platform independence). The layers of this architecture are as follows:

Platform the platform layer is the computer hardware and operating system. Our software is designed to be system independent, which means it can run on a variety of hardware and operating systems from a number of vendors. Our systems can run on computers from any manufacturer that supports Microsoft Windows or commercial Unix operating systems.

Database the database layer consists of a commercial relational database management system such as Oracle, Microsoft SQL Server or InterSystems Cache. Our software is designed to be database independent and is capable of being deployed on a variety of database management systems.

EDR the Enterprise Data Repository (EDR) is the developed implementation of a healthcare specific data model. The design of the EDR continues to be heavily influenced by the HL7 Reference Information Model (RIM). HL7 is the recognized governing standards body for healthcare information technology. The RIM includes definitions for objects and acts specific to healthcare, including complete conceptual definitions of terms like patient, provider, procedure and diagnosis, and the potential relationships among the terms.

Framework the Framework layer is a developed layer that implements a set of core services which are reusable across our applications. By developing a set of core services in a common framework, we are able to support our product families and leverage the vast amount of healthcare domain knowledge that is embedded in products like Health Information Management Coding or Patient Care and Revenue Management CPOE.

Application Logic the Application Logic layer is a developed layer that implements specific applications such as Health Information Management Coding or Pharmacy. Application layers use combinations of Framework layer services and application specific business logic. The differentiating code that makes one product distinct from another is developed in this layer.

Thin Client the Thin Client or presentation layer is responsible for the presentation of the software to the end user, in other words, what the user views on the screen. By designing our systems to run in a web browser, we build in a great deal of flexibility in the deployment of our applications. By separating the presentation layer from the application layer, we greatly simplify the task of supporting new end user devices as they become available.

Product Families the architecture supports our product strategy. QuadraMed s two major product families, Patient Care and Revenue Management and Health Information Management , are being developed in the QuadraMed architecture which is an integrated,

standards-based software platform that simplifies and automates workflow across the continuum of patient care. It is this core technology that supports QuadraMed products and enables their integration into a new or existing system.

Table of Contents

Customers

We primarily market to acute care hospitals and multi-facility care delivery organizations or integrated delivery networks. We also sell products to Veterans Health Administration facilities, specialty hospitals and physicians. We have customers located in all 50 states, the District of Columbia, Puerto Rico, Canada, Australia, New Zealand, and the United Kingdom. In 2006, sales to Veterans Health Administration facilities accounted for approximately 13% of our total revenues and sales to The County of Los Angeles accounted for 11% of our total revenues. In 2005, sales to Veterans Health Administration facilities, both directly and indirectly through Micron Government Computer Systems, accounted for approximately 10% of our total revenues. In 2004, The County of Los Angeles, accounted for 11% of our total revenues and the Veterans Health Administration facilities, both directly and indirectly through Micron Government Computer Systems, accounted for 10% of our total revenues.

Highly Competitive Market

Competition for our products and services is intense and is expected to increase. We compete with other providers of healthcare information software and services, as well as healthcare consulting firms. Our principal competitors include McKesson Corporation, Inc., Siemens Medical Services Health Services Corporation, Meditech Corporation, Eclipsys Corporation, Cerner, GE/IDX Medical Systems, and 3M/SoftMed Corporation. Other competitors include niche providers of electronic document management software, Smart Identity Management products and services, decision support products and financial services consulting and outsourcing.

Some of our competitors may be in a position to devote greater resources to the development, marketing and sales of their products and services. The trend towards merger and consolidation could further increase the level of competition providing other companies with greater ability to develop products on more aggressive schedules. Some of the main considerations of our customers that impact competition are customer service and support, ability to install systems in a reasonable timeframe, use of open standards as well as industry standards that allow disparate systems to work together, product functionality, company reputation and stability, and price.

Environmental

The Company believes that its compliance with federal, state and local environmental laws and regulations has no material effect on its capital expenditures, earnings or competitive position.

FDA

Computer products used or intended for use in the diagnosis, cure, mitigation, treatment or prevention of diseases or other conditions or that affect the structure or function of the body are subject to regulation by the U.S. Food and Drug Administration (FDA) under the Federal Food, Drug and Cosmetic Act (Act). Our Laboratory solutions are considered Class I medical devices that are regulated under the Act and amendments to the Act. As such, we are subject to regulation by the FDA with regard to those solutions that are actively regulated.

Intellectual Property

We rely on a combination of copyright, trademark and trade secret law, and nondisclosure and non-compete agreements to protect our proprietary methodologies, computer software and databases. In addition, we require that all employees sign an agreement prohibiting them from disclosing or using our confidential information and requiring them to disclose and assign to us any new ideas, developments, discoveries or inventions related to our business. Further, we enter into non-disclosure agreements with business partners and customers in the ordinary course of business. The Company initiated a new branding strategy in 2007 that included the adoption of a new slogan, Quality Care. Financial Health., which currently is pending registration at the United States Patent and

Table of Contents

Trademark Office and is expected to be registered soon. We have obtained trademark registrations in the United States for most of our corporate and product trademarks and service marks (to the extent applicable), including QuadraMed, Affinity, Quantim, Tempus, pcMAR, MPIspy, SmartMerge, TempusOne, TempusXpress, nCoder+, WinCoder+, MEDREC Millennium and SmartID, among others. In addition, we are in the process of obtaining trademark registrations in Australia, New Zealand and a number of European countries for the QuadraMed and QuadraMed Affinity marks.

We have not filed for nor obtained any patents for our proprietary technology since 2001, when we filed a provisionary patent application for our Affinity CPOE software application, which has since lapsed. We continue to evaluate our technology for potentially patentable products. In the future, we may seek patents for new products if, in our business judgment, the products are patentable and such protection is warranted. Finally, in order to develop our products, we depend on licenses from third-party vendors. To the extent possible, we ensure that all third-party vendors will indemnify us for infringement of any third-party s intellectual property rights.

Employees

QuadraMed s staff includes product management and development teams with healthcare experience, software engineers, sales and marketing, and corporate support/administrative. We believe that we have a satisfactory relationship with our employees, none of whom are represented by a union or other collective bargaining group. As of December 31, 2006, we had approximately 578 employees: 79 in general and administration, 57 in sales and marketing, and the remaining employees in technical, consulting, research and development and support services. During the first quarter of fiscal year 2006, the Company announced a corporate reorganization and a reduction in our workforce. As a result, approximately 5% of the employees left the Company.

Software Development

All of the Company s software development expense represents costs associated with the development of new products for which technological feasibility has not been achieved, enhancements of existing products and quality assurance activities. These costs primarily relate to employee compensation and benefit costs. As of December 31, 2006, we had 224 full-time employees engaged in software development. Our software development expense was $30.2 million, $30.5 million and $28.1 million for the years ended December 31, 2006, 2005 and 2004, respectively.

Item 1A. Risk Factors

You should carefully consider the following factors and other information set forth in this report, including our financial statements and the related notes. The risks set forth below are in addition to risks that apply to most businesses. Our business and future performance may be affected by the following:

We Have Incurred Losses from Continuing Operations for the Four Years Prior to 2006. Our Losses Have Adversely Affected Our Ability to Compete.

While we had income from continuing operations of $11.9 million for the year ended December 31, 2006, we incurred losses from continuing operations of $1.5 million, $34.8 million, $19.0 million and $19.9 million for the years ended December 31, 2005, 2004, 2003 and 2002, respectively.

Our historical losses have impaired our ability to market our products and services in competition against companies that are more profitable. If we are unable to sustain profitability, it may impair our ability to compete effectively.

Table of Contents

Failure to Maintain Effective Internal Controls Could Have a Material Adverse Effect on Our Business, Operating Results and Stock Price.

We have documented and tested our internal control procedures in connection with Section 404 of the Sarbanes-Oxley Act of 2002. Our annual management assessment of the effectiveness of our internal control over financial reporting is included in this Form 10-K under *Item 9A. Controls and Procedures*. As reported in Item 9A management believes that our internal control over financial reporting and disclosure controls and procedures are effective as of December 31, 2006.

Reports of our management and our independent auditors pursuant to Section 404 were included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2005, filed with the SEC on March 16, 2006, as amended by Amendment No. 1, filed with the SEC on August 17, 2006; in our Annual Report on Form 10-K for the fiscal year ended December 31, 2004, filed with the SEC on March 25, 2005, as amended by Amendment No. 1, filed with the SEC on April 29, 2005, and Amendment No. 2, filed with the SEC on January 4, 2006; and in the Company s Quarterly Reports on Form 10-Q, filed with the SEC on May 10, 2005 (as amended and filed on January 4, 2006), August 9, 2005 and November 9, 2005. In our Annual Report for the fiscal year ended December 31, 2004, our management identified control deficiencies and material weaknesses in internal control over financial reporting and in our disclosure controls and procedures as of December 31, 2004 and as of the end of each quarter in 2005 through September 30, 2005.

During 2005, the Company invested significant time and resources to remediate such material weaknesses, and as such, there were significant changes in our internal control over financial reporting during 2005 that materially affected our internal control over financial reporting in a positive way. These changes were aimed at eliminating internal control deficiencies in both the Company s revenue and closing cycles.

If we fail to maintain the adequacy of our internal control over financial reporting and disclosure controls, as such standards are modified, supplemented or amended from time to time, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002. Moreover, effective internal controls, particularly those related to revenue recognition, are important in helping ensure that we produce reliable financial reports and prevent financial fraud. If we cannot provide reliable financial reports or prevent fraud, our business and operating results could be harmed, investors could lose confidence in our reported financial information and the trading price of our stock could drop significantly.

Additional Costs for Complying With Recent and Proposed Future Changes in SEC, American Stock Exchange and Accounting Rules Could Adversely Affect Our Profits.

Recent and proposed future changes in SEC and American Stock Exchange rules, as well as changes in accounting rules, have caused us, and will continue to cause us, to incur additional costs including professional fees and added personnel costs in order to keep informed of the changes and operate in a compliant manner. We incurred, and expect to continue to incur, additional general and administrative expenses in order to maintain compliance with Section 404 of the Sarbanes-Oxley Act of 2002, which requires management to report on, and (in future periods) our independent auditors to attest to, our internal controls. These additional costs may be significant enough to cause our financial position and results of operation to be adversely affected. In addition, compliance with these rules could also result in continued diversion of management s time and attention, which could prove to be disruptive to our normal business operations. Failure to comply with any of the laws and regulations could adversely impact market perception of our Company, which could make it difficult to access the capital markets or otherwise finance our operations in the future.

Table of Contents

Our Ability to Borrow or Issue Additional Shares of Preferred Stock Is Restricted by the Terms of Our Series A Preferred Stock.

The Certificate of Designation governing our Series A Preferred Stock provides that so long as at least 600,000 shares of Series A Preferred Stock are outstanding, at least 66 2/3% of the votes entitled to be cast by the holders of the Series A Preferred Stock shall be required to approve the incurrence by QuadraMed of any long-term senior indebtedness of QuadraMed in an aggregate principal amount exceeding $8,000,000, excluding certain prior existing indebtedness. Furthermore, the Certificate of Designation requires the affirmative vote of a majority of any outstanding shares of the Series A Preferred Stock prior to the authorization or creation of, or increase in the authorized amount of, any shares of any class or series (or any security convertible into shares of any class or series) ranking senior to or on par with the Series A Preferred Stock in the distribution of assets upon any liquidation, dissolution or winding up of QuadraMed or in the payment of dividends. This may hinder or delay our ability to borrow funds or issue preferred stock.

Our Quarterly Operating Results Are Subject to Fluctuations, which Could Adversely Affect Our Financial Results and the Market Price of Our Common Stock.

Our quarterly operating results have varied significantly in the past and may fluctuate in the future as a result of a variety of factors, many of which are outside our control. Accordingly, quarter-to-quarter comparisons of our operating results may not be indicative of our future performance. Some of the factors causing these fluctuations include:

- Variability in demand for products and services;
- Introduction of product enhancements and new products by us and our competitors;
- Timing and significance of announcements concerning present or prospective strategic alliances;
- Discontinuation of, or reduction in, the products and services we offer;
- Loss of customers due to consolidation in the healthcare industry;
- Delays in product delivery requested by our customers;
- Customer budget cycle fluctuation;
- Investment in marketing, sales, software development and administrative personnel necessary to support anticipated operations;
- Delays in implementation due to product readiness, customer induced delays in training or installation and third-party interface development delays;

Costs incurred for marketing and sales promotional activities;

Software defects and other product quality factors;

General economic conditions and their impact on the healthcare industry;

Cooperation from competitors on interfaces and implementation when a customer chooses a QuadraMed software application to use with various vendors;

Final negotiated sales prices of systems;

The fines and penalties a healthcare provider or system may incur due to fraudulent billing practices;

Federal regulations (*i.e.*, OIG, HIPAA, ICD-10) that can increase demand for new, updated systems; and

Federal regulations that directly affect reimbursements received, and therefore the amount of money available for purchasing information systems.

Table of Contents

In addition to the foregoing, a significant percentage of our total cost of revenue is attributable to the cost of third-party software royalties and licenses relating to third-party software embedded within our software applications. The cost of third-party software royalties and licenses, as a percentage of total cost of revenue, was approximately 26%, 21%, and 20% for the years ended December 31, 2006, 2005, and 2004, respectively. Generally, royalty fees for third-party licenses will fluctuate based on revenue or the number of our customers and therefore will fluctuate on a quarter-to-quarter basis.

Our Operating Expenses are Fixed, and We May Not Be Able to Reduce Them to Offset a Potential Future Revenue Decrease.

Our operating expense levels are relatively fixed. Accordingly, if future revenues are below expectations, we would experience a disproportionate adverse affect on our net income and financial results. In the event of a revenue shortfall, we will likely be unable to, or may elect not to, reduce spending quickly enough to offset any such shortfall. As a result, it is possible that our future revenues or operating results may fall below the expectations of securities analysts and investors. In such a case, the price of our publicly traded securities may be adversely affected.

We Could Experience a Significant Impact on Our Revenue if Our Customers Do Not Renew Maintenance Contracts.

We derive a significant percentage of our revenue, including 45% of our total revenue for fiscal year 2006, from maintenance services. We provide maintenance services under maintenance contracts to many of our customers in connection with our healthcare information technology products. In general, these maintenance contracts renew on an annual basis. If a significant portion of these maintenance contracts were not renewed, our maintenance revenues would decline which could have a material adverse effect on our total revenue for the period(s) in which the maintenance contracts were discontinued.

Future Sales of Our Common Stock in the Public Market, Warrants or Option Exercises and Sales Could Lower Our Stock Price.

A substantial number of shares of our common stock are issuable upon the exercise of stock options and warrants and upon conversion of our Series A Preferred Stock. We cannot predict the effect, if any, those future sales of such shares of common stock, or the availability of shares of common stock for future sale, will have on the market price of our common stock. Sales of substantial amounts of common stock issued or issuable upon the exercise of stock options or warrants or upon the conversion of our Series A Preferred Stock, or the perception that such sales could occur, may adversely affect prevailing market prices for our common stock.

If Our Series A Preferred Stock is Converted into Common Stock, these Converting Stockholders Will Have Significant Voting Power, and They Will Have the Ability to Exert Substantial Influence Over Matters Requiring Stockholder Approval.

Each share of our Series A Preferred Stock is convertible into 8.0645 shares of our common stock, and the Series A Preferred Stockholders may convert at any time. If all of our Series A Preferred Stock is converted into common stock, the shares issued upon this conversion will total approximately 42.5% of our outstanding common stock. In addition, many of our Series A Preferred Stockholders own common stock. Therefore, although these stockholders may not acquire majority control upon conversion of their Series A Preferred Stock, if these distinct stockholders were to act together, they will have the ability to exert substantial influence over all matters requiring approval of our stockholders, including the election and removal of directors, the approval of mergers or other business combinations, and other significant corporate actions. This ability to influence our affairs might not be advantageous to our other stockholders.

16

Table of Contents

The Trading Price of Our Common Stock Has Been, and Is Expected to Continue to Be, Volatile.

The American Stock Exchange and stock markets in general, have historically experienced extreme price and volume fluctuations that have affected companies unrelated to their individual operating performance. The trading price of our common stock has been and is likely to continue to be volatile due to such factors as:

- Variations in quarterly results of operations;
- Announcements of new products or acquisitions by our competitors;
- Government regulatory action;
- Resolution of pending or unasserted litigation;
- Developments or disputes with respect to proprietary rights; and
- General trends in our industry and overall market conditions.

Movements in prices of equity securities in general may also affect the market price of our common stock.

Provisions in Our Certificate of Incorporation and Bylaws and Delaware Law Could Delay or Discourage a Takeover and Could Adversely Affect the Price of Our Common Stock.

Our Board of Directors has the authority to issue an additional one million shares of preferred stock over and above the four million shares already issued, and to determine the price, rights, preferences, privileges and restrictions, including voting rights, of those shares without any further vote or action by holders of our common stock. If additional preferred stock is issued, the voting and other rights of the holders of our common stock may be subject to, and may be adversely affected by, the rights of the holders of our preferred stock. The issuance of preferred stock may have the effect of delaying or preventing a change of control of the Company that could have been at a premium price to our stockholders. Our Board of Directors has issued four million shares of such preferred stock as Series A Preferred Stock and the holders of the Series A Preferred Stock have certain voting and board appointment rights.

