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

FORM 10-Q

Quarterly Report Pursuant To Section 13 Or 15(d) Of The Securities Exchange Act of 1934

For the quarter ended September 30, 2012

Commission file number 000-21129

AWARE, INC.
(Exact Name of Registrant as Specified in Its Charter)

Massachusetts	**04-2911026**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

40 Middlesex Turnpike, Bedford, Massachusetts, 01730
(Address of Principal Executive Offices)
(Zip Code)

(781) 276-4000
(Registrant's Telephone Number, Including Area Code)

Indicate by check 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 o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x NO o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer", and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):
Large Accelerated Filer o Accelerated Filer x Non-Accelerated Filer o Smaller Reporting Company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES o NO x

Indicate the number of shares outstanding of the issuer's common stock as of October 22, 2012:

Class	Number of Shares Outstanding
Common Stock, par value $0.01 per share	22,356,815 shares

AWARE, INC.
FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2012

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PART 1. FINANCIAL INFORMATION
ITEM 1: CONSOLIDATED FINANCIAL STATEMENTS
AWARE, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)
(unaudited)

	September 30, 2012	December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 114,591	$ 46,577
Accounts receivable, net	3,820	3,546
Inventories	9	547
Prepaid expenses and other current assets	423	213
Total current assets	118,843	50,883
Property and equipment, net	5,987	6,232
Investments	1,012	727
Other assets, net	-	9
Total assets	$ 125,842	$ 57,851
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 398	$ 399
Accrued expenses	88	121
Accrued compensation	619	868
Accrued professional	300	109
Accrued income taxes	5,338	-
Deferred revenue	1,602	1,317
Total current liabilities	8,345	2,814
Long-term deferred revenue	289	462
Stockholders' equity:		
Preferred stock, $1.00 par value; 1,000,000 shares authorized, none outstanding	-	-
Common stock, $.01 par value; 70,000,000 shares authorized; issued and outstanding 22,356,815 as of September 30, 2012 and 20,622,889 as of December 31, 2011	223	206
Additional paid-in capital	101,277	79,512
Accumulated other comprehensive loss	(4)	(20)
Retained earnings (accumulated deficit)	15,712	(25,123)
Total stockholders' equity	117,208	54,575
Total liabilities and stockholders' equity	$ 125,842	$ 57,851

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

AWARE, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands, except per share data)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	**2011**	**2012**	**2011**
Revenue:				
Product sales	$ 4,048	$ 3,900	$ 10,541	$ 9,621
Services	724	971	2,100	3,176
Royalties	484	549	1,599	1,542
Total revenue	5,256	5,420	14,240	14,339
Costs and expenses:				
Cost of services	421	414	1,138	1,221
Research and development	1,466	1,357	4,431	4,063
Selling and marketing	1,069	977	3,143	2,900
General and administrative	854	1,083	2,915	4,069
Total costs and expenses	3,810	3,831	11,627	12,253
Operating income before gain on sale of patent assets	1,446	1,589	2,613	2,086
Gain on sale of patent assets	15,167	-	86,394	-
Operating income after gain on sale of patent assets	16,613	1,589	89,007	2,086
Other income	-	-	85	-
Interest income	45	12	137	47
Income from continuing operations before income taxes	16,658	1,601	89,229	2,133
Provision for income taxes	6,578	-	23,248	2
Income from continuing operations	10,080	1,601	65,981	2,131
Income (loss) from discontinued operations, net of income taxes	217	(317)	360	(524)
Net income	$ 10,297	$ 1,284	$ 66,341	$ 1,607
Basic net income per share:				
Basic net income per share from continuing operations	$ 0.45	$ 0.08	$ 3.05	$ 0.10
Basic net income (loss) per share from discontinued operations	0.01	(0.02)	0.02	(0.02)
Basic net income per share	$ 0.46	$ 0.06	$ 3.07	$ 0.08
Diluted net income per share:				
Diluted net income per share from continuing operations	$ 0.45	$ 0.08	$ 3.01	$ 0.10
Diluted net income (loss) per share from discontinued operations	0.01	(0.02)	0.02	(0.02)
Diluted net income per share	$ 0.46	$ 0.06	$ 3.03	$ 0.08
Weighted-average shares – basic	22,339	20,599	21,609	20,507
Weighted-average shares - diluted	22,501	20,780	21,888	20,730
Comprehensive income:				
Net income	$ 10,297	$ 1,284	$ 66,341	$ 1,607
Other comprehensive income, net of $0 tax:				
Unrealized gains (losses) on available for sale securities	(4)	-	16	-
Comprehensive income	$ 10,293	$ 1,284	$ 66,357	$ 1,607

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

AWARE, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Nine Months Ended September 30,	
	2012	**2011**
Cash flows from operating activities:		
Net income	$ 66,341	$ 1,607
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	343	362
Stock-based compensation	299	1,102
Gain on sale of patent assets	(86,394)	-
Excess tax benefits from stock-based compensation	15,761	-
Amortization of discount on investments	(24)	-
Gain on sale of investments	(85)	-
Provision for doubtful accounts	4	-
Changes in assets and liabilities:		
Accounts receivable	(277)	1,388
Inventories	538	887
Prepaid expenses and other current assets	(210)	(105)
Accounts payable	(1)	(23)
Accrued expenses, compensation, and professional	(90)	(830)
Accrued income taxes	7,727	-
Deferred revenue	112	558
Net cash provided by operating activities	4,044	4,946
Cash flows from investing activities:		
Purchases of property and equipment	(90)	(122)
Purchases of investments	(1,017)	-
Sales of investments	855	-
Proceeds from sale of patent assets, net	86,394	-
Tax payments on gain on sale of patent assets	(2,388)	-
Net cash provided by (used in) investing activities	83,754	(122)
Cash flows from financing activities:		
Proceeds from issuance of common stock	5,896	1,711
Payment of dividends	(25,506)	-
Payments made for taxes of employees who surrendered shares related to unrestricted stock	(174)	(224)
Repurchase of common stock	-	(735)
Net cash provided by (used in) financing activities	(19,784)	752
Increase in cash and cash equivalents	68,014	5,576
Cash and cash equivalents, beginning of period	46,577	39,949
Cash and cash equivalents, end of period	$ 114,591	$ 45,525

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

A) ***Basis of Presentation.*** The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions for Form 10-Q and therefore do not include all information and notes necessary for a complete presentation of our financial position, results of operations and cash flows, in conformity with generally accepted accounting principles. We filed audited financial statements which included all information and notes necessary for such presentation for the three years ended December 31, 2011 in conjunction with our 2011 Annual Report on Form 10-K. This Form 10-Q should be read in conjunction with that Form 10-K.

The accompanying unaudited consolidated balance sheets, statements of comprehensive income, and statements of cash flows reflect all adjustments (consisting only of normal recurring items) which are, in the opinion of management, necessary for a fair presentation of financial position at September 30, 2012, and of operations and cash flows for the interim periods ended September 30, 2012 and 2011.

The results of operations for the interim period ended September 30, 2012 are not necessarily indicative of the results to be expected for the year.

B) ***Fair Value Measurements.*** The Financial Accounting Standards Board ("FASB") Codification defines fair value, and establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to the unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under the FASB Codification are: Level 1 – valuations are based on quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 2- valuations are based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly. Level 3- valuations that require inputs that are both significant to the fair value measurement and unobservable.

Cash and cash equivalents, which primarily include money market mutual funds, were $114.6 million and $46.6 million as of September 30, 2012 and December 31, 2011, respectively. We classified our cash equivalents of $111.6 million within Level 1 of the fair value hierarchy because they are valued using quoted market prices.

Our investments, which consist of high yield corporate debt securities, are also classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices. We categorize our investments as available-for-sale securities, and carry them at fair value in our financial statements. We had $1.0 million and $0.7 million of available-for-sale investments as of September 30, 2012 and December 31, 2011, respectively.

C) ***Inventories.*** Inventories are stated at the lower of cost or net realizable value with cost being determined by the first-in, first-out ("FIFO") method. Inventory reserves are established for estimated excess and obsolete inventory. Inventories consist primarily of the following (in thousands):

	September 30, 2012	December 31, 2011
Raw materials	$ -	$ 339
Finished goods	9	208
Total	$ 9	$ 547

D) ***Computation of Earnings per Share.*** Basic earnings per share is computed by dividing net income or loss by the weighted average number of common shares outstanding. Diluted earnings per share is computed by dividing net income or loss by the weighted average number of common shares outstanding plus additional common shares that would have been outstanding if dilutive potential common shares had been issued. For the purposes of this calculation, stock options are considered common stock equivalents in periods in which they have a dilutive effect. Stock options that are anti-dilutive are excluded from the calculation.