Certain provisions of our Certificate of Incorporation and Bylaws could discourage potential takeover attempts and make stockholders attempts to change management difficult. Our Board of Directors has the authority to impose various procedural and other requirements that could make it more difficult for our stockholders to effect certain corporate actions. In addition, our Certificate of Incorporation provides that directors may be removed only by the affirmative vote of the holders of two-thirds of the shares of our capital stock entitled to vote. Any vacancy on our Board of Directors may be filled only by a vote of the majority of directors then in office. Further, our Certificate of Incorporation provides that the affirmative vote of two-thirds of the shares entitled to vote, voting together as a single class, subject to certain exceptions, is required for certain business combination transactions. These provisions, and certain other provisions of our Certificate of Incorporation, could have the effect of delaying or preventing (i) a tender offer for our common stock or other changes of control of the Company that could be at a premium price or

(ii) changes in our management.

In addition, certain provisions of Delaware law could have the effect of delaying or preventing a change of control of the Company. Section 203 of the Delaware General Corporation Law, for example, prohibits a Delaware corporation from engaging in any business combination with any interested stockholder for a period of three years from the date the person became an interested stockholder unless certain conditions are met.

We Do Not Expect to Pay Cash Dividends on Common Stock in the Foreseeable Future.

We have not declared or paid cash or other dividends on our common stock and do not expect to pay cash dividends for the foreseeable future. Our ability to pay dividends is also restricted by the terms of our Series A Preferred Stock which require us to pay full cumulative dividends on the Series A Preferred Stock before making

Table of Contents

any dividend payment on our common stock. Further, the Series A Preferred Stock is entitled to quarterly dividends of $0.34375 (5.5% per annum) per share. Upon conversion of the Series A Preferred Stock into shares of common stock, the Series A Preferred stockholders have the right to receive, when declared by our Board of Directors, dividends equal to the total previously unpaid dividends payable from the effective date of conversion through June 1, 2007 at a rate of $1.375 (5.5%) per share per annum, discounted to present value at a rate of 5.5% per annum, payable in cash or common shares, or any combination thereof at our option. We currently intend to retain all future earnings for use in the operation of our business and to fund future growth. Any future cash dividends will depend upon our results of operations, financial conditions, cash requirements, the availability of a surplus and other factors.

Our Inability to Protect Our Intellectual Property Could Lead to Unauthorized Use of Our Products, which Could Have an Adverse Effect on Our Business.

We rely on a combination of trade secret, copyright and trademark laws, nondisclosure, non-compete and other contractual provisions to protect our proprietary rights. In 2001, we filed our first patent application covering our developed technology, the Affinity CPOE software application. This application lapsed, and we have no patents. Measures taken by us to protect our intellectual property may not be adequate, and our competitors could independently develop products and services that are substantially equivalent or superior to our products and services. Any infringement or misappropriation of our proprietary software and databases could put us at a competitive disadvantage in a highly competitive market and could cause us to lose revenues, incur substantial litigation expense and divert management s attention from other operations.

We are Dependent Upon Third-Party Software Licenses in Connection with the Sale of Our Software. If These Licenses Are Not Renewed or Are Terminated, We May Not Be Able to Continue to Use the Related Technology on Commercially Reasonable Terms or at All.

We depend on licenses from a number of third-party vendors for certain technology, including the computer hardware, operating systems, database management systems, programming language and runtime environment upon which we develop and operate our products. We are materially reliant upon licenses with the following third-party vendors: InterSystems Corporation, Document Storage Systems, Inc., Megas Corporation, Unicor Medical, Oracle, Microsoft, Quovadx, the American Medical Association and the American Hospital Association. Most of these licenses expire within three to five years. Such licenses can be renewed only by mutual consent and may be terminated if we breach the license terms and fail to cure the breach within a specified time period. If such licenses are terminated, we may not be able to continue using the technology on commercially reasonable terms or at all. As a result, we may have to discontinue, delay or reduce product shipments until equivalent technology is obtained, which could have a material adverse effect on our business, financial condition and results of operations. However, as all application software companies, including QuadraMed and our competitors, are reliant on licensed technology and third-party components, we believe our reliance on such technology and licenses does not place us at a competitive disadvantage.

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

Most of our third-party licenses are non-exclusive and competitors may obtain the same or similar technology. In addition, if vendors choose to discontinue support of the licensed technology, we may not be able to modify or adapt our products.

Table of Contents

We Face Product Development Risks Associated with Rapid Technological Changes.

The healthcare software market is highly fragmented and characterized by ongoing technological developments, evolving industry standards and rapid changes in customer requirements. Our success depends on our ability to timely and effectively:

- Offer a broad range of software products;
- Enhance existing products and expand product offerings;
- Respond promptly to new customer requirements and industry standards;
- Remain compatible with popular operating systems and develop products that are compatible with new or otherwise emerging operating systems; and
- Develop new interfaces with competing healthcare information system vendors to fully integrate our Health Information Management product suite in order to maximize features and functionality of the new products.

Our performance depends in large part upon our ability to provide the increasing functionality required by our customers through the timely development and successful introduction of new products and enhancements to our existing suite of products. We may not successfully, or in a timely manner, develop, acquire, integrate, introduce or market new products or product enhancements. Product enhancements or new products developed by us also may not meet the requirements of hospitals or other healthcare providers and payers or achieve or sustain market acceptance. Our failure to either estimate accurately the resources and related expenses required for a project, or to complete our contractual obligations in a manner consistent with the project plan upon which a contract was based, could have a material adverse effect on our business, financial condition and results of operations. In addition, our failure to meet a customer s expectations in the performance of our services could damage our reputation and adversely affect our ability to attract new business.

If Our Products Fail to Accurately Assess, Process or Collect Healthcare Claims or Administer Managed Care Contracts, We Could Be Subject to Costly Litigation and Be Forced to Make Costly Changes to Our Products.

Some of our products and services are used in the payment, collection, coding and billing of healthcare claims and the administration of managed care contracts. If our employees or products fail to accurately assess, process or collect these claims, customers could file claims against us. Our insurance coverage may not be adequate to cover such claims. A successful claim that is in excess of, or is not covered by, insurance coverage could adversely affect our business, financial condition and results of operations. Even a claim without merit could result in significant legal defense costs and could consume management time and resources. In addition, claims could increase our premiums such that appropriate insurance could not be found at commercially reasonable rates. Furthermore, if we were found liable, we may have to alter significantly one or more of our products, possibly resulting in additional unanticipated software development expenses.

Changes in Procurement Practices of Hospitals Have and May Continue to Have a Negative Impact on Our Revenues.

A substantial portion of our revenues has been and is expected to continue to be derived from sales of software products and services to hospitals. Hospitals are slow to make changes and generally favor their existing vendor when considering an upgrade in their systems. Consolidation in the healthcare industry, particularly in the hospital and managed care markets, could decrease the number of existing or potential purchasers of products and services and could adversely affect our business. In addition, the decision to purchase our products often involves a committee approval. Consequently, it is difficult for us to predict the timing or outcome of the buying decisions of our customers or potential customers. In addition, many healthcare providers are consolidating to create integrated delivery networks with greater regional market power. Others are participating in the regional health information organizations (RHIOs) or health information networks (HINs), some of which may seek to

Table of Contents

implement a single electronic health information solution for participating organizations. These emerging systems RHIOs, and HINs could have greater bargaining power, which may lead to decreases in prices for our products, and consequently could adversely affect our business, financial condition and results of operations.

Changes in the Healthcare Financing and Reimbursement System Could Adversely Affect the Amount of and Manner in which Our Customers Purchase Our Products And Services.

Changes in current healthcare financing and reimbursement systems (e.g., Medicaid) could result in unplanned product enhancements, delays or cancellations of product orders or shipments, or reduce the need for certain systems. We could also have the endorsement of products by hospital associations or other customers revoked. Any of these occurrences could have a material adverse effect on our business. Alternatively, the federal government recently mandated that all but small healthcare providers submit claims to Medicare in electronic format, which may positively affect sales of our systems and products.

Healthcare Regulations and Reform Proposals Could Adversely Affect Demand for Our Products.

The healthcare industry in the United States is subject to changing political, economic and regulatory influences that may affect the procurement practices and operations of healthcare organizations. The traditional hospital delivery system is evolving as more hospital services are being provided by niche, free standing practices and outpatient providers. The commercial value and appeal of our products may be adversely affected if the current healthcare financing and reimbursement systems were to change. During the past several years, the healthcare industry has been subject to increasing levels of governmental regulation. Proposals to reform the healthcare system have been and are being considered by the United States Congress. These proposals, if enacted, could adversely affect the commercial value and appeal of our products or change the operating environment of our customers in ways that cannot be predicted. Healthcare organizations may react to these proposals by curtailing or deferring investments, including those for our products and services. In addition, the regulations promulgated under the Health Insurance Portability and Accountability Act of 1996 (HIPAA) could lead healthcare organizations to curtail or defer investments in non-HIPAA related features in the next several years.

Government Regulation of E-Prescribing and Electronic Health Record Technologies Could Increase Administrative Costs and Decrease Product Demand.

The U.S. Department of Health and Human Services (DHHS) has issued final rules protecting certain eligible entities that provide electronic prescribing (e-prescribing) and electronic health record (EHR) items and services to certain eligible recipients. The final rules became effective October 10, 2006. The EHR safe harbor protects, among other things, donations of software or information technology. The rule requires that a recipient pay 15% of the donor s cost for the items and services and also requires that reference to the donor s cost of the items or services be included in the agreement between the parties. The safe harbor will sunset on December 31, 2013. The e-prescribing safe harbor is largely reflective of the Congressional mandate requiring its implementation under MMA. This safe harbor does not include a requirement that the provider bear 15% of costs. The EHR and e-prescribing exceptions to the physician self-referral (Stark) law are very similar to the anti-kickback safe harbors, described above, while nevertheless accounting for the differences in the underlying statutes. For example, the EHR exception requires a receiving physician to pay 15% of the cost of the items or services, and the exception will sunset in 2013.

One or more of the above-referenced rules may increase the administrative costs typically associated with the sale of our products to the extent we are required to provide more detailed cost estimates to both parties participating in a proposed donation of technology. Failure on our part to provide accurate cost estimates could lead to contractual or legal exposure. In addition, we may be asked to execute agreements between

prospective donors and recipients as a third party. Such requests may require additional review and analysis. In some cases, an agreement may provide either or both parties with the option to terminate the agreement upon either a change

Table of Contents

in law or experienced counsel s opinion of the law. As these safe harbors and exceptions may be subject to ambiguity, differing interpretation, and potential future sub-regulatory guidance, and given the inherent sensitivities to achieving compliance with safe harbors and exceptions, such termination provisions may have a negative impact on contractual certainty, especially in the context of certain longer-term arrangements, including servicing arrangements.

Customer frustration with the compliance obligations associated with the above-referenced rules, or fear that failure to comply fully with these rules could result in legal exposure, could decrease demand for our products. Alternatively, the protection afforded by these rules for the donation of electronic health information technologies may positively affect sales of our systems and products.

The Variability and Length of Our Sales Cycle for Our Products May Exacerbate the Unpredictability and Volatility of Our Operating Results.

We cannot accurately forecast the timing of customer purchases due to the complex procurement decision processes of most healthcare providers and payers. How and when to implement, replace, expand or substantially modify an information system are major decisions for hospitals, and such decisions require these entities to make significant capital expenditures. As a result, we typically experience sales cycles that extend over several quarters. In particular, our Patient Care and Revenue Management software has a higher average selling price and longer sales cycle than many of our other products. As a result, we have only a limited ability to forecast the timing and size of specific sales, making the prediction of quarterly financial performance more difficult.

We Operate in a Highly Competitive Market.

Competition for our products and services is intense and is expected to increase. Increased competition could result in reductions in our prices, gross margins and market share and have a material adverse effect on our business, financial condition and results of operations. We compete with other providers of healthcare information software and services, as well as healthcare consulting firms. Some competitors have formed business alliances with other competitors that may affect our ability to work with some potential customers. In addition, if some of our competitors merge, a stronger competitor may emerge. Some principal competitors include:

In the market for healthcare information systems: McKesson Corporation, Inc., Siemens Health Services, a division of Siemens Medical Solutions of Siemens AG, MediTech Corporation, Eclipsys Corporation and Cerner;

In the market for electronic document management products: McKesson Corporation, SoftMed Corporation Inc., FileNet, Streamlined Health, MedPlus and Eclipsys Corporation;

In the market for Smart Identity Management products and services: Initiate Systems, Inc., McKesson Corporation, Siemens Health Services, a division of Siemens Medical Solutions of Siemens AG, and Medibase;

In the market for decision support products: Eclipsys Corporation, Healthcare Microsystems, Inc., a division of Health Management Systems Inc., McKesson Corporation, Siemens Health Services, a division of Siemens Medical Solutions of Siemens AG, and MediQual Systems, Inc., a division of Cardinal Health, Inc.; and

In the market for coding, compliance, data, and record management products in the Health Information Management Software Division: 3M Corporation, SoftMed Corporation, Inc., MetaHealth, Eclipsys Corporation and HSS, Inc., an Ingenix Corporation.

Prospective customers may evaluate our products capabilities against the merits of their existing information systems and expertise and decide to stay with their incumbent vendor due to the cost associated with conversion. In addition, existing and prospective customers may be reluctant to buy from us because of the losses we have incurred in past years.

Table of Contents

Many of our current and potential competitors have significantly greater financial, technical, product development, marketing and other resources, and market recognition than we have. These competitors may be in a position to devote greater resources to the development, promotion and sale of their products than we can. Our competitors also have, or may develop or acquire, substantial installed customer bases in the healthcare industry. As a result of these factors, our competitors may be able to respond more quickly to new or emerging technologies, changes in customer requirements and changes in the political, economic or regulatory environment in the healthcare industry.

As a result of the current emphasis on patient safety, the selection of a new hospital information system is frequently based on the strength of the vendor s clinical application and many of our competitors have invested considerably more in clinical development than we have.

Major software information systems companies, including those specializing in the healthcare industry, that do not presently offer competing products may enter our markets.

We may not be able to compete successfully against current and future competitors, and such competitive pressures could have a materially adverse affect on our business, financial condition and operating results.

We Have Encountered Significant Challenges Integrating Acquired Businesses, and Future Transactions May Adversely Affect Our Business, Operations and Financial Condition.

Throughout our history, we have made many acquisitions and have encountered significant challenges integrating the acquired businesses into our operations. In recent years, we have made significant progress toward that integration. However, we continue to support different technology platforms. In the future, we plan to make investments in or acquire additional complementary businesses, products, services or technologies. These investments and acquisitions will create new integration challenges. Some of the challenges we have encountered, and may encounter with acquisitions in the future, in integrating acquired businesses include:

Interruption, disruption or delay of our ongoing business;

Distraction of management s attention from other matters;

Additional operational and administrative expenses;

Difficulty managing geographically dispersed operations;

Failure of acquired businesses to achieve expected results, resulting in our failure to realize anticipated benefits;

Write-down or reclassification of acquired assets;

Failure to retain key acquired personnel and difficulty and expense of training those retained;

Increases in compensation and stock compensation expenses resulting from newly hired employees;

Assumption of liabilities and potential for disputes with the sellers of acquired businesses;

Customer dissatisfaction or performance problems related to acquired businesses;

Failure to maintain good relations with customers or suppliers;

Exposure to the risks of entering markets in which we have no prior direct experience and to risks associated with market acceptance of acquired products and technologies; and

Platform and technical issues related to integrating systems from various acquired companies.

In the past, all of these factors have had an adverse effect on our business, financial condition and results of operations. We could also face these same challenges in the future.

Table of Contents

Our Laboratory Solutions are Subject to FDA Regulation. We May Be Required to Make Substantial Changes to Our Products if More of Our Products Become Subject to FDA Regulation, which Could Require a Significant Capital Investment.

Computer products used or intended for use in the diagnosis, cure, mitigation, treatment or prevention of diseases or other conditions or that affect the structure or function of the body are subject to regulation by the U.S. Food and Drug Administration (FDA) under the Federal Food, Drug and Cosmetic Act (Act). Our Laboratory solutions are considered Class I medical devices that are regulated under the Act and amendments to the Act. While we were required to register our Laboratory solutions with the FDA, they are exempted from the FDA s more onerous and costly premarket notification procedures.

In the future, the FDA could determine that some of our products, because of their predictive aspects, are clinical decision tools and subject them to regulation, including registration and, perhaps, premarket notification requirements. Compliance with such FDA regulations could be burdensome, time consuming and expensive. Other new laws and regulations affecting healthcare software development also could be enacted in the future. If so, it is possible that our costs and the length of time for product development could increase and that other unforeseeable consequences could arise.

Governmental Regulation of the Confidentiality of Patient Health Information Could Result in Our Customers Being Unable to Use Our Products Without Significant Modification, which Could Require Significant Capital Expenditures.

There is substantial state and federal regulation of the confidentiality of patient health information and the circumstances under which such information may be used by, disclosed to, or processed by us as a consequence of our contacts with various health plans and healthcare providers. This includes state and federal requirements designed to prevent I.D. theft. Although compliance with these laws and regulations is presently the principal responsibility of our customers (*e.g*., health plans, hospitals, physicians or other healthcare providers), regulations governing patient confidentiality rights are dynamic and rapidly evolving. As such, laws and regulations currently applicable only to certain healthcare entities could be modified so that they could directly apply to us. Additionally, changes to the laws and regulations that would require us to change our systems and our methods may be made in the future, which could require significant expenditure of capital and decrease future business prospects. Also, additional federal and state legislation governing the dissemination of patient health information may be proposed and adopted, which may also significantly affect our business. Finally, certain existing laws and regulations require healthcare entities to contractually pass on their obligations to other entities with which they do business; as such, we are indirectly impacted by various additional laws and regulations.