Net income per share is calculated as follows (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net income:				
Income from continuing operations	$ 10,080	$ 1,601	$ 65,981	$ 2,131
Income (loss) from discontinued operations	217	(317)	360	(524)
Net income	$ 10,297	$ 1,284	$ 66,341	$ 1,607
Shares outstanding:				
Weighted-average common shares outstanding	22,339	20,599	21,609	20,507
Additional dilutive common stock equivalents	162	181	279	223
Diluted shares outstanding	22,501	20,780	21,888	20,730
Basic net income per share:				
Basic net income per share from continuing operations	$ 0.45	$ 0.08	$ 3.05	$ 0.10
Basic net income (loss) per share from discontinued operations	0.01	(0.02)	0.02	(0.02)
Basic net income per share	$ 0.46	$ 0.06	$ 3.07	$ 0.08
Diluted net income per share:				
Diluted net income per share from continuing operations	$ 0.45	$ 0.08	$ 3.01	$ 0.10
Diluted net income (loss) per share from discontinued operations	0.01	(0.02)	0.02	(0.02)
Diluted net income per share	$ 0.46	$ 0.06	$ 3.03	$ 0.08

For the three month periods ended September 30, 2012 and 2011, options to purchase 25,000 and 2,884,326 shares of common stock, respectively, were outstanding, but were not included in the computation of diluted EPS because the options' exercise prices were greater than the average market price of the common stock and thus would be anti-dilutive. For the nine month periods ended September 30, 2012 and 2011, options to purchase 829,504 and 2,883,826 shares of common stock, respectively, were outstanding, but were not included in the computation of diluted EPS because the options' exercise prices were greater than the average market price of the common stock and thus would be anti-dilutive.

E) ***Stock-Based Compensation.*** The following table presents stock-based employee compensation expenses included in our unaudited consolidated statements of comprehensive income (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Cost of services	$ 2	$ 8	$ 14	$ 26
Research and development	6	50	68	151
Selling and marketing	-	21	134	62
General and administrative	13	122	70	809
Income (loss) from discontinued operations	-	17	13	54
Stock-based compensation expense	$ 21	$ 218	$ 299	$ 1,102

Stock Option and SAR Grants. We grant stock options and stock appreciation rights ("SARs") under our 2001 Nonqualified Stock Plan. We estimate the fair value of stock options and SARs using the Black-Scholes valuation model. This valuation model takes into account the exercise price of the award, as well as a variety of significant assumptions. The assumptions used to estimate the fair value of stock options and SARs include the expected term, the expected volatility of our stock over the expected term, the risk-free interest rate over the expected term, and our expected annual dividend yield. We believe that the valuation technique and the approach utilized to develop the underlying assumptions are appropriate in calculating the fair values of our stock options and SARs. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by persons who receive equity awards.

Unrestricted Stock Grants. We also grant unrestricted shares of stock to directors, officers and employees under our 2001 Nonqualified Stock Plan. Stock-based compensation expense for stock grants is determined based on the fair market value of our stock on the date of grant; provided the number of shares in the grant is fixed on the grant date.

Stock Option, SAR, and Unrestricted Stock Grant Activity. The following summarizes stock-based grant activity in 2012 and 2011.

- Stock options and SARS – We did not grant any stock options in the three months ended September 30, 2012 and 2011. We granted 50,000 stock options in the nine months ended September 30, 2012 and no stock options in the nine months ended September 30, 2011. No SARs were granted in the three or nine month periods ended September 30, 2012 and 2011.

- Unrestricted Stock Grants - In July 2010, we granted 575,443 shares of stock to directors, officers and employees of which 111,163 shares were issued immediately and 464,280 shares were to be issued in four equal increments on December 31, 2010, June 30, 2011, December 31, 2011, and June 30, 2012; provided that grantees remain employed on each of those dates. We expensed $0 and $100,000 of stock-based compensation expense related to this grant in the three months ended September 30, 2012 and 2011, respectively. We expensed $189,000 and $346,000 of stock-based compensation expense related to this grant in the nine months ended September 30, 2012 and 2011, respectively.

  Shares issued in connection with the July 2010 stock grant were as follows in the nine month periods ended September 30, 2012 and 2011:

  - *Nine months ended September 30, 2012* - We issued 76,906 shares on January 3, 2012 to officers and employees who were employed on December 31, 2011. Grantees were allowed to surrender a portion of their stock in return for the Company paying their related withholding taxes. As a result of this provision, grantees surrendered 12,153 shares of common stock and the Company paid approximately $36,000 of withholding taxes on their behalf. After the share surrender, 64,753 net shares of common stock were issued.

    We issued the final installment under the 2010 grant on July 2, 2012 to officers and employees who were employed on June 30, 2012. We issued a total of 74,668 shares less 21,288 shares surrendered by employees for withholding taxes. The Company paid approximately $137,000 of withholding taxes on behalf of grantees who surrendered shares. After the share surrender, 53,380 net shares of common stock were issued.

  - *Nine months ended September 30, 2011* - We issued 115,682 shares on January 4, 2011 to officers and employees who were employed as of December 31, 2010 and 79,304 shares on July 1, 2011 to officers and employees who were employed as of June 30, 2011. Grantees were allowed to surrender a portion of their stock in return for the Company paying their related withholding taxes. As a result of this provision, grantees surrendered 13,721 and 23,277 shares of common stock and the Company paid approximately $39,000 and $70,000 of withholding taxes on their behalf on January 4, 2011 and July 1, 2011, respectively. After the share surrender, 101,961and 56,027 net shares of common stock were issued on January 4, 2011 and July 1, 2011, respectively.

  Our former President and CEO resigned in April 2011. As part of his separation arrangement he was granted 105,000 shares of common stock, which resulted in a stock-based compensation charge of $362,000 in the three months ended June 30, 2011. He had an option to surrender a portion of his shares in return for the Company paying his taxes. He exercised that option, and we issued 71,662 shares of common stock to him and paid $115,000 of withholding taxes on his behalf.

F) ***Business Segments***. We organize ourselves into multiple segments reporting to the chief operating decision makers. The following table provides our reportable segment financial data for the three and nine months ended September 30, 2012 and 2011 (in thousands):

	Segments			
	Biometrics & Imaging	DSL Service Assurance	Corporate	Total Company
Three Months Ended September 30, 2012				
Revenue	$ 4,287	$ 485	$ 484	$ 5,256
Operating income (loss) before gain on sale of patent assets	2,111	(446)	(219)	1,446
Gain on sale of patent assets			15,167	15,167
Interest income			45	45
Income from continuing operations before taxes				16,658
Provisions for income taxes			(6,578)	(6,578)
Income from continuing operations				10,080
Income from discontinued operations, net of tax				217
Net income				$ 10,297
Three Months Ended September 30, 2011				
Revenue	$ 4,202	$ 669	$ 549	$ 5,420
Operating income (loss) before gain on sale of patent assets	2,295	(347)	(359)	1,589
Interest income			12	12
Income from continuing operations before taxes				1,601
Provisions for income taxes				-
Income from continuing operations				1,601
Loss from discontinued operations, net of tax				(317)
Net income				$ 1,284

	Segments			
	Biometrics & Imaging	DSL Service Assurance	Corporate	Total Company
Nine Months Ended September 30, 2012				
Revenue	$ 10,847	$ 1,794	$ 1,599	$ 14,240
Operating income (loss) before gain on sale of patent assets	4,725	(1,062)	(1,050)	2,613
Gain on sale of patent assets			86,394	86,394
Other income			85	85
Interest income			137	137
Income from continuing operations before taxes				89,229
Provisions for income taxes			(23,248)	(23,248)
Income from continuing operations				65,981
Income from discontinued operations, net of tax				360
Net income				$ 66,341
Nine Months Ended September 30, 2011				
Revenue	$ 10,058	$ 2,740	$ 1,541	$ 14,339
Operating income (loss) before gain on sale of patent assets	4,361	(392)	(1,883)	2,086
Interest income			47	47
Income from continuing operations before taxes				2,133
Provisions for income taxes			(2)	(2)
Income from continuing operations				2,131
Loss from discontinued operations, net of tax				(524)
Net income				$ 1,607

We conduct our operations in the United States and sell our products and services to domestic and international customers. Revenues were generated from the following geographic regions (in thousands):

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
United States	$ 3,350	$ 3,916	$ 9,302	$ 9,444
Rest of World	1,906	1,504	4,938	4,895
	$ 5,256	$ 5,420	$ 14,240	$ 14,339

There were no single foreign countries from which we derived revenue that accounted for 10% or more of our total revenue in the three or nine month periods ended September 30, 2012 and 2011.