HIPAA is a federal law that affects the use, disclosure, transmission and storage of individually identifiable health information referred to as protected health information. As directed by HIPAA, DHHS must promulgate standards or rules for certain electronic health transactions, code sets, data security, unique identification numbers and privacy of protected health information. DHHS has issued some of these rules in final form, while others remain in development. In general, under these rules, we function as a business associate to some of our customers (who are considered to be covered entities under HIPAA). The three rules primarily relevant to us and our customers the Transactions Rule, the Privacy Rule and the Security Rule are discussed below. It is important to note that DHHS could, at any time in the future, modify any existing final rule in a manner that could require us to change our systems or operations.

First, DHHS has published a final HIPAA rule governing transactions and code set standards (Transactions Rule). The Transactions Rule had a compliance date of October 16, 2003. To the extent necessary to help our covered entity customers conduct transactions, we believe that our current products and services meet the requirements of the Transactions Rule. Nevertheless, as noted above, DHHS may make further revisions to the Transactions Rule, which could require us to change our products and systems to enable our covered entity customers to meet such obligations.

Second, DHHS has published a final HIPAA privacy rule (Privacy Rule) which had a compliance date of April 14, 2003. The Privacy Rule is complex and far reaching. Similar to the Transactions Rule, as noted above, the Privacy Rule directly applies to covered entities. Also, covered entities are, in most instances, required to

Table of Contents

execute a contract with any business associate that performs certain services on the covered entity s behalf involving the exchange or creation of protected health information. Our hospital and health plan customers are covered entities, and to the extent that we are required by our customers to comply with various contractual safeguards mandated by the Privacy Rule, we believe that we meet the requirements. The Privacy Rule and other similar state healthcare privacy regulations could materially restrict the ability of healthcare providers and health plans to disclose protected health information from patient records using our products and services, or it could require us to make additional capital expenditures to be in compliance. Accordingly, the Privacy Rule and state privacy laws may significantly impact our products use in the healthcare delivery system and, therefore, decrease our revenues, increase working capital requirements and decrease future business prospects.

Third, DHHS has published the final HIPAA security rule (Security Rule) with a compliance date of April 20, 2005. The Security Rule applies to the use, disclosure, transmission, storage and destruction of electronic protected health information by covered entities. The Security Rule requires that covered entities must implement administrative, technical and physical security measures to safeguard electronic protected health information. Also, as with the Privacy Rule, under the Security Rule, covered entities are required to enter into contracts with their business associates that include certain mandatory health information safeguards. As such, where we function as a business associate to a customer that is a covered entity, we are required to enter into a business associate contract with that customer. Implementing such measures may require us to expend substantial capital due to required product, service and procedure changes.

We have completed modifications to our business practices and software offerings so that we are able to assist our customers in complying with the Transactions Rule, Privacy Rule and Security Rule. However, DHHS continues to publish change notices to the existing rules and propose new rules. There is no certainty that we will be able to respond to all such rules in a timely manner and our inability to do so could adversely affect our business.

Government Regulation to Adopt and Implement ICD-10-CM and ICD-10-PCS Medical Code Set Standards Could Require Substantial Modification of our Coding and Compliance Software

The American Health Information Management Association and other prominent healthcare industry advocacy groups are calling on DHHS and the healthcare industry to take action to adopt and implement ICD-10-CM and ICD-10-PCS code sets, rules and guidelines as a replacement for current ICD-9-CM guidelines used in our software products. Adoption of these new code sets would require us to change our systems and our methods which could require a significant expenditure of software development capital and decrease future business prospects for our current product line.

Item 1B. Unresolved Staff Comments

None

Item 2. Properties

We lease all of our facilities and do not own any real property. Our executive and corporate offices are located in Reston, Virginia, in approximately 70,750 square feet of leased office space under a lease that expires in 2011. We also lease approximately 41,000 and 34,000 square feet of office space in San Marcos, California and San Rafael, California, respectively. The San Marcos lease expires in May 2008 and the San Rafael lease expires in December 2009. In connection with the relocation of our corporate headquarters to Reston, Virginia, we actively

marketed and subleased 33% of the vacant San Rafael, California facility in 2006. We continue to actively market for sublease the remaining space. The San Marcos facility housed, among other things, the Financial Services Division, which was closed as of February 14, 2005. The Company actively marketed this space and subleased 100% of the facility in 2006. We believe that our facilities provide sufficient space for our present needs, and that additional suitable space, if needed, would be available on reasonable terms.

Table of Contents

Item 3. Legal Proceedings

None

Item 4. Submission of Matters to a Vote of Security Holders

The results of the voting at the Company s 2006 Annual Meeting of Stockholders, held on May 11, 2006, were previously reported by the Company in its Current Report on Form 8-K filed with the SEC on May 26, 2006.

Item 4A. Executive Officers of the Registrant

QuadraMed s executive officers as of December 31, 2006 are as follows:

Name	Age	Position
Keith B. Hagen	44	Chief Executive Officer and President
David L. Piazza	52	Chief Financial Officer and Executive Vice President
James R. Klein	59	Chief Technology Officer and Executive Vice President, Product Management
James R. Milligan	46	Senior Vice President, Sales and Government Programs
Steven V. Russell	50	Senior Vice President, Corporate Development

Keith B. Hagen (44) has served as our Chief Executive Officer and President since October 2005. From March 2003 until joining the Company, Mr. Hagen served as the President and a director of M. Transaction Services, Inc., a national healthcare electronic data interchange (EDI) service provider and subsidiary of Misys PLC, where he was responsible for their transaction service operations. He served as Senior Vice President for Product Development and Chief Technology Officer of Misys Healthcare Systems, a leading healthcare IT company and subsidiary of Misys PLC, from July 2001 to March 2003. He also served as Senior Vice President for Product Development and Chief Technology Officer with Sunquest Information Systems from March 2000 until July 2001, at which time Misys PLC acquired Sunquest. Until January 2000, he served as Senior Vice President for Products and Technology and Chief Technology Officer for The Compucare Company, which was acquired by QuadraMed in 1999. Mr. Hagen has over twenty-one years of experience in healthcare information technology and operations. Mr. Hagen received a Bachelor of Science degree in Computer Science from the State University of New York.

David L. Piazza (52) became our Chief Financial Officer and Executive Vice President in August 2005. Mr. Piazza joined the Company in October 2003 as Vice President of Finance and has been responsible for all non-accounting finance and administrative matters for the Company. From June 2001 to October 2003, Mr. Piazza was Chief Financial Officer of Gemplex Inc., a global Virtual Private Network provider in Vienna, Virginia, and from December 1999 to June 2001, he was Chief Financial Officer and Senior Vice President, International of Teligent International in Vienna, Virginia. Mr. Piazza has twenty years of experience in the telecommunications sector, where he has worked with both public and private companies. He is a CPA and began his career in the public accounting practice, where he specialized in the audits of regulated companies. Mr. Piazza is a graduate of the University of Illinois.

James R. Klein (59) became our Chief Technology Officer and Executive Vice President of Product Management in August 2005. Mr. Klein is a healthcare information technology veteran who served as Director of Healthcare Technology from August 2004 to August 2005 for the Company s technology partner, InterSystems Corporation. In addition, he served as Vice President and Research Director at the Gartner Group from April 1997 to August 2004. Prior to joining the Gartner Group, he was Vice President of The Compucare Company, a company later acquired by QuadraMed in 1999. Mr. Klein has over twenty-five years of experience in the healthcare information technology industry. Mr. Klein received a Bachelor of Science degree in Mathematics from Villanova University and a Masters Degree from the University of Maryland.

Table of Contents

James R. Milligan (*46*) became our Senior Vice President for Sales and Government Programs in November 2005. Mr. Milligan joined QuadraMed in October 2001 as a regional Vice President for Enterprise Sales, and he assumed responsibility for the Company s Client Management program in January 2005 and the Government business in July 2005, and was named Senior Vice President for Enterprise Marketing and General Manager for Government Programs in August 2005. Prior to joining the Company, he was District Manager at EMC Corporation from November 2000 to October 2001 and Vice President of Sales and Marketing for Milbrook Corporation in Addison, Texas from March 1999 to November 2000. Mr. Milligan has over twenty years of hospital and physician information systems experience. Mr. Milligan holds a Bachelor of Science degree in Business Administration from The University of Ashland.

Steven V. Russell (*50*) became our Senior Vice President of Corporate Development in November 2005. Most recently, Mr. Russell had been Vice President for HIM National Sales at Precyse Solutions, an HIM consulting and services company, from April 2005 to November 2005. From May 2000 to February 2005, he was Senior Vice President at Healthscribe, Inc. serving as an Executive Officer and member of the Executive Operating Committee, charged with the sales, marketing, business development and client implementation functions. He served as Executive Vice President of Phycom, Inc. from 1999 to 2000, Senior Vice President of Field Operations for The Compucare Company from 1997 to 1999, and Regional Vice President for Cerner Corporation, from 1996 to 1997, where he was responsible for branch office operations of the Washington DC/Mid-Atlantic office including sales, client installations, client management and office administration. Mr. Russell has over twenty years of healthcare sales and marketing and operations experience in the healthcare information technology and healthcare services industries. Mr. Russell holds a Bachelor of Arts degree from Indiana University.

Table of Contents

PART II

Item 5. Market for Registrant s Common Equity and Related Stockholder Matters

(a) Market Information

Our common stock currently trades on the American Stock Exchange (symbol: QD).

On March 14, 2007, the high and low prices for our common stock on the American Stock Exchange were $3.31 and $3.21 per share, respectively.

The following table sets forth the high and low prices for our common stock traded on the American Stock Exchange for the periods indicated.

Fiscal Year Ended December 31, 2006	**High**	**Low**
Quarter ended March 31	$ 2.300	$ 1.300
Quarter ended June 30	$ 2.540	$ 1.850
Quarter ended September 30	$ 2.300	$ 1.660
Quarter ended December 31	$ 3.250	$ 2.180
Fiscal Year Ended December 31, 2005	**High**	**Low**
Quarter ended March 31	$ 2.590	$ 1.300
Quarter ended June 30	$ 1.890	$ 1.100
Quarter ended September 30	$ 2.150	$ 1.600
Quarter ended December 31	$ 1.950	$ 1.150

Table of Contents

Stock Price Performance Graph

The Stock Price Performance Graph below represents a comparison of the five year total return of QuadraMed Corporation Common Stock, the AMEX Market Index and the NASDAQ Market Index. The graph assumes $100 was invested on December 31, 2001 and dividends are reinvested for all years ending December 31.

We have authorized 150,000,000 shares of common stock, with a par value of $0.01 per share. We have authorized 5,000,000 shares of preferred stock, par value $0.01 per share. Our Board of Directors has authority to provide for the issuance of our shares of preferred stock in series, to establish from time to time the number of shares to be included in each such series and to fix the designation, powers, preferences and rights of the shares of each such series and the qualifications, limitations or restrictions thereof, without any further vote or action by the stockholders. As of December 31, 2006, we had 43,220,970 shares of common stock outstanding, plus warrants to purchase 2,069,718 shares of common stock, and 4,000,000 shares of preferred stock designated as Series A Cumulative Mandatory Convertible Preferred Stock (Series A Preferred Stock), which are convertible into 8.0645 shares of common stock per share of Series A Preferred Stock.

Table of Contents

(b) Holders

On March 7, 2007, there were 315 holders of record and approximately 4,900 beneficial holders of our common stock.

(c) Dividends

We have never declared or paid any cash dividends on our common stock and do not anticipate paying any cash dividends in the foreseeable future. We anticipate that we will retain earnings, if any, to finance the growth and development of our business. Generally, the Series A Preferred Stock is entitled to quarterly dividends of $0.34 (5.5% per annum) per share. However, as provided in the Certificate of Designation relating to the Series A Preferred Stock, because a registration statement covering the resale of such shares was not declared effective by the SEC on or before June 15, 2005, the quarterly dividends for such stock increased to $0.40625 per share (6.5% per annum) commencing on June 16, 2005, and such dividends applied through December 1, 2006 when the registration statement was declared effective. Upon conversion into shares of common stock, the Series A Preferred stockholders have the right to receive, when declared by our Board of Directors, dividends equal to the total previously unpaid dividends payable from the effective date of conversion through June 1, 2007 at a rate of $1.375 (5.5%) per share per annum, discounted to present value at a rate of 5.5% per annum, payable in cash or common stock, or any combination thereof at our option. The terms of the Series A Preferred Stock require us to pay full cumulative dividends on the Series A Preferred Stock before making any dividend payment on our common stock. Therefore, we do not expect to pay cash dividends on our common stock for the foreseeable future. Any future determination to pay cash dividends will be at the discretion of our Board of Directors and will depend upon our financial condition, operating results, capital requirements, plans for expansion, restrictions imposed by any financing arrangements and whatever other factors that our Board of Directors determines are relevant.

(d) Securities Authorized for Issuance Under Equity Compensation Plans

This table provides information about our common stock subject to equity compensation plans as of December 31, 2006.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans
Approved By Stockholders (1)	7,783,087(2)	$ 3.63	561,710(3)
Not Approved by Stockholders (4)	1,565,000	$ 1.79	n/a

(1) The Company has issued stock options and restricted stock under its 1996 Stock Incentive Plan (the 1996 Plan), the 1999 Supplemental Stock Option Plan (the 1999 Plan) and the 2004 Stock Compensation Plan (the 2004 Plan), all of which were approved by stockholders. The 2004 Plan superseded the Company s 1996 Stock Incentive Plan, as amended, and the 1999 Supplemental Stock Option Plan, as amended, as of May 6, 2004, although stock options and restricted stock under the 1996 and 1999 Plans outstanding as of that date remain subject to the terms of those plans.

(2) Includes options originally issuable under various benefit plans of entities acquired by us.

(3) This number excludes options and restricted shares outstanding and shares issued upon exercise of options plan-to-date, as of December 31, 2006.

(4)

The Company has issued stock options outside of stockholder-approved equity compensation plans as inducements for the employment of the following executives: Keith B. Hagen (550,000; exercise price of $1.83), James R. Klein (200,000; exercise price of $1.74), Steven V. Russell (75,000; exercise price of $1.24) and John C. Wright (750,000; exercise price of $1.82). Mr. Wright s service to the Company terminated on August 31, 2005. All such options were granted pursuant to an Inducement Stock Option Agreement entered into between the Company and the individual executive. The terms of these Inducement

Table of Contents

Stock Option Agreements provide (i) for a fixed exercise price as set forth in each agreement, which is the closing price of the Company s common stock on the grant date or the last trading day prior to the grant date or state the exercise price will be the closing price of the Company s common stock on the grant date or the last trading day prior to the grant date; (ii) options have a maximum term of ten years; (iii) 25% of the recipient s options vest on the first anniversary of the grant, with the remaining 75% vesting pro rata in a series of 36 equal monthly installments upon the recipient s completion of each month of employment after the first anniversary of the grant date; (iv) upon the executive s involuntary termination (other than a termination for cause) or a change in control of the Company, all options fully vest and remain exercisable for 12 months (for Mr. Wright, this was 36 months) or until the expiration date (which is ten years from the grant date); (v) upon the executive s death or permanent disability, all options that had vested until the date of cessation of service remained exercisable for 12 months (for Mr. Klein, 6 months; for Mr. Wright, 36 months, and Mr. Wright was to be credited with an extra 12 months of service in the event of his death or permanent disability); (vi) upon the executive s voluntary termination, all options that had vested until the date of cessation of service remained exercisable for 3 months (for Mr. Wright, 36 months); and (vii) upon the executive s termination for cause, the options terminate immediately.

(e) Recent Sales of Unregistered Securities

None

(f) Stock Repurchases

None

Table of Contents

Item 6. Selected Financial Data

The selected consolidated financial data presented below for the five years ended December 31, 2006, is derived from our Consolidated Financial Statements and related notes thereto. This selected consolidated financial data should be read in conjunction with *Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations*, and the Consolidated Financial Statements and related notes thereto included in Financial Statements and Supplementary Data of this Annual Report on Form 10-K. Historical results are not necessarily indicative of future results.