G) ***Statement of Stockholders' Equity.*** A statement of changes in stockholders' equity for the nine month period ended September 30, 2012 is as follows (in thousands):

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Retained Earnings/ (Accumulated Deficit)	Total Stockholders' Equity
Balance at December 31, 2011	20,623	$ 206	$ 79,512	($ 20)	($ 25,123)	$ 54,575
Exercise of common stock options	1,613	16	5,868			5,884
Issuance of unrestricted stock	152	1	(1)			-
Shares surrendered by employees to pay taxes related to unrestricted stock	(33)		(174)			(174)
Issuance of common stock under employee stock purchase plan	2		12			12
Stock-based compensation expense			299			299
Tax benefits from stock-based awards			15,761			15,761
Dividend payment					(25,506)	(25,506)
Accumulated other comprehensive loss				16		16
Net income					66,341	66,341
Balance at September 30, 2012	22,357	$ 223	$ 101,277	($ 4)	$ 15,712	$ 117,208

H) ***Recent Accounting Pronouncements.*** There are no recently issued accounting pronouncements applicable to the Company that have not been adopted as of September 30, 2012.

I) ***Sale of Patent Assets.*** We recorded gains on the sale of patent assets of $15.2 million and $86.4 million in the three and nine month periods ended September 30, 2012, respectively. Those gains were the result of two separate patent sales that closed in the second and third quarters of 2012. These two patent sales are described below.

On April 26, 2012, we entered into an agreement to sell a portion of our patent portfolio pertaining to wireless technology for $75.0 million. The proceeds from the sale were reduced by $3.8 million of transaction costs, which consisted primarily of fees from the law firm that assisted us in the sale. The transaction closed on June 21, 2012 and a gain of $71.2 million was included in our financial results for the three months ended June 30, 2012.

On August 22, 2012, we entered into an agreement to sell a portion of our patent portfolio pertaining to digital subscriber line ("DSL") technology for $16.0 million. The proceeds from the sale were reduced by $0.8 million of transaction costs, which also consisted primarily of fees from the law firm that assisted us in the sale. The transaction closed on September 21, 2012 and a gain of $15.2 million was included in our financial results for the three months ended September 30, 2012.

The majority of the remaining patents in our patent portfolio relate to our biometrics and imaging and DSL service assurance software product lines. At the current time, we do not intend to pursue patent monetization alternatives for these patents, although that decision is subject to change. We believe that the sale of wireless and DSL patents in the second and third quarters of 2012 will have no material impact on our biometrics and imaging and DSL service assurance product lines.

J) ***Income Taxes***. The gains on sale of patent assets were primarily responsible for producing $89.2 million of income from continuing operations before taxes in the nine month period ended September 30, 2012. We used a significant portion our available deferred tax assets to reduce income taxes on year-to-date pre-tax earnings. Income taxes due on pre-tax earnings for the nine months ended September 30, 2012 were $7.7 million. The $5.3 million income tax liability on our balance sheet at September 30, 2012 consisted of $3.8 million of federal income taxes and $1.5 million of state income taxes, after being reduced by $2.4 million of estimated taxes that we paid during the third quarter of 2012.

A substantial portion of the deferred tax assets we utilized comprised cumulative deductions for stock options in excess of book expense. Under income tax accounting rules, that portion of tax benefits attributable to such deductions must be recorded as an adjustment to equity versus a reduction of income tax expense. In the three and nine months ended September 30, 2012, the tax benefits from such stock-based awards were $3.1 million and $15.8 million, which we recorded as an equity adjustment to additional paid-in capital.

Total income tax expense for the three months ended September 30, 2012 was $6.7 million, including $6.6 million that was recorded in continuing operations and $0.1 million that was recorded in discontinued operations. Total income tax expense for the nine months ended September 30, 2012 was $23.5 million, including $23.2 million that was recorded in continuing operations and $0.3 million that was recorded in discontinued operations. The Company's actual tax liability for the first nine months of 2012 was $7.7 million as taxes that are currently payable were reduced by the $15.8 million equity adjustment mentioned above.

We continue to record a full valuation allowance against our remaining deferred tax assets because based on all the available evidence, we continue to believe that it is more likely than not that our deferred tax assets are not currently realizable. In reaching this determination, we evaluated our three-year cumulative results as well as the impact that current economic conditions may have on our future results.