	Year ended December 31,				
(in thousands, except per share amounts)	**2006**	**2005**	**2004**	**2003**	**2002**
Consolidated Statement of Operations Data:					
Revenue	$ 125,201	$ 122,313	$ 124,804	$ 115,955	$ 97,103
Gross margin	$ 78,879	$ 76,669	$ 74,375	$ 71,023	$ 53,554
Sales & marketing, general & administrative	$ 34,007	$ 41,604	$ 53,812	$ 55,598	$ 45,718
Software development	$ 29,858	$ 30,476	$ 28,056	$ 23,798	$ 20,471
Amortization of intangible assets and depreciation (1)	$ 4,195	$ 4,904	$ 4,495	$ 4,525	$ 5,574
Restatement costs	$	$	$	$ 7,461	$ 7,463
Exit cost of facility closing	$	$ 1,066	$ 4,190	$	$
Income (loss) from operations	$ 10,819	$ (1,381)	$ (16,178)	$ (12,898)	$ (18,209)
Interest expense	$ (379)	$ (607)	$ (4,814)	$ (7,704)	$ (2,833)
Gain (loss) on redemption or retirement of debentures	$	$	$ (14,871)	$	$
Income (loss) from continuing operations before income taxes	$ 12,287	$ (1,226)	$ (34,982)	$ (19,095)	$ (19,919)
Benefit (provision) for income taxes	$ (342)	$ (277)	$ 175	$ 48	$
Income (loss) from continuing operations	$ 11,945	$ (1,503)	$ (34,807)	$ (19,047)	$ (19,919)
Loss from discontinued operations	$	$	$ (3,690)	$ (4,896)	$ (3,219)
(Loss) gain on disposal of discontinued operations	$	$ (2,435)	$ (3,332)	$	$ 8,776
Net income (loss)	$ 11,945	$ (3,938)	$ (41,829)	$ (23,943)	$ (14,362)
Preferred stock accretion	$ (5,978)	$ (5,338)	$ (2,465)	$	$
Net income (loss) attributable to common shareholders	$ 5,967	$ (9,276)	$ (44,294)	$ (23,943)	$ (14,362)
Basic income (loss) per share from continuing operations	$ 0.14	$ (0.17)	$ (1.04)	$ (0.70)	$ (0.74)
Basic net income (loss) per share	$ 0.14	$ (0.23)	$ (1.23)	$ (0.87)	$ (0.53)
Diluted income (loss) per share from continuing operations	$ 0.14	$ (0.17)	$ (1.04)	$ (0.70)	$ (0.74)
Diluted net income (loss) per share	$ 0.14	$ (0.23)	$ (1.23)	$ (0.87)	$ (0.53)

	As of December 31,				
(in thousands, except per share amounts)	**2006**	**2005**	**2004**	**2003**	**2002**
Consolidated Balance Sheet Data:					
Cash, cash equivalents and short term investments	$ 43,299	$ 33,042	$ 22,429	$ 36,944	$ 26,191
Total assets	$ 116,198	$ 119,896	$ 119,410	$ 133,155	$ 126,927
Deferred revenue	$ 46,347	$ 52,169	$ 44,040	$ 48,502	$ 39,492
Working capital	$ 10,757	$ (6,650)	$ (15,092)	$ 13,008	$ 18,137
Long-term debt	$	$	$	$ 84,225	$ 73,719
Stockholders equity (deficit)	$ 42,471	$ 31,192	$ 32,639	$ (16,883)	$ (7,235)

Note:

(1) Did not include $11.1 million at December 31, 2003 of unamortized discount associated with warrants issued in connection with the Senior Secured Notes due 2008 (2008 Notes).

31

Table of Contents

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

Cautionary Statement on Risks Associated With Forward-Looking Statements

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

Product Naming Conventions

In connection with the Company s launch of its new identity and corporate branding strategy, developed in conjunction with the Company s strategy to further integrate its patient access, identity management, care management, health information management and patient revenue management product lines under the Care-Based Revenue Cycle , we have revised the naming conventions associated with certain of our products, as follows:

What we have historically referred to as *Affinity*, is now referred to as ***Patient Care & Revenue Management***

What we have historically referred to as *Quantim* is now referred to as ***Health Information Management***

What we have historically referred to as *TempusOne* or *Scheduling* is now referred to as ***Patient Access***

What we have historically referred to as *MPI* is now referred to as ***Smart Identity Management***

What we have historically referred to as *Performance Measurement* or *COPE* is now referred to as ***Decision Support***

What we have historically referred to as *PFS* or *WinPFS* is now referred to as ***Acuity Plus***

The revised product names presented above are used throughout this Management s Discussion and Analysis of Financial Condition and Results of Operations section. Further, product line names for previously reported periods have also been updated throughout this Annual Report on Form 10-K.

Financial Statement Overview

During 2006, we were able to effectively manage our business to improve financial performance in several of our key financial performance categories as indicated in the highlights presented below:

Total revenue increased $2.9 million, or 2%, to $125.2 million in 2006 from $122.3 million in 2005. The increase in revenue was primarily due to collection of past due accounts and resolution of certain outstanding project implementation issues; the increases year over year were reflected in license revenue, maintenance revenue, and installation and other revenue, partially offset by decreases in services and hardware revenue.

Gross margin increased $2.2 million, or 3%, to $78.9 million in 2006 from $76.7 million in 2005. As a percentage of revenue, gross margin remained constant at 63% in both 2006 and 2005. This was mainly attributable to increased maintenance and license revenue and lower amortization associated with acquired software, lower hardware and personnel related costs, offset in part by higher royalty and other direct costs.

Table of Contents

Income (loss) from operations increased from a net loss from operations of $(1.4) million in 2005 to net income from operations of $10.8 million in 2006. The net increase resulted primarily from increased revenues and resultant gross margin, a 28% decrease in general and administrative expenses, and the absence of additional exit costs incurred in 2006.

Net income (loss) increased from a net loss of $(3.9) million in 2005 to a net income of $11.9 million in 2006, mainly attributable to the increase in income from operations, an increase in interest income, and a decrease in losses from discontinued operations.

Cash, cash equivalents and short-term investments increased by $10.3 million to $43.3 million at December 31, 2006 from $33.0 million at December 31, 2005. Cash provided by operating activities of $16.7 million in 2006, compared to $11.8 million in 2005, was offset in part by $1.0 million of cash used for purchases of property and equipment, $10.6 million in net purchases related to investment activity, and $5.6 million of net cash used in financing activities, principally for the payment of preferred stock dividends.

Days sales outstanding (DSO) at December 31, 2006 was 60 days compared to 81 days at December 31, 2005. During 2006, the Company focused on the collection of outstanding receivables as a corporate initiative, which lowered outstanding receivables from $27.1 million at December 31, 2005 to $20.4 million at December 31, 2006.

Management believes that the Company s internal control over financial reporting and disclosure controls and procedures are currently effective and were effective for both reporting periods ended December 31, 2006 and 2005. During 2005, the Company invested significant effort and resources in eliminating the Company s previously disclosed internal control deficiencies in the revenue and closing cycles and related weaknesses in disclosure controls and procedures. These remedial actions included establishing a revenue assurance group responsible for managing ongoing quality assurance; utilizing the PeopleSoft system for revenue related activities; increasing staffing, training and supervision of personnel; improving delineation of responsibilities and segregation of duties; and improving the general ledger account reconciliation and journal entry preparation and review processes. During 2006, the Company continued to manage, monitor and improve its internal control environment to provide assurance that the requisite prevent and detect controls were in place and operating effectively.

Critical Accounting Policies and Estimates

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

Use of Estimates

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

Revenue Recognition

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

Table of Contents

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

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

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

We recognize revenue when all of the following criteria are met: there is persuasive evidence of an arrangement; the product has been delivered; we no longer have significant obligations with regard to implementation; the fee is fixed and determinable; and collectibility is probable. Delivery is considered to have occurred when title and risk of loss have been transferred to the customer, which generally occurs when media containing the licensed programs is provided to a common carrier. Revenue for arrangements with extended payment terms is recognized when the payments become due, provided all other recognition criteria are satisfied. If collectibility is not considered probable, revenue is recognized when the fee is collected.

We allocate revenue to each element in a multiple-element arrangement based on the element s respective fair value, with the fair value determined by the price charged when that element is sold separately. Specifically, we determine the fair value of the maintenance portion of the arrangement based as if sold separately and measured by the renewal rate offered to the customer. The professional services portion of the arrangement is based on hourly rates which we charge for these services when sold separately from software. If evidence of fair value of all undelivered elements exists but evidence does not exist for one or more delivered elements, then revenue is recognized using the residual method. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is recognized as revenue. The proportion of revenue recognized upon delivery varies from quarter to quarter depending upon the mix of licensing arrangements, perpetual or term-based and the determination of vendor-specific objective evidence (VSOE) of fair value for undelivered elements. Many of our licensing arrangements include fixed implementation fees and do not allow us to recognize license revenue until these services have been performed.

Certain of the licenses are term or time-based licenses. QuadraMed recognizes revenue from these contracts ratably over the term of the arrangement. Postcontract customer support (PCS) for all of the license term is bundled together with the term license and is included in the license revenue in our consolidated financial statements.

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

34

Table of Contents

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

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

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

Accounts Receivable and Allowance for Doubtful Accounts

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

Intangible Assets

QuadraMed s acquisitions of other companies typically result in the acquisition of certain intangible assets and goodwill.

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

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

Other Intangible Assets. Other intangible assets primarily relate to developed technology, trademarks and customer lists acquired in our business acquisitions. Other intangible assets also include acquired technology whose amortization is included in cost of license. On January 1, 2002, we

adopted the provisions of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. The provisions of this statement did not have a significant impact on our financial condition or operating results.

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

Table of Contents

Stock-based Compensation

In December 2004, the FASB issued SFAS No. 123(R), *Share-Based Payment*, which is a revision of SFAS No. 123. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their grant-date fair values, using prescribed option-pricing models. The fair value is expensed over the requisite service period of the individual grantees, which generally equals the vesting period. Since the adoption of SFAS No. 123(R) on January 1, 2006, pro forma disclosure is no longer an alternative.

As permitted by SFAS No. 123, for 2004 and 2005, the Company accounted for share-based payments using APB Opinion No. 25 s intrinsic value method and, as such, generally recognized no compensation cost for employee stock options. Effective January 1, 2006, we adopted SFAS No. 123(R) s fair value method of accounting for share-based payments using the modified prospective transition method. Accordingly, periods prior to adoption have not been restated and are not directly comparable to periods after adoption. However, had we adopted SFAS No. 123(R) in prior periods, the impact of that standard would have approximated the impact of SFAS No. 123 illustrated in the disclosure of pro forma net income and net income per share contained in our notes to condensed consolidated financial statements included herein. Under the modified prospective method, compensation cost recognized in 2006 includes (a) compensation cost for all share-based payments granted prior to, but not yet vested as of December 31, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, less estimated forfeitures, and (b) compensation costs for all share-based payments granted and vested subsequent to December 31, 2005, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R).

Recent Accounting Standards

In December 2004, the FASB issued SFAS No. 123(R), *Share-Based Payment,* which is a revision of SFAS No. 123. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their grant-date fair values, using prescribed options-pricing models. We have adopted SFAS No. 123(R) for our fiscal year beginning January 1, 2006. See NOTE 11 STOCK-BASED COMPENSATION.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109* (FIN 48), which clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes,* FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosures, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company has not determined the effect, if any, the adoption of FIN 48 on January 1, 2007 will have on its financial condition, results of operations or cash flows.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB 108 is effective for the Company s fiscal year ending December 31, 2006. We have adopted SAB 108 as of December 31, 2006 and have initially applied its provisions using the cumulative effect transition method in connection with the preparation of our annual financial statements for the year ended December 31, 2006. Accordingly, the Company has decreased retained earnings as of January 1, 2006 approximately $1.9 million with a corresponding offset to other liabilities in the accompanying consolidated financial statements. See NOTE 12 STAFF ACCOUNTING BULLETIN NO. 108.

Table of Contents

In September 2006, the FASB issued Statement 157, *Fair Value Measurements*. This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. However, for some entities, the application of this Statement will change current practice. This statement is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company believes the adoption of Statement 157 will not have an impact on its financial condition, results of operations or cash flows.

Results of Operations

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

	Year ended December 31, (in thousands, except percentages)			
	2006		2005	
Revenue				
Services	$ 12,279	10%	$ 13,135	11%
Maintenance	55,975	45%	54,453	44%
Installation and other	11,756	9%	11,060	9%
Services and other	80,010	64%	78,648	64%
Licenses	42,756	34%	41,067	34%
Hardware	2,435	2%	2,598	2%
Total revenue	125,201	100%	122,313	100%
Cost of revenue				
Cost of services and other revenue	28,819	36%	29,510	38%
Royalties and other	12,095	28%	9,779	24%
Amortization of acquired technology and capitalized software	3,401	8%	4,014	10%
Cost of licenses revenue	15,496	36%	13,793	34%
Cost of hardware revenue	2,007	82%	2,341	90%
Total cost of revenue	46,322	37%	45,644	37%
Gross margin	78,879	63%	76,669	63%
Operating expenses				
General and administrative	19,325	15%	26,874	22%
Software development	29,858	24%	30,476	25%
Sales and marketing	14,682	12%	14,730	12%
Amortization of intangible assets and depreciation	4,195	3%	4,904	4%
Exit costs of facility closing		0%	1,066	1%

Total operating expenses	$ 68,060	54%	$ 78,050	64%
Income (loss) from operations	$ 10,819	9%	$ (1,381)	-1%

Year Ended December 31, 2006 compared to 2005

Revenue

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

Table of Contents

Total revenue. Total revenue for 2006 of $125.2 million increased $2.9 million, or 2%, over total revenue for 2005 of $122.3 million. The net increase of $2.9 million consists of a $1.7 million or 4% increase in license revenue, a $1.5 million or 3% increase in maintenance revenue and a $0.7 million or 6% increase in installation and other revenue, all offset by a $0.9 million or 7% decrease in services revenue and a $0.1 million or 4% decrease in hardware revenue. Significant contributors to the overall increase in revenues during 2006 were the collection of certain past due accounts and the resolution of certain project implementations. For each quarter during 2006, total revenue was $28.9 million, $32.0 million, $33.0 million and $31.3 million, respectively.

Services and other revenue. Services and other revenue consist of professional services, such as implementation and installation services, training, maintenance (which consists of technical support and product upgrades), reimbursable expenses and other service revenue. Professional services are typically provided over a period of three to nine months for the Health Information Management Suite and two to three years for Patient Care and Revenue Management products. These services are provided subsequent to the signing of a software license arrangement and depend in large part on our software license revenues. Our maintenance revenue depends on both licenses of our software products and renewals of maintenance agreements by our existing customer base.

Services revenue decreased approximately $0.9 million, or 7%, to $12.3 million in 2006 from $13.1 million in 2005. A decrease of approximately $2.3 million is attributed to the Smart Identity Management products primarily as a result of completing two large contracts in 2005. A decrease of $0.3 million is attributed to the EDI products as a result of the sale of the EDI business in the third quarter of 2005. These decreases were offset by an increase of approximately $1.1 million for Patient Care and Revenue Management products, an increase of $0.3 million for Acuity Plus products, an increase of $0.3 million for government solutions products and an increase of $0.1 million for the Health Information Management Suite. Services revenue for Patient Care and Revenue Management products increased primarily as a result of completion of significant supplemental service projects in 2006. Increases in services revenue for Acuity Plus and government solutions products are mainly attributed to completion of benchmarking studies and workflow analyses, respectively. Services revenue for the Health Information Management Suite increased due to completion of supplemental services.

Maintenance revenue increased $1.5 million, or 3%, to $56.0 million in 2006, compared to $54.5 million in 2005. Of this overall increase in maintenance revenue, $0.7 million and $0.6 million resulted from the Health Information Management Suite and Patient Care and Revenue Management products, respectively. Maintenance revenue for Decision Support, Pharmacy, and Acuity Plus products also increased approximately $0.3 million, $0.1 million and $0.2 million, respectively. The increases were principally due to revenue that was recognized from certain cash-basis customers and reactivation of revenue plans that were previously on hold, as well as contractually-based increases in fees, partially offset by a decrease of $0.4 million attributed to the EDI products.

Installation and other revenue increased $0.7 million, or 6%, to $11.8 million in 2006 from $11.1 million in 2005. This increase is driven primarily by an $0.7 million increase in training revenue for government solutions products, a $0.8 million increase in installation and other revenue for Patient Care and Revenue Management products and a $0.2 million increase in Patient Access product revenue, partially offset by a $0.5 million decrease in the Health Information Management Suite, a $0.3 million decrease in Acuity Plus products and a $0.2 million decrease in Smart Identity Management product revenue. Resolution of disputed projects and completion of delayed projects caused installation and other revenue for Patient Care and Revenue Management products to increase. During 2006, we had two new Patient Care and Revenue Management sales. Installation and other revenue for Patient Access products increased principally due to completion of implementation activities for four large contracts in 2006. The decreases in installation and other revenue for the Health Information Management Suite, Acuity Plus and Smart Identity Management products are primarily the result of a decreased number of significant contracts being completed in 2006. Installation and other revenue for the Health Information Management Suite, Patient Access and government solutions products is typically recognized upon completion of a contract, whereas the installation and other revenue for many of our other products, including Patient Care and Revenue Management, are recognized on a percentage of completion (POC) basis of accounting.

Table of Contents

Licenses. License revenue consists of fees for licensing our proprietary software, as well as third-party software that we bundle into our suite of products. License revenue increased $1.7 million, or 4%, to $42.8 million in 2006, compared to $41.1 million in 2005. The net increase of $1.7 million was mainly due to a $1.8 million increase in Patient Access, a $0.9 million increase in government solutions and a $0.8 million increase in Health Information Management Suite products, all offset by a $0.9 million decrease in Patient Care and Revenue Management, a $0.4 million decrease in Lab & Radiology, a $0.3 million decrease in EDI and a $0.2 million decrease in Pharmacy products. License revenue for Patient Access products increased due to increased numbers of significant contracts being completed in 2006 compared to 2005. Government solutions license revenue increased mainly due to a full year s recognition of term license revenue from government sites that were added during 2005. Health Information Management Suite license revenue increased due to revenue recognized on cash-basis customers whose revenue plans had been on hold. License revenue for Patient Care and Revenue Management and Pharmacy products decreased due to decreased hours worked in 2006. Hours worked for Patient Care and Revenue Management projects were 37% less in 2006 compared to 2005, resulting in decreased revenue for these contracts which are being recognized on the POC basis. The decrease in license revenue for Lab and Radiology products is due to completion of certain contracts in 2005, with no similar volume of contracts completed in 2006. In 2006, 86% of Lab & Radiology revenue is derived from maintenance revenue. The decrease in EDI license revenue was due to the sale of the EDI business in 2005.