Included in total deferred tax assets at September 30, 2012 is approximately $11.8 million of federal and state research credit carryforwards. As mentioned above, the Company has provided a full valuation allowance against these carryforwards, based on the uncertainty surrounding the realization of these assets. In addition, in connection with a detailed review of the prior year credits, the Company has determined that up to $7.7 million of these credit carryforwards represent an uncertain tax position.

We will continue to assess the level of valuation allowance required in future periods. Should more positive than negative evidence regarding the realizability of tax assets exist at a future point in time, the valuation allowance may be reduced or eliminated altogether.

K) ***Dividends.*** In April 2012, our board of directors declared a special cash dividend of $1.15 per share. The dividend was paid on May 25, 2012 to shareholders of record as of May 11, 2012. The total amount of the dividend paid was $25.5 million.

L) ***Variable Interest Entity.*** In previous periods, we disclosed that we had a patent arrangement with a third party that we classified as a variable interest entity. We also disclosed that: i) we had no equity interest in this entity; ii) we were not contractually obligated to fund this entity, therefore our maximum exposure to loss as a result of our involvement with this entity was zero; iii) we may receive royalties in the future if certain conditions are met; iv) we were not the primary beneficiary of this entity; v) we have not consolidated this entity's results into our financial statements, therefore we carried the assets and liabilities of this entity in our balance sheet at zero; and vi) this arrangement has had no impact on our results of operations, financial position or cash flows in any previous periods.

During the three months ended September 30, 2012, certain contractual provisions of the arrangement were amended. As a result, the arrangement is no longer considered a variable interest entity under generally accepted accounting principles, and we shall no longer classify it as such. This arrangement had no impact on our results of operations, financial position or cash flows, including the three and nine month periods ended September 30, 2012 and 2011. We are unable to predict whether we will receive any meaningful income from this arrangement in future periods, because such a prediction is inherently uncertain. If this arrangement generates material income to us in future quarters, we will report such income in the quarters in which it is earned.

M) ***Discontinued Operations.*** In January 2012, our Board of Directors approved the shutdown of our DSL service assurance hardware product line which was a component of our DSL Service Assurance Segment. We continued to build and ship DSL service assurance hardware products to satisfy final customer orders during the three and nine month periods ended September 30, 2012. During the third quarter of 2012, we substantially completed the shutdown and we will no longer have any significant continuing involvement or cash flows from this product line. Accordingly, we began reporting the results of our DSL service assurance hardware product line as discontinued operations in the third quarter of 2012.

Income (loss) from discontinued operations attributable to the DSL service assurance hardware product line was (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenue	$ 724	$ 1,002	$ 2,809	$ 4,355
Expenses	364	1,319	2,206	4,879
Income (loss) before income taxes	360	(317)	603	(524)
Income taxes	143	-	243	-
Income (loss) from discontinued operations	$ 217	($ 317)	$ 360	($ 524)

There were $286,000 of assets and $20,000 of liabilities remaining on the balance sheet as of September 30, 2012 related to the DSL service assurance hardware product line. Approximately $273,000 of the total asset amount represents accounts receivable that were collected in the first week of October 2012. The liability amount represents a warranty reserve for potential product returns under customer warranty rights.

We incurred one-time costs related to the shutdown of approximately $282,000, the majority of which were severance and employee-related costs. Such costs were included in income from discontinued operations during the nine month period ended September 30, 2012. The following table is a rollfoward of our exit cost liability account, which was included in the accrued compensation line of our balance sheet. (in thousands):

	Three Months Ended		
	March 31, 2012	June 30, 2012	September 30, 2012
Beginning liability balance	$ 0	$ 77	$ 178
Expense	181	101	-
Utilization	(104)	-	(178)
Ending liability balance	$ 77	$ 178	$ 0

ITEM 2:
Management's Discussion and Analysis of
Financial Condition and Results of Operations

Cautionary Statement for Purposes of the "Safe Harbor" Provisions of the Private Securities Litigation Reform Act of 1995

Some of the information in this Form 10-Q contains forward-looking statements that involve substantial risks and uncertainties. You can identify these statements by forward-looking words such as "may," "will," "expect," "anticipate," "believe," "estimate," "continue" and similar words. You should read statements that contain these words carefully because they: (1) discuss our future expectations; (2) contain projections of our future operating results or financial condition; or (3) state other "forward-looking" information. However, we may not be able to predict future events accurately. The risk factors listed in our Annual Report on Form 10-K for the year ended December 31, 2011, as well as any cautionary language in this Form 10-Q, provide examples of risks, uncertainties and events that may cause our actual results to differ materially from the expectations we describe in our forward-looking statements. You should be aware that the occurrence of any of the events described in these risk factors and elsewhere in this Form 10-Q could materially and adversely affect our business.