Hardware. Hardware revenue decreased $0.1 million, or 4%, to $2.4 million for 2006 compared to $2.5 million in 2005. This decrease was primarily attributed to decreased POC hours in 2006.

Deferred Revenue

The following table presents a summary roll-forward schedule of the deferred revenue (in thousands) for each quarter of the respective years:

	For the three months ended,				
	March 31, 2006	**June 30, 2006**	**September 30, 2006**	**December 31, 2006**	**Total 2006**
	(unaudited)	**(unaudited)**	**(unaudited)**	**(unaudited)**	
Deferred revenue, beginning balance	$ 52,169	$ 61,729	$ 55,868	$ 47,009	$ 52,169
Add: revenue deferred	36,993	25,435	23,452	29,569	115,449
Add: SAB 108 implementation	1,314				1,314
Less: deferred revenue recognized	(28,747)	(31,296)	(32,311)	(30,231)	(122,585)
Deferred revenue, ending balance	$ 61,729	$ 55,868	$ 47,009	$ 46,347	$ 46,347

	For the three months ended,				
	March 31, 2005	**June 30, 2005**	**September 30, 2005**	**December 31, 2005**	**Total 2005**
	(unaudited)	**(unaudited)**	**(unaudited)**	**(unaudited)**	
Deferred revenue, beginning balance	$ 44,040	$ 54,634	$ 52,436	$ 50,025	$ 44,040
Add: revenue deferred	39,767	27,260	26,672	32,660	126,359
Less: deferred revenue recognized	(29,173)	(29,458)	(29,083)	(29,679)	(117,393)
Less: other				(837)	(837)

Deferred revenue, ending balance	$ 54,634	$ 52,436	$ 50,025	$ 52,169	$ 52,169

Deferred revenue includes amounts billed to or received from customers for which revenue has not been recognized. Fluctuation of the deferred revenue balance depends on the timing associated with reaching billing milestones and revenue recognition criteria. Deferred revenue is typically increased when the Company invoices a customer based on the terms of the contracts and is decreased when revenue is recognized based on percentage of completion or attainment of a milestone in the customer contract.

Revenue deferred tends to be greater in the first quarter due to the issuance of annual maintenance invoices. Revenue deferred also tends to be higher in the fourth quarter compared to the second and third quarters primarily due to the issuance of invoices related to our government business. The majority of the Company s government contract terms start on October 1 of each year.

Table of Contents

The majority of the Company s revenue flows through the deferred revenue accounts and is attributable to favorable payment terms such as execution payments and achievement of billing milestones prior to meeting all revenue recognition criteria.

The deferred revenue balance decreased approximately $5.9 million to $46.3 million as of December 31, 2006 from $52.2 million as of December 31, 2005. Approximately $4.0 million of the decrease in the deferred revenue balance is attributable to revenue recognized as a result of settlements of disputed contracts, resolution of stalled projects and amounts received from cash-basis customers. $1.9 million of the decrease was related to the decreased deferred revenue balance for the government contracts due to a change in billing terms. $0.6 million of the decrease was attributable to a termination of support for a single customer, $0.5 million of the decrease was attributable to revenue recognized for Health Information Management product perpetual license contracts as a result of completion of implementation during the first quarter of 2006, offset by an increase in deferred revenue of $1.3 million relating to the Company s implementation of SAB 108 (see Note 12 STAFF ACCOUNTING BULLETIN No. 108).

The deferred revenue balance of $46.3 million as of December 31, 2006 consisted of approximately $16.9 million in deferred license revenue, approximately $18.8 million in deferred maintenance revenue, and approximately $11.9 million in deferred services and other revenue. Included in the deferred revenue balance as of December 31, 2006 were $0.7 million in deferred license revenue, $2.7 million in hardware revenue and $0.3 million in deferred services revenue related to a hardware sale to a single customer, totaling $3.7 million and approximately $5.5 million for Veterans Health Administration contracts. In 2005, our deferred revenue balance included $3.4 million relating to the single customer hardware sale. The $3.4 million was comprised of $2.7 million of deferred hardware revenue and $0.7 million of deferred license revenue.

The deferred revenue balance of $52.2 million as of December 31, 2005 consisted of approximately $22.2 million in deferred license revenue, approximately $20.7 million in deferred maintenance revenue, and approximately $9.3 million in deferred services and other revenue.

Cost of Revenue and Gross Margin

Cost of services and other revenue. Cost of services and other revenue consists of salaries and related expenses associated with project implementation, consulting services, and customer support. Cost of services and other revenue decreased $0.7 million to $28.8 million in 2006 from $29.5 million in 2005. The reduction in cost was primarily attributable to the reduction in force, which occurred in the first quarter of 2006 and lower personnel related costs. As a percentage of services and other revenue, cost of services and other revenue was 36% in 2006, compared to 38% in 2005.

Cost of licenses. Cost of licenses consists primarily of third-party software, royalties and amortization of acquired technology and capitalized software. A significant percentage of our total cost of revenue is the cost of third-party software royalties and licenses relating to third-party software embedded in our software applications. Generally, royalty fees for third-party licenses will fluctuate based on revenue or the number of the Company s customers. Royalties are associated primarily with our Health Information Management Suite and government solutions product revenues. Cost of licenses increased $1.7 million, or 12%, to $15.5 million in 2006 from $13.8 million in 2005 mainly due to a $1.6 million increase in royalty expense in 2006, as a result of higher government solutions and Health Information Management Suite revenues. As a percentage of revenue, royalty expenses increased from 7% to 8% year over year, primarily due to changes in the revenue mix within the Health Information Management Suite and government solutions product lines.

Cost of hardware. Cost of hardware consists of third-party hardware and installation costs. Cost of hardware decreased $0.3 million, or 13%, to $2.0 million in 2006 from $2.3 million in 2005, primarily as a result of lower hardware revenue in 2006, and better margins overall on the mix of hardware installations.

Gross margin. Total gross margin increased by approximately $2.2 million, or 3%, to $78.9 million in 2006 from $76.7 million in 2005. The increase in gross margin was primarily attributable to an overall increase in revenues of $2.9 million, offset in part by a net increase of $0.7 million in cost of revenue. Overall, gross margin remained constant at 63% for both 2006 and 2005.

Table of Contents

Operating Expenses

General and administrative. General and administrative expense consists of compensation and benefit costs for executive, finance, legal, information technology, and administrative personnel. General and administrative expenses decreased $7.6 million, or 28%, to $19.3 million in 2006 from $26.9 million in 2005. As a percentage of total revenue, general and administrative expense was 15% in 2006 compared to 22% in 2005. In 2006, general and administrative expenses significantly decreased primarily due to the absence of $3.3 million in severance costs associated with the departure of former executives during 2005, a decrease of $1.4 million in bad debt expense as a result of our 2006 collection efforts and $2.4 million lower professional and consulting fees related to Sarbanes Oxley implementation and compliance, strategic activities and consulting services with regard to our PeopleSoft system conversion. The remaining decrease is principally due to lower salary and wage related expenses as a result of the March 2006 reduction in force and the implementation of cost savings initiatives during 2006 which resulted in lower telecom, property taxes and other administrative expenses. These decreases are offset by the incurrence of $1.0 million in legal settlement costs in 2006.

Software development. Software development expense includes costs associated with the development of new products for which technological feasibility has not been achieved, enhancements of existing products, and quality assurance activities. These expenses consist primarily of compensation and benefit costs. Software development expense decreased $0.6 million, or 2%, to $29.9 million in 2006 from $30.5 million in 2005. In 2006, higher bonus expense and cost of employee stock options were offset by lower overall personnel related costs due to the March 2006 reduction in force and associated benefit costs, lower consulting, travel, and general operating expenses. As a percentage of revenue, software development expense was 24% in 2006 compared to 25% in 2005. There were no capitalized software development costs in 2006 or 2005.

Sales and marketing. Sales and marketing expenses include costs associated with our sales, marketing and certain product management personnel, and consist primarily of salaries and benefits, commissions, bonuses, promotional and advertising expenses. Sales and marketing expenses remained constant at $14.7 million in both 2006 and 2005. As a percentage of revenue, sales and marketing expense was approximately 12% for both years.

Amortization of intangible assets and depreciation. Amortization of intangible assets pertains to identifiable intangible assets such as customer lists and trade names, among other items. Depreciation expense pertains to computer and office equipment, office furniture and fixtures, and leasehold improvements. Amortization of intangible assets decreased $0.2 million to $2.0 million in 2006 compared to $2.2 million in 2005. Depreciation expense decreased $0.5 million to $2.2 million in 2006 compared to $2.7 million in 2005. The decrease in depreciation and amortization expense in 2006 as compared to 2005 was primarily the result of decreased capital expenditures.

Exit cost of facility closing. During 2004, we moved our headquarters from San Rafael, California to Reston, Virginia vacating the San Rafael office facility. The lease for this facility terminates at the end of 2009. Our annual expense under the lease is approximately $1.2 million, and we have been actively seeking a qualified subtenant for the property. We subleased 33% of the available space during 2006 and continue to actively market the remaining space. We have estimated the closing costs for this facility based upon current market information available related to potential sublease rental income, sublease commission costs, and the length of time expected to secure a sublease. In consideration of these facts, in 2004 we estimated a cost of approximately $4.0 million in connection with our future obligations on the lease, net of estimated sublease income, and recorded this as expense and as an accrued exit cost at December 31, 2004. During the third quarter of 2005, we reevaluated our estimated sublease income assumptions, and recorded an additional expense with a corresponding increase in the liability of $1.1 million. We do not believe that any adjustment to the outstanding lease liability is warranted at December 31, 2006.

Other Income (Expense)

Other income (expense). Other income (expense) increased $1.3 million, from a net other income of $0.2 million in 2005 to a net other income of $1.5 million in 2006. This increase was primarily attributable to higher rates of return associated with our money market accounts and the implementation of a low risk investment strategy designed to capitalize on the higher short-term interest rates on high-grade commercial paper and government bonds. The increase in interest income was offset in part by higher corporate state income tax

Table of Contents

expense. Interest expense, which decreased $0.2 million in 2006 from 2005, included non-cash charges of $0.4 million in 2006 and $0.6 million in 2005 relating to amortization of the preferred stock dividend discount and interest due on notes payable.

Discontinued Operations of Financial Services Division

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

During 2005, the Company recorded a charge of approximately $1.8 million in connection with our future obligations on the Division s San Marcos, California lease, net of estimated sublease income. The lease for this facility terminates in May 2008. We estimated facility closing costs based upon current market information available related to sublease rental income and associated commission costs. In 2006, we subleased 100% of the available space.

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

	Year ended December 31,		
	2006	2005	2004
Revenue	$	$ 223	$ 5,652
Loss from operations		(704)	(3,690)
Exit cost of facility closing		(1,849)	(3,332)
Other		118	
Total loss	$	$ (2,435)	$ (7,022)

Year Ended December 31, 2005 compared to 2004

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

	Year ended December 31,	
	(in thousands, except percentages)	
	2005	2004

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

Table of Contents

Revenue

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

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

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

Services revenue increased approximately $2.7 million, or 26%, to $13.1 million in 2005 from $10.4 million in 2004. An increase of approximately $0.5 million is attributed to the Patient Care and Revenue Management and other related products, and an increase of $0.4 million is related to the Health Information Management Suite products. In addition, services revenue for Smart Identity Management products increased $1.8 million primarily as a result of completing work on two large contracts signed in 2005.

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

Installation and other revenue decreased $1.4 million, or 11%, to $11.1 million in 2005 from $12.5 million in 2004. This decrease is driven primarily by installation and other revenue for Patient Care and Revenue Management and related products which is $2.7 million lower in 2005; during 2004 we had only three new Patient Care and Revenue Management sales and in 2005 we had no new Patient Care and Revenue Management sales. Although we had significant sales of products to the existing Patient Care and Revenue Management base customers, a significant amount of installation revenue is traditionally earned on new installations, and recognized on a percentage of completion basis. This decrease was offset by increases in installation revenues for the Health Information Management Suite and government solutions products, which are typically recognized upon completion of a contract; revenue from installation of these products increased by $1.3 million in 2005.

Licenses. License revenue consists of fees for licenses of our proprietary software, as well as third-party software that we bundle into our suite of products. Overall, license revenue decreased $4.0 million, or 9%, in 2005 to $41.0 million from $45.0 million in 2004. This decrease is due primarily to a $3.7 million decrease in license revenue for our Patient Care and Revenue Management products, which is a result of the lack of

sales to new Patient Care and Revenue Management customers; during 2004, we made only three new Patient Care and Revenue Management sales, and in 2005, we made no such sales.

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

Table of Contents

Revenue recognized for the year ended December 31, 2005 includes:

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

Cost of Revenue and Gross Margin

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

Cost of licenses. Cost of licenses consists primarily of third-party software, royalties and amortization of acquired technology and capitalized software. A significant percentage of our total cost of revenue is attributable to the cost of third-party royalties and licenses pertaining to software embedded within our software applications. Generally, royalty fees for third-party licenses will fluctuate based on revenue or the number of the Company s customers and therefore may vary on a quarter-to-quarter basis. Royalties are associated primarily with our Health Information Management Suite and government solutions product revenues. Cost of licenses decreased $0.3 million, or 2%, to $13.8 million in 2005 from $14.1 million in 2004. The decrease is comprised primarily of a $1.5 million decrease in third party software licenses and a decrease in amortization of capitalized software of $0.8 million, offset by $0.7 million increase related to the amortization of technology acquired with Détente Systems Pty Limited and Tempus Software, Inc., and a $1.3 million increase in royalty expense, most of which is related to our government solutions products. Overall, the cost of royalties, as a percentage of government solutions product revenues, has increased from 41% in 2004 to 44% in 2005.

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

Gross margin. Total gross margin increased by approximately $2.3 million, or 3%, to $76.7 million in 2005 from $74.4 million in 2004. The increase in gross margin is primarily attributable to the combination of the $5.7 million or 12% increase in maintenance revenues, the $2.7 million or 26% increase in service revenues, and the $5.5 million reduction in low margin hardware revenues. These positive variances were partially offset by lower license and installation revenues. In addition, the costs of royalties for government solutions and Health Information Management Suite products increased. Overall, gross margin for all license revenue declined from 69% in 2004 to 66% in 2005. Gross margin for services and other revenues increased from 58% in 2004 to 62% in 2005, and gross margin on hardware decreased from 25% in 2004 to 10% in 2005. In total, gross margin increased from 60% in 2004 to 63% in 2005.

Operating Expenses

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

Table of Contents

Professional and legal fees increased $1.3 million in 2005 primarily related to Sarbanes-Oxley Act consulting efforts, merger and acquisition expenses and other activities. Severance expense increased $1.6 million in 2005 primarily due to severance payments to the Company s former CEO and CFO. These increases were largely offset by a decrease in salaries of $1.5 million in 2005. In 2004, salaries included the carrying of duplicate staff for at least the first three months of the year related to the transition of the headquarters to Reston, Virginia and salaries for both the CEO and COO positions, which were consolidated in late 2004. Rent expense decreased $1.4 million in 2005 from 2004, but our payments of rent were virtually the same year over year. Rent expense in 2004 included rent for the Company s prior headquarters in San Rafael, California, which was not included in 2005 because we recorded a facility exit cost related to that lease of $4.2 million in December 2004. Bad debt expense decreased $0.9 million in 2005 and other non-wage expenses decreased $1.2 million. In addition, the $0.4 million gain on the sale of the EDI division in September 2005 is included in expense.

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

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

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

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

Exit cost of facility closing. During 2004, we moved our headquarters from San Rafael, California to Reston, Virginia and vacated and closed down the San Rafael office facility. The lease for this facility terminates at the end of 2009; our annual expense under the lease is approximately $1.2 million, and we have been actively seeking a qualified subtenant for the property. In 2006, we secured a subtenant for 33% of the available space and continue

Table of Contents

to actively market the remaining space. We estimated the closing costs for this facility based upon current market information available related to potential sublease rental income, sublease commission costs and the length of time expected to secure a sublease. In consideration of these facts, in 2004 we estimated a cost of approximately $4.2 million in connection with our future obligations on the lease, net of estimated sublease income, and recorded this as an expense and as an accrued exit cost at December 31, 2004. During the third quarter of 2005, we reevaluated our assumptions, and recorded an additional expense and an additional accrual of $1.1 million. Please see further discussion in Note 4 DISCONTINUED OPERATION FINANCIAL SERVICES DIVISION AND EXIT COST OF FACILITY CLOSING of our notes to consolidated financial statements included herein.

Due to increasing operating losses in our Financial Services Division (FSD), and the lack of a qualified buyer for the business, we announced the shutdown of the division on December 15, 2004. The shutdown of this division was completed on February 14, 2005. We recorded a $1.0 million charge related to the future lease obligation of the FSD s office in San Marcos, California in the third quarter of 2005. We recorded an additional charge of approximately $0.8 million in connection with the lease obligation.

The following table sets forth a summary of the exit cost of facility closing charged and accrued facility cost as of December 31, 2005 (in thousands):

	December 31, 2005
Exit Costs for San Rafael Facility:	
Accrued exit cost of facility closing, beginning of year	$ 4,048
Exit cost of facility closing related to Financial Services Division	
Principal reduction in 2005	(897)
Sublease losses in September 2005	1,066
Accrued exit cost of facility closing, end of year	4,217
Exit Costs for San Marcos Facility:	
Accrued exit cost of facility closing, beginning of year	
Exit cost for facility closing of former headquarters	1,032
Principal reduction in 2005	(574)
Sublease losses in September 2005	817
Accrued exit cost of facility closing, end of year	1,275
Total Exit Cost Charges and Accrued Exit Costs	$ 5,492
Accrued Exit Costs Liability:	
Short-term	1,879
Long-term	3,613
Total	$ 5,492

Other Income (Expense)

Other income (expense). Other income (expense) increased $19.0 million, from a net other expense of $18.8 million in 2004 to a net other income of $0.2 million in 2005. This change is due primarily to the inclusion in 2004 of the $14.9 million loss incurred in connection with the retirement of our 2005 and 2008 Notes in June and July of 2004; in addition, the 2004 other expense includes $4.2 million of interest expense related to the retired Notes. Interest expense for the years ended December 31, 2005, 2004 and 2003 included non-cash charges of $0.6 million, $1.6 million, and $2.8 million, respectively, relating to amortization of debt offering costs, warrant discount and preferred stock dividend discount.

Table of Contents

Liquidity and Capital Resources

Balance Sheet

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

As of December 31, 2006, we had $43.3 million in cash, cash equivalents and short-term investments, compared to $33.0 million as of December 31, 2005. As of December 31, 2006, we had working capital of $10.8 million compared to $(6.7) million as of December 31, 2005. Management believes that we have adequate liquidity to meet our short-term cash requirements.

As of December 31, 2006, we had $10.7 million invested in short-term investments as a result of an investment strategy implemented during the year.

Accounts receivable, net, decreased by $6.7 million to $20.4 million as of December 31, 2006 from $27.1 million as of December 31, 2005. Accounts receivable decreased primarily due to a corporate collection initiative to reduce DSO (Days Sales Outstanding). For the year ended December 31, 2006, bad debt expense was $0.8 million. As of December 31, 2006, the allowance for doubtful accounts decreased to $2.6 million from $4.2 million as of December 31, 2005. We maintain an allowance for doubtful accounts to reflect the expected non-collection of accounts receivable based on past collection history and specific risks identified within the portfolio. If the financial condition of our customers were to deteriorate resulting in an impairment of their ability to make payments, or if payments from customers are significantly delayed, additional allowance might be required.

Unbilled receivables increased by $0.9 million to $4.3 million as of December 31, 2006 from $3.4 million as of December 31, 2005. This increase was mainly due to a greater mix of contracts that the Company was not able to bill in advance of revenue recognition during 2006.

Prepaid expenses and other current assets decreased by $1.3 million as of December 31, 2006 to $10.8 million, compared to $12.1 million as of December 31, 2005. This decrease was primarily due to lower deferred government royalties which are related to a similar decrease in deferred license revenue, this is offset in part by an increase of $1.0 million for deferred hardware costs.

Other intangible assets decreased by $5.5 million to $2.1 million as of December 31, 2006 from $7.6 million as of December 31, 2005 as a result of standard amortization.

Accrued payroll and other related liabilities increased by $1.3 million to $8.7 million as of December 31, 2006 from $7.4 million as of December 31, 2005 primarily as a result of an additional $1.5 million in incentive compensation accruals, offset by a $0.4 million decrease in

accrued severance for departed executives.

Other accrued liabilities decreased by $4.4 million to $5.7 million as of December 31, 2006 from $10.1 million as of December 31, 2005. This decrease was primarily related to a $1.8 million decrease in accrued royalties, a $0.6 million decrease associated with our implementation of SAB 108 See *Recent Accounting Standards* discussion above, a $0.2 million decrease in accrued legal expense, a $0.8 million decrease related to the settlement of the MedCath litigation during 2006, and a $1.0 million reduction in tax accruals.

Dividends payable decreased by $5.3 million to $3.8 million as of December 31, 2006 from $9.1 million as of December 31, 2005. This decrease corresponds to the accretion in the carrying value of the Company s

Table of Contents

Series A Preferred Stock issued in 2004 (see NOTE 10 SERIES A PREFERRED STOCK) and resulted from the payment of $6.5 million in dividends during 2006.

The deferred revenue balance decreased approximately $5.9 million to $46.3 million as of December 31, 2006 from $52.2 million as of December 31, 2005. Approximately $4.0 million of the decrease in the deferred revenue balance was attributable to revenue recognized as a result of settlements of disputed contracts, resolution of stalled projects and amounts received from cash-basis customers. $1.9 million of the decrease is related to the decreased deferred revenue balance for the government contracts due to a change in billing terms. $0.6 million of the decrease was attributable to a termination of support for a single customer, $0.5 million of the decrease was attributable to revenue recognized for Health Information Management product perpetual license contracts as a result of completion of implementation during the first quarter of 2006, offset by an increase in deferred revenue of $1.3 million relating to the Company s implementation of SAB 108 (see NOTE 12 STAFF ACCOUNTING BULLETIN No. 108).

Accrued exit cost of facility closing pertains to the long-term portion of the accrued future lease obligations related to the closed facilities in San Marcos, California and San Rafael, California. The balance decreased by $1.5 million to $2.1 million as of December 31, 2006 from $3.6 million as of December 31, 2005. The decrease is due to the amortization of the original lease loss obligation established at the point the facilities were vacated.

Deferred income taxes increased by $0.8 million to $1.1 million as of December 31, 2006 from $0.3 million as of December 31, 2005, resulting from differences between book and tax treatment of goodwill amortization. The majority of this deferred tax liability was recorded with our implementation of SAB 108. See *Recent Accounting Standards* above.

Cash Flows

	Year ended December 31,		
(in thousands)	**2006**	**2005**	**2004**
Cash provided by (used in) operating activities	$ 16,662	$ 11,757	$ (10,348)
Cash provided by (used in) investing activities	$ (11,546)	$ 3,222	$ (12,178)
Cash provided by (used in) financing activities	$ (5,562)	$ (4,366)	$ 8,011
Net increase (decrease) in cash and cash equivalents	$ (446)	$ 10,613	$ (14,515)

Cash provided by (used in) operating activities was $16.7 million in 2006, compared to $11.8 million in 2005 and $(10.3) million in 2004. The net income of $6.0 million in 2006 was offset by non-cash charges totaling approximately $16.0 million, including depreciation and amortization of $7.6 million, bad debt expense of $0.8 million, preferred stock accretion and preferred dividend premium of $6.0 million and stock based compensation of $0.9 million. In addition, changes in assets and liabilities resulted in a use of cash of $5.3 million in 2006 which is comprised of a decrease in deferred revenue and accounts payable and accrued expenses, offset by a decrease in accounts receivable. Deferred revenue decreased from 2005 to 2006 due to the timing associated with reaching billing milestones and achievement of revenue recognition criteria for the contract mix in 2006.

The net loss of $9.3 million in 2005 was offset by non-cash items totaling approximately $21.5 million, including depreciation and amortization of $8.9 million, bad debt expense of $2.3 million, preferred stock accretion and preferred dividend premium of $5.3 million and exit cost

associated with facility closings of $2.8 million. In addition, changes in current assets and liabilities resulted in an additional use of cash of $0.4 million in 2005, comprised of an increase in deferred revenue of $8.2 million, an increase in prepaid and other expenses of $1.2 million, all partially offset by a decrease in accounts payable and accrued liabilities of $1.1 million and an increase in accounts receivable of $3.2 million and the $3.1 million payment to a former

Table of Contents

executive from the liquidation of certain assets held in trust. In 2004, the $(10.3) million use of cash in operations arose from the $44.3 million net loss and approximately $12.9 million in decreases in accounts payable, accrued liabilities, and deferred revenue, offset by $40.1 million of non-cash expenses and approximately $6.7 million in decreases in accounts receivable, prepaid expenses and other assets.

Net cash provided by (used in) investing activities was $(11.5) million in 2006, compared to $3.2 million in 2005 and $(12.2) million in 2004. In 2006, the use of cash from investing activities primarily resulted from the net purchase of short-term investments in the amount of $10.6 million and $1.0 million used for the purchase of property and equipment.

Investing activities in 2005 included a $1.5 million reduction in restricted cash related to letters of credit, $1.3 million of capital expenditure purchases and $3.1 million from the liquidation of certain assets held in trust which were used in connection with a settlement associated with a former executive who left the company several years ago. In 2004, investing activities used $12.2 million of cash in, including $4.5 million for capital expenditure purchases primarily related to our PeopleSoft system and $9.4 million for the acquisitions of Détente Systems Pty Limited and Tempus Software, Inc. In addition, there were reductions to restricted cash balances during 2004 in the amount of $1.6 million.

Net cash used in financing activities was $5.6 million in 2006, compared to $4.4 million used by financing activities in 2005 and $8.0 million net cash provided by financing activities in 2004. The cash used by financing activities in both 2006 and 2005 was primarily due to the payment of dividends on our Series A Preferred Stock of $6.5 million and $5.8 million, respectively. The dividends were offset by the proceeds from the issuance of common stock in both years. The $8.0 million of cash generated from financing activities in 2004 arose from $96.1 million in proceeds from the issuance of Series A Preferred Stock, offset by $88.1 million which was used for the early retirement of our 2005 and 2008 Notes.

Cash provided by operating activities was $5.3 million, $4.1 million, $3.0 million and $4.3 million sequentially for the four quarters of 2006. The changes primarily relate to the fluctuations between net (loss) and net income during the year, which were $(3.3) million, $2.3 million, $4.5 million and $2.5 million per quarter, respectively from the first through fourth quarters of 2006, as adjusted for non-cash charges of $4.2 million, $4.1 million, $3.5 million and $4.2 million per quarter; in addition, changes in working capital items increased (decreased) cash in the amounts of $4.2 million, $(2.6) million, $(5.1) million and $(1.8) million per quarter, sequentially for the four quarters of 2006.

Commitments

The following table summarizes financial data for our contractual obligations and other commercial commitments, including accrued future dividends on our Series A Preferred Stock, as of December 31, 2006 (in thousands):

		Payments Due by Period			
Contractual Obligations	**Total**	**Less than 1 year**	**1-3 years**	**4-5 years**	**After 5 years**
Accrued dividends (1)	$ 3,775	$ 3,775	$	$	$

Operating leases (2)	15,719	4,155	10,000	1,564	
Total contractual obligations	$ 19,494	$ 7,930	$ 10,000	$ 1,564	$
Other Commercial Commitments					
Standby letters of credit (3)	$ 2,366	$ 2,000	$	$ 366	$
Total commercial commitments	$ 2,366	$ 2,000	$	$ 366	$

Table of Contents

(1) The Series A Preferred Stock holders have an option to convert and receive, when declared by the Board, dividends equal to the total previously unpaid dividends payable from effective date of conversion through June 1, 2007 at a rate of $1.375 per annum, discounted to present value at a rate of 5.5% per annum, payable in cash or common shares or any combination thereof at the option of the Company. See NOTE 10 SERIES A PREFERRED STOCK.

(2) In 2006, the Company subleased 33% of the San Rafael, California facility and 100% of the San Marcos, California facility. In the schedule above, the sublease income has been deducted from the minimum future rentals required under the master lease.

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

As of December 31, 2006, we had approximately $15.6 million in minimum operating lease commitments that will be paid through 2011. In addition, we have $2.4 million of funds in certificates of deposit held as collateral for the aforementioned standby letters of credit under bank financing agreements. These amounts reflect current requirements as of December 31, 2006, and may be reduced in the future.

We expect that cash provided by operating activities may fluctuate in future periods as a result of a number of factors, including fluctuations in our operating results, specifically the timing of when we recognize revenue, our accounts receivable collections and the timing of other payments. In addition, cash used in investing activities may fluctuate due to our software development efforts, any acquisition or disposition we may undertake and costs associated with our investments in fixed assets and information technology. For additional discussion, see *Item 1A. Risk Factors* of this Annual Report on Form 10-K.

Off-Balance Sheet Arrangements

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

Inflation

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

Table of Contents

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

In addition to the market risks discussed herein, refer to our discussion of business risks in *Item 1A. Risk Factors* above.

Interest Rate Risk

Our exposure to market risk for changes in interest rates primarily relates to our investment portfolio. It is our intent to ensure the safety and preservation of our invested principal funds by limiting default risk, market risk and reinvestment risk. We invest in high-quality issuers, including money market funds, corporate debt securities, and debt securities issued by the U.S. government and U.S. governmental agencies. We do not invest in derivative financial or foreign investments.

The table that follows presents fair values of principal amounts and weighted average interest rates for our investment portfolio as of December 31, 2006 and 2005 (in thousands, except average interest rates).

	Aggregate Fair Value		Weighted Average Interest Rate	
	2006	2005	2006	2005
Cash and Cash equivalents:				
Cash (1)	$ 16,652	$ 17,023		
Money market funds	15,944	16,019		
Total cash and cash equivalents	$ 32,596	$ 33,042		
Short-term investments:				
Certificates of deposit	$ 2,024	$		
Corporate debt securities	2,999			
Debt issued by US government	4,680			
Municipal bonds	1,000			
	$ 10,703	$		
Long-term investments:				
Corporate debt securities	$	$ 501		
Debt issued by US government	1,244	833		
Total long-term investments (2)	$ 1,244	$ 1,334		
Summary:				

Cash	$ 16,652	$ 17,023		
Money market funds	15,944	16,019	4.48%	2.93%
Certificates of deposit	2,024		4.90%	4.96%
Corporate debt securities	2,999	501	5.26%	4.82%
Debt issued by US government	5,924	833	4.76%	
Municipal bonds	1,000		5.28%	
	$ 44,543	$ 34,376		

Note:

(1) Excluded from the fair value of the principal amounts of cash is $2.3 million, which is restricted cash that is held in escrow for rental properties, meeting customer performance expectations and employee benefit obligations.

(2) Included in other long term assets on the balance sheet.

Table of Contents

Performance of Equity Markets

The performance of the equity markets can have an effect on our operations as certain of our variable life insurance policies have premiums invested in equity securities.

Foreign Currency Risk

Our primary market risk exposure relates to changes in foreign currency exchange rates and potentially adverse effects of differing tax structures. Changes in foreign exchange rates did not materially impact our results of operations. For the year ended December 31, 2006, only approximately 1% of total revenue was denominated in currencies other than the United States dollar and approximately 2% of our total direct and operating costs were incurred in currencies other than the United States dollar. The foreign currencies are limited to the Australian dollar and the British Pound Sterling.

Item 8. Financial Statements and Supplementary Data

Our financial statements and supplementary data are included in this Annual Report on Form 10-K beginning on page F-1 and are incorporated by reference into this Item 8.

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

There are no changes in, or disagreements with, our accountants based on accounting principles and financial disclosures required to be disclosed in this Item 9.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, including our principal executive and principal financial officers, our chief executive officer (CEO) and chief financial officer (CFO), is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934). An evaluation was performed under the supervision and with the participation of the Company s management, including the CEO and CFO, of the effectiveness of design and operation of our internal control over financial reporting based on the framework in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission. Based on that evaluation, our management, including the CEO and CFO, concluded that our disclosure controls and procedures were effective as of December 31, 2006.

Changes in Internal Control over Financial Reporting

No change to our internal control over financial reporting occurred during the quarter ended December 31, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Management s Annual Report on Internal Control over Financial Reporting

The management of QuadraMed Corporation is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f), and 15d-15(f) under the Securities Exchange Act of 1934). Management has used the framework set forth in the report entitled *Internal Control- Integrated Framework* published by the COSO of the Treadway Commission to evaluate the effectiveness of the Company s internal control over financial reporting.

Table of Contents

The internal control over financial reporting refers to the process designed by, or under the supervision of, our CEO and CFO, and overseen by our 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, and includes those policies and procedures that:

Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;

Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with general 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

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.

Neither internal control over financial reporting nor disclosure controls and procedures can provide absolute assurance of achieving financial reporting objectives because of their inherent limitations. Internal control over financial reporting and disclosure controls are processes that involve human diligence and compliance, and are subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting and disclosure controls also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented, detected or reported on a timely basis by internal control over financial reporting or disclosure controls. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design safeguards for these processes that will reduce, although may not eliminate, these risks.

Management has concluded that our internal controls over financial reporting and our disclosure controls and procedures were effective as of December 31, 2006.

Table of Contents

PART III

Item 10. Director, Executive Officers and Corporate Governance

Information regarding QuadraMed s directors appears under Election of Directors in our Proxy Statement for the 2007 Annual Meeting of Stockholders (the 2007 Proxy Statement). That portion of the 2007 Proxy Statement is incorporated by reference into this Item 10. Information regarding QuadraMed s executive officers appears in *Item 4A. Executive Officers of the Registrant* of this Annual Report on Form 10-K.