Summary of Operations. We have been a supplier of signal processing and digital communications technology for imaging and telecommunications applications since the early 1990s. Presently, our business operations are focused along three product lines: i) biometrics and imaging; ii) DSL service assurance; and iii) patent management, which is included in our Corporate segment.

Biometrics & Imaging. Our biometrics products consist of software and services used in biometric systems, and our imaging products consist of software used primarily in medical imaging applications. Biometrics systems are used in applications such as law enforcement, border control, national defense, secure credentialing, access control and background checks. We typically sell our biometrics software and services to: i) systems integrators that incorporate our software products into biometrics systems that they are developing on behalf of their customers; ii) OEMs that incorporate our products into their biometrics hardware and software solutions; and iii) directly to government agencies that are deploying biometrics systems. Our imaging software is primarily sold to OEMs and systems integrators that incorporate our software into their medical and imaging products.

DSL Service Assurance. Our DSL service assurance products consist of DSL software products that are used by telephone companies to improve the quality of their DSL service offerings. We sell our DSL service assurance software products through OEMs and directly to telephone companies.

Patent Management. As previously disclosed, we have been executing a strategy to monetize a significant portion of our patent portfolio unrelated to our biometrics and DSL service assurance product lines. Those activities have produced two significant patent sales in the second and third quarters of 2012, which are described below:

> On April 26, 2012, we entered into an agreement to sell a portion of our patent portfolio pertaining to wireless technology for $75.0 million. The proceeds from the sale were reduced by $3.8 million of transaction costs, which consisted primarily of fees from the law firm that assisted us in the sale. The transaction closed on June 21, 2012 and a gain of $71.2 million was included in our financial results for the three months ended June 30, 2012.
>
> On August 22, 2012, we entered into an agreement to sell a portion of our patent portfolio pertaining to digital subscriber line ("DSL") technology for $16.0 million. The proceeds from the sale were reduced by $0.8 million of transaction costs, which also consisted primarily of fees from the law firm that assisted us in the sale. The transaction closed on September 21, 2012 and a gain of 15.2 million was included in our financial results for the three months ended September 30, 2012.

The majority of the remaining patents in our patent portfolio relate to our biometrics and imaging and DSL service assurance software product lines. At the current time, we do not intend to pursue patent monetization alternatives for these patents, although that decision is subject to change.

We believe that the wireless and DSL patent sales will have no material impact on our biometrics and imaging and DSL service assurance software product lines.

Prior to November 2009, we were also a supplier of DSL silicon intellectual property to the semiconductor industry. We continue to receive royalties from two customers that use our DSL silicon IP in their DSL chipsets.

Discontinued Operations. In January 2012, our Board of Directors approved the shutdown of our DSL service assurance hardware product line which was a component of our DSL Service Assurance Segment. We continued to build and ship DSL service assurance hardware products to satisfy final customer orders during the three and nine month periods ended September 30, 2012. During the third quarter of 2012, we substantially completed the shutdown and we will no longer have any significant continuing involvement or cash flows from this product line. Accordingly, we began reporting the results of our DSL service assurance hardware product line as discontinued operations in the third quarter of 2012.

Income (loss) from discontinued operations attributable to the DSL service assurance hardware product line was (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	**2011**	**2012**	**2011**
Revenue	$ 724	$ 1,002	$ 2,809	$ 4,355
Expenses	364	1,319	2,206	4,879
Income (loss) before income taxes	360	(317)	603	(524)
Income taxes	143	-	243	-
Income (loss) from discontinued operations	$ 217	($ 317)	$ 360	($ 524)

There were $286,000 of assets and $20,000 of liabilities remaining on the balance sheet as of September 30, 2012 related to the DSL service assurance hardware product line.

Included in income from discontinued operations for the nine months ended September 30, 2012 was approximately $282,000 of one-time shutdown costs, the majority of which were severance and employee-related costs.