Section 16(a) Beneficial Ownership Reporting Compliance

Information about compliance with Section 16(a) of the Securities Exchange Act of 1934 appears under Section 16(a) Beneficial Ownership Reporting Compliance in the 2007 Proxy Statement. That portion of the 2007 Proxy Statement is incorporated by reference into this Item 10.

Code of Ethics

Information about our Code of Ethics for Principal Executive Officers and Senior Financial Officers appears under Code of Ethics in the 2007 Proxy Statement. That portion of our 2007 Proxy Statement is incorporated by reference into this Item 10.

Item 11. Executive Compensation

Information about compensation of QuadraMed s named executive officers appears under Executive Compensation in the 2007 Proxy Statement. Information about compensation of QuadraMed s directors appears under Director Compensation in the 2007 Proxy Statement. Those portions of the 2007 Proxy Statement are incorporated by reference into this Item 11.

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

Information about securities authorized for issuance under equity compensation plans is discussed in this report under Securities Authorized for Issuance under Equity Compensation Plans in *Item 5. Market for Registrant s Common Equity, Related Stockholders Matters and Issuer Purchases of Equity Securities* of this Annual Report on Form 10-K.

Information about security ownership of certain beneficial owners and management appears under Security Ownership of Directors and Officers in the 2007 Proxy Statement. That portion of the 2007 Proxy Statement is incorporated by reference into this report.

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

Information about certain relationships and related transactions appears under Certain Relationships and Related Transactions in the 2007 Proxy Statement. That portion of the 2007 Proxy Statement is incorporated by reference into this Item 13.

Item 14. Principal Accountant Fees and Services

Information regarding audit fees and all other fees, in addition to the Audit Committee s pre-approval policies and procedures appears under Fees of Independent Registered Public Accounting Firm in the 2007 Proxy Statement. That portion of the 2007 Proxy Statement is incorporated by reference into this Item 14.

Table of Contents

PART IV

Item 15. Exhibits and Financial Statement Schedules

The following documents are filed as a part of this Annual Report on Form 10-K:

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

2. Financial Statement Schedule. Reference is made to Schedule II Valuation and Qualifying Accounts on page S-1.

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

Table of Contents

SIGNATURES

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

QUADRAMED CORPORATION

Date: March 16, 2007 By: /s/ KEITH B. HAGEN

Keith B. Hagen

Chief Executive Officer

Date: March 16, 2007 By: /s/ DAVID L. PIAZZA

David L. Piazza

Chief Financial Officer

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

/s/ KEITH B. HAGEN **Keith B. Hagen**	Chief Executive Officer, Director (Principal Executive Officer)	March 16, 2007
/s/ DAVID L. PIAZZA **David L. Piazza**	Executive Vice President, Chief Financial Officer (Principal Financial and Accounting Officer)	March 16, 2007
/s/ ROBERT L. PEVENSTEIN **Robert L. Pevenstein**	Chairman of the Board	March 16, 2007
/s/ LAWRENCE P. ENGLISH **Lawrence P. English**	Director	March 16, 2007
/s/ ROBERT W. MILLER **Robert W. Miller**	Director	March 16, 2007
/s/ JAMES E. PEEBLES **James E. Peebles**	Director	March 16, 2007

56

Table of Contents

EXHIBIT INDEX

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

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

Table of Contents

Exhibit Number	Exhibit Description
10.3	1999 Supplemental Stock Option Plan of QuadraMed. (Exhibit 10.5 to our Annual Report on Form 10-K, as filed with the SEC on March 30, 2000, as amended by May 1, 2000.)
10.4	2002 Employee Stock Purchase Plan of QuadraMed. (Exhibit 99.1 to our Registration Statement on Form S-8, No. 333-87426, as filed with the SEC on May 2, 2002, as amended by Exhibit C to our Schedule 14A, as filed with the SEC on April 6, 2004.)
10.5	2004 Stock Compensation Plan of QuadraMed. (Exhibit 4.36 to our Registration Statement on Form S-8, No. 333-118581, as filed with the SEC on August 26, 2004.)
10.6	Form of Indemnification Agreement between QuadraMed and its directors and executive officers. (Exhibit 10.6 to our Annual Report on Form 10-K for the year ended December 31, 2005, as filed with the SEC on March 16, 2006, as amended by Amendment No. 1 thereto, as filed with the SEC on August 17, 2006.)
10.7	Employment Agreement dated August 1, 2005, between James R. Klein and QuadraMed Corporation. (Exhibit 10.15 to our Annual Report on Form 10-K for the year ended December 31, 2005, as filed with the SEC on March 16, 2006, as amended by Amendment No. 1 thereto, as filed with the SEC on August 17, 2006.)
10.8	Inducement Stock Option Agreement dated as of August 1, 2005, between James R. Klein and QuadraMed Corporation. (Exhibit 99.3 to our Current Report on Form 8-K, as filed with the SEC on August 15, 2005.)
10.9	Restricted Stock Agreement dated as of August 1, 2005, between James R. Klein and QuadraMed Corporation. (Exhibit 99.4 to our Current Report on Form 8-K, as filed with the SEC on August 15, 2005.)
10.10	Employment Agreement dated as of August 10, 2005, between David L. Piazza and QuadraMed Corporation. (Exhibit 99.1 to our Current Report on Form 8-K, as filed with the SEC on September 1, 2005.)
10.11	Severance Agreement dated as of August 22, 2005, between James Milligan and QuadraMed. (Exhibit 99.2 to our Current Report on Form 8-K, as filed with the SEC on August 26, 2005.)
10.12	Employment Agreement dated as of October 17, 2005, between Keith B. Hagen and QuadraMed Corporation. (Exhibit 99.2 to our Current Report on Form 8-K, as filed with the SEC on September 29, 2005.)
10.13	Inducement Stock Option Agreement dated as of October 17, 2005, between Keith B. Hagen and QuadraMed Corporation. (Exhibit 99.3 to our Current Report on Form 8-K, as filed with the SEC on September 29, 2005.)
10.14	Restricted Stock Agreement dated as of October 17, 2005, between Keith B. Hagen and QuadraMed Corporation. (Exhibit 99.4 to our Current Report on Form 8-K, as filed with the SEC on September 29, 2005.)
10.15	Proprietary Information and Non-Competition Agreement dated September 26, 2005, between Keith B. Hagen and QuadraMed Corporation. (Exhibit 99.5 to our Current Report on Form 8-K, as filed with the SEC on September 29, 2005.)
10.16	Employment Agreement dated as of November 21, 2005, between Steven V. Russell and QuadraMed Corporation. (Exhibit 99.1 to our Current Report on Form 8-K, as filed with the SEC on November 28, 2005.)
10.17	Inducement Stock Option Agreement dated as of November 21, 2005, between Steven V. Russell and QuadraMed Corporation. (Exhibit 99.2 to our Current Report on Form 8-K, as filed with the SEC on November 28, 2005.)

Table of Contents

Exhibit Number	Exhibit Description
10.18	Proprietary Information and Non-Competition Agreement dated as of November 21, 2005, between Steven V. Russell and QuadraMed Corporation. (Exhibit 99.3 to our Current Report on Form 8-K, as filed with the SEC on November 28, 2005.)
10.19	Settlement Agreement dated July 6, 2005, between James D. Durham and QuadraMed Corporation. (Exhibit 99.1 to our Current Report on Form 8-K, as filed with the SEC on July 8, 2005.)
10.20	Negotiable Promissory Note dated July 6, 2005, between James D. Durham and QuadraMed Corporation. (Exhibit 99.2 to our Current Report on Form 8-K, as filed with the SEC on July 8, 2005.)
10.21	Security Agreement dated July 6, 2005, between James D. Durham and QuadraMed Corporation. (Exhibit 99.3 to our Current Report on Form 8-K, as filed with the SEC on July 8, 2005.)
10.22	Lease dated November 19, 1998 for facilities located at 22 Pelican Way, San Rafael, California. (Exhibit 1.7 to our Annual Report on Form 10-K for the year ended December 31, 1999, as filed with the SEC on March 30, 2000.)
10.23	Lease dated November 26, 2001 for facilities located at 1050 Los Vallecitos Boulevard, San Marcos, California. (Exhibit 10.18 to our Registration Statement on Form S-1, No. 333-112040, as filed January 21, 2004.)
10.24	Lease dated September 15, 2001 for facilities located at 12110 Sunset Hills Road, Reston, Virginia. (Exhibit 10.19 to our Registration Statement on Form S-1, No. 333-112040,as filed January 21, 2004.)
10.25	Value Added Remarketing Agreement dated September 26, 1989, by and between InterSystems Corporation and the Compucare Company. (Exhibit 10.28 to our Registration Statement on Form S-1, No. 333-112040, as filed with the SEC on August 25. 2004.)
10.26	Amendment to VAR Agreement between QuadraMed Affinity Corporation and InterSystems Corporation. (Exhibit 10.29 to our Registration Statement on Form S-1, No. 333-112040, as filed with the SEC on August 25. 2004.)
14.1	QuadraMed Corporation Code of Ethics for Principal Executive Officers and Senior Financial Officers. (Exhibit 14.1 to our Current Report on Form 8-K, as filed with the SEC on March 15, 2006.)
21.1**	QuadraMed Corporation subsidiaries.
23.1**	Consent of BDO Seidman, LLP, Independent Registered Public Accounting Firm.
31.1**	Section 302 Certification CEO
31.2**	Section 302 Certification CFO
32.1**	Section 906 Certification CEO
32.2**	Section 906 Certification CFO

** Filed herewith

Table of Contents

QUADRAMED CORPORATION

CONSOLIDATED FINANCIAL STATEMENTS

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders

QuadraMed Corporation

Reston, Virginia

We have audited the accompanying consolidated balance sheets of QuadraMed Corporation as of December 31, 2006 and 2005 and the related consolidated statements of operations, changes in stockholders equity and comprehensive income (loss), and cash flows for each of the three years in the period ended December 31, 2006. We have also audited the schedule listed in the accompanying index. These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our 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 and schedules are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements and schedule, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements and schedule. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of QuadraMed Corporation at December 31, 2006 and 2005, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2006**,** in conformity with accounting principles generally accepted in the United States of America.

Also, in our opinion, the schedule presents fairly, in all material respects, the information set forth therein.

As discussed in Note 11, effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment*. As discussed in Note 12 to the financial statements, effective January 1, 2006, the Company changed its method of quantifying misstatements of prior year financial statements. The Company adopted the dual method, as required by SEC Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*.

/s/ BDO Seidman, LLP

BDO Seidman, LLP

Bethesda, Maryland

March 16, 2007

Table of Contents

QUADRAMED CORPORATION

CONSOLIDATED BALANCE SHEETS

(in thousands, except per share amounts)

	December 31,	
	2006	**2005**
ASSETS		
Current assets		
Cash and cash equivalents	$ 32,596	$ 33,042
Short-term investments	10,703	
Accounts receivable, net of allowance for doubtful accounts of $2,612 and $4,177, respectively	20,358	27,089
Unbilled receivables	4,253	3,387
Prepaid expenses and other current assets, net of allowance on other receivable of $833 and $715, respectively	10,848	12,142
Total current assets	78,758	75,660
Restricted cash	2,341	2,391
Long-term investments	1,244	1,334
Property and equipment, net of accumulated depreciation and amortization of $21,131, and $19,052, respectively	2,557	3,737
Goodwill	25,983	25,983
Other amortizable intangible assets, net of accumulated amortization of $41,397 and $35,905, respectively	2,132	7,624
Other long-term assets	3,183	3,167
Total assets	$ 116,198	$ 119,896
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable and accrued expenses	$ 3,493	$ 3,551
Accrued payroll and related	8,720	7,422
Other accrued liabilities	5,666	10,114
Dividends payable	3,775	9,054
Deferred revenue	46,347	52,169
Total current liabilities	68,001	82,310
Accrued exit cost of building closing	2,066	3,613
Deferred income taxes	1,042	269
Other long-term liabilities	2,618	2,512
Total liabilities	73,727	88,704
Commitments and Contingencies		
Stockholders equity		
Preferred stock, $0.01 par, 5,000 shares authorized, 4,000 shares issued and outstanding respectively	93,290	88,231

Common stock, $0.01 par, 150,000 shares authorized; 43,678 and 41,702 shares issued and $43,221 and 41,245 outstanding, respectively	437	417
Shares held in treasury	(5)	(5)
Additional paid-in-capital	304,504	302,324
Accumulated other comprehensive loss	(49)	(89)
Accumulated deficit	(355,706)	(359,686)
Total stockholders equity	42,471	31,192
Total liabilities and stockholders equity	$ 116,198	$ 119,896

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

Table of Contents

QUADRAMED CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

	Year ended December 31,		
	2006	**2005**	**2004**
Revenue			
Services	$ 12,279	$ 13,135	$ 10,446
Maintenance	55,975	54,453	48,713
Installation and other	11,756	11,060	12,469
Services and other	80,010	78,648	71,628
Licenses	42,756	41,067	45,036
Hardware	2,435	2,598	8,140
Total revenue	125,201	122,313	124,804
Cost of revenue			
Cost of services and other revenue	28,819	29,510	30,252
Royalties and other	12,095	9,779	9,977
Amortization of acquired technology and capitalized software	3,401	4,014	4,138
Cost of license revenue	15,496	13,793	14,115
Cost of hardware revenue	2,007	2,341	6,062
Total cost of revenue	46,322	45,644	50,429
Gross margin	78,879	76,669	74,375
Operating expense			
General and administration	19,325	26,874	29,707
Software development	29,858	30,476	28,056
Sales and marketing	14,682	14,730	24,105
Amortization of intangible assets and depreciation	4,195	4,904	4,495
Exit costs of facility closing		1,066	4,190
Total operating expenses	68,060	78,050	90,553
Income (loss) from operations	10,819	(1,381)	(16,178)
Other income (expense)			
Interest expense, includes non-cash charges of $374, $600 and $1,571, respectively	(379)	(607)	(4,814)
Interest income	1,746	749	481
Other income (expense), net	101	13	400
Loss on retirement of debt			(14,871)
Other income (expense)	1,468	155	(18,804)

Income (loss) from continuing operations before income taxes	$ 12,287	$ (1,226)	$ (34,982)
Benefit (provision) for income taxes	(342)	(277)	175
Income (loss) from continuing operations	11,945	(1,503)	(34,807)
Loss from discontinued operations (net of income taxes)			(3,690)
Loss on discontinued operations (net of income taxes)		(2,435)	(3,332)
Net income (loss)	$ 11,945	$ (3,938)	$ (41,829)
Preferred stock accretion and dividend premium	(5,978)	(5,338)	(2,465)
Net income (loss) attributable to common shareholders	$ 5,967	$ (9,276)	$ (44,294)
Income (loss) per share-basic			
Continuing operations	$ 0.14	$ (0.17)	$ (1.04)
Discontinued operations		(0.06)	(0.19)
Net income (loss)	$ 0.14	$ (0.23)	$ (1.23)
Income (loss) per share-diluted			
Continuing operations	$ 0.14	$ (0.17)	$ (1.04)
Discontinued operations		(0.06)	(0.19)
Net income (loss)	$ 0.14	$ (0.23)	$ (1.23)
Weighted average shares outstanding			
Basic	42,057	40,658	35,982
Diluted	78,125	40,658	35,982

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

Table of Contents

QUADRAMED CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDER S EQUITY (DEFICIT)

AND COMPREHENSIVE (LOSS)

(in thousands)

	Preferred Stock		Common Shares		Treasury Shares		Additional Paid-in	Accumulated Other Comprehensive	Accumulated	Total Stockholder	Other Comprehensive
	Shares	Amount	Shares	Amount	Shares	Amount	Capital	Loss	Deficit	Equity	Income (Loss)
December 31, 2003			**28,871**	**289**	**(265)**	**(2)**	**289,076**	**(65)**	**(306,116)**	**(16,883)**	**(23,698)**
Issuance of preferred stock	4,000	80,947								**80,947**	
Issuance of common stock			569	5			1,702			**1,707**	
Issuance of common stock under ESPP program			225	2						**2**	
Issuance of treasury stock upon exercise of options					65		(65)				
Issuance of common stock upon exercise of warrants			8,019	80						**80**	
Issuance of common stock for acquisition			2,559	26			7,632			**7,658**	
Accretion of preferred stock		2,465							(2,465)		(2,465)
Amortization of deferred compensation							1,016			**1,016**	
Net unrealized loss on available-for-sale securities								(49)		**(49)**	(49)
Foreign currency translation								(10)		**(10)**	(10)
Net loss									(41,829)	**(41,829)**	(41,829)
December 31, 2004	**4,000**	**83,412**	**40,243**	**402**	**(200)**	**(2)**	**299,361**	**(124)**	**(350,410)**	**32,639**	**(44,353)**
Issuance of common stock			722	7			1,004			**1,011**	
Issuance of common stock under ESPP program			87	1						**1**	
Issuance of restricted shares of common stock			650	7						**7**	
Repurchase of restricted shares					(257)	(3)	(3)			**(6)**	
Issuance of common stock upon exercise of warrants											
Accretion of preferred stock		4,796							(4,796)		(4,796)
Amortization of deferred compensation							1,962			**1,962**	
Dividends declared									(208)	**(208)**	(208)
Dividends declared and paid									(334)	**(334)**	(334)
Unrecognized SERP costs								69		**69**	69
Net unrealized loss on available-for-sale securities								(54)		**(54)**	(54)
Foreign currency translation								20		**20**	20
Other		23								**23**	
Net loss									(3,938)	**(3,938)**	(3,938)
December 31, 2005	**4,000**	**$ 88,231**	**41,702**	**$ 417**	**(457)**	**$ (5)**	**$ 302,324**	**$ (89)**	**$ (359,686)**	**$ 31,192**	**$ (9,241)**
Cumulative effect of adjustments resulting from the adoption of SAB 108, net of tax									(1,915)	**(1,915)**	
Issuance of common stock			674	7			904			**911**	
			92	1						**1**	

Issuance of common stock under ESPP program											
Issuance of common stock upon exercise of warrants			1,210	12			12			**24**	
Accretion of preferred stock		5,059							(5,059)		(5,059)
Amortization of deferred compensation							385			**385**	
Stock based compensation							879			**879**	
Dividends declared									(128)	**(128)**	(128)
Dividends declared and paid									(791)	**(791)**	(791)
Net unrealized gain on available-for-sale securities								102		**102**	102
Foreign currency translation								(62)		**(62)**	(62)
Other									(72)	**(72)**	
Net income									11,945	**11,945**	11,945
December 31, 2006	**4,000**	**$ 93,290**	**43,678**	**$ 437**	**(457)**	**$ (5)**	**$ 304,504**	**$ (49)**	**$ (355,706)**	**$ 42,471**	**$ 6,007**

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

Table of Contents

QUADRAMED CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Year ended December 31,		
	2006	**2005**	**2004**
Cash flows from operating activities			
Net income (loss) attributable to common shareholders	$ 5,967	$ (9,276)	$ (44,294)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	7,598	8,918	9,524
Deferred compensation amortization	385	1,962	1,016
Stock based compensation	879		
Dividend discount amortization	303	565	1,571
Interest expense on note payable	72	35	
Provision for bad debts	820	2,263	3,185
Gain on sale of assets		(383)	
Loss on retirement of debt			14,871
Exit cost on facility closing		2,797	4,190
Preferred stock accretion and dividend premium	5,978	5,338	2,465
Loss on discontinued operations			3,332
Other	(21)		(5)
Changes in assets and liabilities:			
Accounts receivable	5,911	(3,240)	4,057
Prepaid expenses and other	413	(1,217)	2,626
Accounts payable and accrued liabilities	(4,508)	(1,114)	(5,659)
Deferred revenue	(7,135)	8,209	(7,227)
Payment to former executive out of trust		(3,100)	
Cash provided by (used in) operating activities	16,662	11,757	(10,348)
Cash flows from investing activities			
Decrease in restricted cash	50	1,498	1,634
Sales of available-for-sale securities, net	7,227	(98)	77
Purchases of available-for-sale securities	(17,813)		
Acquisitions of businesses, net of cash acquired			(9,376)
Purchases of property and equipment	(982)	(1,278)	(4,513)
Termination of Trust		3,100	
Other	(28)		
Cash provided by (used in) investing activities	(11,546)	3,222	(12,178)
Cash flows from financing activities			
Repayments of debt			(88,090)
Proceeds from issuance of preferred stock			96,121
Proceeds from the sale of assets		431	
Payment of preferred stock dividends	(6,500)	(5,833)	(1,803)
Proceeds from issuance of common stock and other	936	1,036	1,793

Other	2		(10)
Cash (used in) provided by financing activities	(5,562)	(4,366)	8,011
Net increase (decrease) in cash and cash equivalents	(446)	10,613	(14,515)
Cash and cash equivalents, beginning of period	33,042	22,429	36,944
Cash and cash equivalents, end of period	$ 32,596	$ 33,042	$ 22,429
Supplemental disclosure of cash flow information			
Cash paid for interest	$ 5	$	$ 3,481
Cash paid (refunded) for taxes	$ 42	$	$ (175)
Non-cash transfer of liabilities for implementation of SAB 108 to accumulated deficit	$ 1,915	$	$
Supplemental disclosure of non-cash investing and financing transactions			
Issuance of restricted shares of common stock	$	$ 1,147	$
Issuance of common stock upon acquisition of Tempus	$	$	$ 7,650

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

Table of Contents

QUADRAMED CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS

The business mission of QuadraMed Corporation, along with our subsidiaries, is to advance the success of healthcare organizations through IT solutions that leverage quality care into positive financial outcomes. QuadraMed s driving principles include: maintaining long-term client relationships, building a culture of customer care, focusing on innovation as the key to winning, and striving to always deliver value. QuadraMed offers innovative, user-friendly software applications designed and developed by the healthcare professionals and software specialists we employ.

In the healthcare market, clinical information and quality measurements are becoming drivers of revenue management. Access management, financial decision support, health information management (HIM) processes and systems combined with patient accounting systems are driving revenue management improvements and the movement to new quality based reimbursement models. As evolving reimbursement scenarios will challenge hospitals to leverage quality of care into appropriate payment, we envision that customers committing to QuadraMed s Care-Based Revenue Cycle solutions will realize improved financial performance. QuadraMed s goal is to assist our customers in attaining significant improvement in hospital financial success by leveraging quality of care into positive financial outcomes through performance-based IT solutions. We accomplish this by delivering healthcare information technology products and services supporting the healthcare organizations efforts to improve the quality of care they deliver and the efficiency with which it is delivered.

Using QuadraMed s end-to-end solutions to optimize the patient experience and leverage quality of care into payment, our clients seek to receive the proper reimbursement, in the shortest time, at the lowest administrative cost. Our products are designed to eliminate paper, improve processes, improve efficiencies and decrease error through the efficient management of patient clinical and financial records, resulting in better patient safety. Healthcare organizations of varying size from small single entity hospitals to large multi-facility care delivery organizations, acute care hospitals, specialty hospitals, Veterans Health Administration facilities and associated/affiliated businesses such as outpatient clinics, long-term care facilities, and rehabilitation hospitals gain value from our solutions.

We do business directly and through our subsidiaries, all of which are wholly owned and operated under common management. In February 2004 we acquired Détente Systems Pty Limited of Sydney, Australia, a vendor of laboratory and radiology management software and in June 2004 we acquired Tempus Software, Inc. of Jacksonville, Florida, a vendor of enterprise-wide hospital scheduling software. The operations of both Tempus and Détente have been rolled into our Software Division. In December 2004, we announced the shut down of the Financial Services Division; operations ceased in February 2005. Beginning 2005, the Company considers itself to be a single reporting segment, specifically the software segment, as a result of the discontinued operations of the Financial Services Division in the first quarter of 2005. The financial results for these operating segments for prior years have been reclassified to conform to the current year presentation.

2. QUADRAMED CORPORATION AND BASIS OF PRESENTATION

Principles of Consolidation

These consolidated financial statements, which include the accounts of QuadraMed and all significant business divisions and wholly owned subsidiaries, have been prepared in conformity with (i) generally accepted accounting principles (GAAP) in the United States and (ii) the rules and regulations of the U.S. Securities and Exchange Commission (SEC). All significant intercompany accounts and transactions between QuadraMed and its subsidiaries are eliminated in consolidation.

Table of Contents

QUADRAMED CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Use of Estimates in Preparation of Financial Statements

QuadraMed makes estimates, assumptions and judgments that affect the reported amounts of assets and liabilities, contingent assets and liabilities, revenues and expenses. Significant estimates and assumptions have been made regarding revenue recognition, the allowance for doubtful accounts, contingencies, litigation, intangibles resulting from our purchase business combinations and other amounts. QuadraMed bases its estimates and assumptions on historical experience and on various other assumptions which management believes to be reasonable under the circumstances. Uncertainties inherent in these estimates include, among other things, significant estimates within percentage-of-completion accounting. In addition, QuadraMed annually reviews its estimates related to the valuations of intangibles including acquired technology, goodwill, customer lists, trademarks and other intangibles and capitalized software. Actual results may differ materially from these estimates and assumptions.

Reclassifications

Certain reclassifications have been made to prior year balances and categories of revenue and expense to conform them to the current year presentation.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Revenue Recognition QuadraMed s revenue is principally generated from three sources: (i) licensing arrangements, (ii) services and (iii) hardware.

The Company s license revenue consists of fees for licenses of the proprietary and third-party software. Cost of license revenue primarily includes the costs of third-party software, royalties and amortization of acquired technology and capitalized software. The Company s services revenue consists of maintenance, software installation, customer training and consulting services related to our license revenue, fees for providing management services, specialized staffing, and analytical services. Cost of services consists primarily of salaries, benefits and allocated costs related to providing such services. Hardware revenue includes third-party hardware used by our customers in connection with software purchased. Cost of hardware revenue consists of third-party equipment and installation.

QuadraMed licenses its products through its direct sales force. The Company s license agreements for such products do not provide for a right of return, and historically, product returns have not been significant.

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

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

Table of Contents

QUADRAMED CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

QuadraMed allocates revenue to each element in a multiple-element arrangement based on the element s respective fair value, with the fair value determined by the price charged when that element is sold separately. Specifically, QuadraMed determines the fair value of the maintenance portion of the arrangement based on the price if sold separately and measured by the renewal rate offered to the customer. The professional services portion of the arrangement is based on hourly rates which QuadraMed charges for these services when sold separately from software. If evidence of fair value of all undelivered elements exists but evidence does not exist for one or more delivered elements, then revenue is recognized using the residual method. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is recognized as revenue. The proportion of revenue recognized upon delivery varies from quarter-to-quarter depending upon the mix of licensing arrangements, perpetual or term-based, and the determination of vendor-specific objective evidence (VSOE) of fair value for undelivered elements. Many of our licensing arrangements include fixed implementation fees and do not allow us to recognize license revenue until these services have been performed. We recognize revenue only after establishing that we have VSOE for all undelivered elements.

Some of the licenses are term or time-based licenses. QuadraMed recognizes revenue from these contracts ratably over the term of the arrangement. Postcontract Customer Support (PCS) for all of the license term is bundled together with the term license and is included in license revenue on our consolidated financial statements.

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

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

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

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

QuadraMed s revenue recognition policy, however the Company does not have the right to bill the customer per the contract terms.

Cash and Cash Equivalents Cash and cash equivalents consist of highly liquid investments that are comprised principally of taxable, short-term certificates of deposit, money market instruments and commercial

Table of Contents

QUADRAMED CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

paper with original maturities of three months or less at the time of purchase and demand deposits with financial institutions. These instruments carry insignificant interest rate risk because of their short-term maturities. Cash equivalents are stated at amounts that approximate fair value based on quoted market prices.

Investments QuadraMed considers its holdings of short-term and long-term securities, consisting primarily of fixed income securities, to be available-for-sale securities. The difference between cost or amortized cost (cost adjusted for amortization of premiums and accretion of discounts that are recognized as adjustments to interest income) and fair value, representing unrealized holdings gains or losses, net of the related tax effect, if any, is recorded, until realized, as a separate component of stockholders equity. Gains and losses on the sale of debt securities are determined on a specific identification basis. Realized gains and losses are included in other income (expense) in the accompanying Consolidated Statements of Operations.

Accounts Receivable and Allowance for Doubtful Accounts Accounts receivable consist primarily of amounts due to QuadraMed from its normal business activities. QuadraMed provides an allowance for doubtful accounts to reflect the expected non-collection of accounts receivable based on past collection history and specific risks identified.

Concentration of Credit Risk Accounts receivable subject QuadraMed to its highest potential concentration of credit risk. QuadraMed reserves for credit losses and does not require collateral on its trade accounts receivable. In addition, QuadraMed maintains cash and investment balances in accounts at various domestic banks and brokerage firms. QuadraMed is insured by the Federal Deposit Insurance Corporation for up to $100,000 at each bank. Balances maintained at the brokerage firm are not insured.

Property and Equipment Property and equipment are stated at cost and depreciated using the straight-line method over their estimated useful lives, which are generally three years for computer equipment and purchased software and five years for office furnishings and equipment. Leasehold improvements are amortized over the shorter of the term of the lease or the useful life (generally 10 years). Maintenance and repair costs are expensed as incurred. QuadraMed reviews property and equipment for potential impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Goodwill QuadraMed adopted Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*, effective for fiscal years beginning after December 15, 2001, and ceased amortization of goodwill as of January 1, 2002. Prior to this point, goodwill was amortized using the straight-line method over its estimated useful life.

As of January 1, 2006 and 2007, QuadraMed reviewed the goodwill for impairment and determined that the fair values of the analyzed reporting units exceeded the carrying values of the net assets. Accordingly, no indicators of impairment existed.

During 2004, QuadraMed acquired all of the assets of Détente Systems Pty Limited and outstanding shares of Tempus Software, Inc. and recorded goodwill of $0.7 million and $6.9 million, respectively. During 2002, QuadraMed acquired all of the outstanding shares of Pharmacy Data Systems, Inc. and the assets of Cascade Health Information Software, Inc. and recorded goodwill of $7.9 million and $0.9 million, respectively. There were no changes in the carrying amount of goodwill during 2006.

Capitalized Software Software development costs are capitalized upon the establishment of technological feasibility, in accordance with SFAS No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed*. Upon the general release of the product to customers, development costs for that product

Table of Contents

QUADRAMED CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

are amortized over the greater of the ratio that current revenues bear to total and anticipated future revenues for the applicable product, or the straight-line method, generally five years. These amounts are charged to cost of licenses. No amount of software development costs were capitalized in 2006 and 2005.

Other Intangible Assets Other intangible assets primarily relate to customer lists, acquired technology including developed and core technology and tradenames, and other intangible assets acquired in QuadraMed s purchase business combinations. On an annual basis, QuadraMed reviews its intangible assets for impairment based on estimated future undiscounted cash flows attributable to the assets in accordance with the provisions of SFAS No. 144. In the event such cash flows are not expected to be sufficient to recover the recorded value of the assets, the assets are written down to their net realizable values. In accordance with SFAS 142, amortization of other intangible assets is computed on a straight-line basis over lives ranging from 3-5 years, as the pattern of economic benefit is not otherwise determinable. See NOTE 8 OTHER INTANGIBLE ASSETS for additional information.

Accounting for and Disclosure of Guarantees and Indemnifications QuadraMed s software license agreements generally include a performance guarantee that QuadraMed s software products will substantially operate as described in the applicable program documentation for a period of 90 days after delivery. QuadraMed also generally warrants that services performed will be provided in a manner consistent with reasonably applicable industry standards. To date, QuadraMed has not incurred any material costs associated with these warranties. QuadraMed s software license agreements typically provide for indemnification of customers for claims for infringement of intellectual property. To date, no such claims have been filed against the Company.

Stock Based Compensation In December 2004, the FASB issued SFAS No. 123(R), *Share-Based Payment,* which is a revision of SFAS No. 123. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their grant-date fair values, using prescribed options-pricing models. We have adopted SFAS No. 123(R) for our fiscal year beginning January 1, 2006. See NOTE 11 STOCK-BASED COMPENSATION.

Net Income (Loss) Per Share Basic income (loss) per share is determined using the weighted average number of common shares outstanding during the period. Diluted income (loss) per share is determined using the weighted average number of common shares and common equivalent shares outstanding during the period. Common equivalent shares consist of shares issuable upon the exercise of stock options and warrants (using the treasury stock method) and conversion of preferred stock (using the as-converted method). Common equivalent shares are excluded from the diluted computation if their effect is anti-dilutive.

In our Annual Report on Form 10-K for the year ended December 31, 2005, filed with the SEC on March 16, 2006, as amended by Amendment No. 1, filed with the SEC on August 17, 2006, basic net loss per share was based on net income attributable to common shareholders, which reflects a deduction for the preferred stock accretion. As presented in the following table, we are revising our calculation of net income attributable to common shareholders and net loss per basic share, as a result of excluding the dividend premium on our preferred stock from preferred stock accretion calculation, for the year ended December 31, 2005.

Table of Contents

QUADRAMED CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table sets forth the computation of basic and diluted net income (loss) per common share (in thousands, except per share amounts):

	Year ended December 31,		
	2006	2005	2004
Numerator:			
Net income (loss), as originally reported	$ 11,945	$ (3,938)	$ (41,829)
Preferred stock accretion, as originally reported	(5,978)	(4,796)	(2,465)
Net income (loss) attributable to common shareholders, as originally reported	$ 5,967	$ (8,734)	$ (44,294)
Numerator:			
Net income (loss), revised	$ 11,945	$ (3,938)	$ (41,829)
Preferred stock accretion, revised	(5,978)	(5,338)	(2,465)
Net income (loss) attributable to common shareholders, revised	$ 5,967	$ (9,276)	$ (44,294)
Denominator:			
Weighted average number of common shares outstanding:			
Basic	42,057	40,658	35,982
Diluted	78,125	40,658	35,982
Income (loss) per common share:			
Basic, as originally reported	$ 0.14	$ (0.21)	$ (1.23)
Basic, revised	$ 0.14	$ (0.23)	$ (1.23)
Diluted	$ 0.14	$ (0.23)	$ (1.23)

For the year ended December 31, 2006 the following common equivalent shares were included in the calculation of diluted net income per share. As QuadraMed recorded net losses for each of the years ended December 31, 2005 and 2004, no common equivalent shares were included in the diluted net loss per share calculation in those years because they were anti-dilutive. If QuadraMed had reported net income for 2005 and 2004, the calculation of diluted earnings per share would have included the following common stock equivalent shares from the indicated equity instruments (in thousands):