Summary of Financial Results

Net income from continuing operations for the three months ended September 30, 2012 was $10.1 million, or $0.45 per diluted share, which compares to net income from continuing operations of $1.6 million, or $0.08 per diluted share, for the three months ended September 30, 2011.

Net income from continuing operations for the nine months ended September 30, 2012 was $66.0 million, or $3.01 per diluted share, which compares to net income from continuing operations of $2.1 million, or $0.10 per diluted share, for the nine months ended September 30, 2011.

Higher net income from continuing operations in three and nine month periods ended September 30, 2012 versus the corresponding periods in 2011 was primarily a result of gains on the sale of patent assets. Operating income before gain on the sale of patent assets in the three and nine month periods ended September 30, 2011 and 2012 was comparable in both years.

Results of Operations

Product Sales. Product sales consist primarily of revenue from the sale of software products. Software products consist of software licenses and maintenance contracts for biometrics, medical imaging, and DSL service assurance applications.

Product sales increased 4% from $3.9 million in the three months ended September 30, 2011 to $4.0 million in the same three month period in 2012. As a percentage of total revenue, product sales increased from 72% in the third quarter of 2011 to 77% in the current year quarter. The dollar increase in product sales was primarily due to a $0.2 million increase in revenue from the sale of biometrics and imaging software which was partially offset by a $0.1 million decrease in revenue from the sale of DSL service assurance software.

Product sales increased 10% from $9.6 million in the nine months ended September 30, 2011 to $10.5 million in the same nine month period in 2012. As a percentage of total revenue, product sales increased from 67% in the first nine months of 2011 to 74% in the corresponding period of 2012. The dollar increase in product sales was primarily due to a $1.6 million increase in revenue from the sale of biometrics and imaging software which was partially offset by a $0.7 million decrease in revenue from the sale of DSL service assurance software.

Increases in revenue from the sale of biometrics and imaging software in the three and nine month periods ended September 30, 2012 versus the corresponding periods in 2011 were primarily due to larger-sized license transactions as a result of our channel partners purchasing licenses for their end user customers projects. In addition, in the third quarter of 2012 we had a large direct license sale to a U.S. government customer.

Decreases in revenue from the sale of DSL service assurance software in the three and nine month periods ended September 30, 2012 were primarily due to a lack of any significant sales of our LDP product during the three and nine month periods of 2012.

Services. Services primarily consist of engineering service fees related to: i) our biometrics and imaging product line; ii) our DSL service assurance software product line; and iii) a legacy DSL silicon contract.

Services decreased 25% from $1.0 million in the three months ended September 30, 2011 to $0.7 million in the same three month period in 2012. As a percentage of total revenue, services decreased from 18% in the third quarter of 2011 to 14% in the current year quarter. The dollar decrease in services sales was primarily due to a $0.2 million decrease in revenue from the sale of biometrics engineering services; a $46,000 decrease in revenue from the sale of DSL service assurance engineering services; and a $47,000 decrease in revenue from the sale of legacy DSL silicon services.

Services decreased 34% from $3.2 million in the first nine months of 2011 to $2.1 million in the same nine month period in 2012. As a percentage of total revenue, services decreased from 22% in the first nine months of 2011 to 15% in the corresponding period of 2012. The dollar decrease in services sales was primarily due to a $0.8 million decrease in revenue from the sale of biometrics engineering services; a $0.2 million decrease in revenue from the sale of DSL service assurance engineering services; and a $47,000 decrease in revenue from the sale of legacy DSL silicon services.

Decreases in revenue from biometrics engineering services in the three and nine month periods ended September 30, 2012 were primarily due to two factors: i) we had two large projects with U.S. government customers in 2011, one of which ended in late 2011, and the other has been winding down in 2012; and ii) we had fewer larger projects with other customers in 2012. While we are attempting to grow our biometrics services business, we are unable to predict whether services revenue will trend upward or downward in future periods as we continue to develop this business.

Decreases in revenue from DSL service assurance engineering services in the three and nine month periods ended September 30, 2012 were primarily due to no significant LDP product sales during these periods.

Royalties. Royalties consist of royalty payments we receive under legacy DSL silicon contracts. We receive royalties from DSL silicon customers for the right to incorporate our silicon IP in their DSL chipsets.

Royalties decreased 12% from $549,000 in the three months ended September 30, 2011 to $484,000 in the same three month period in 2012. As a percentage of total revenue, royalties decreased from 10% in the third quarter of 2011 to 9% in the current year quarter. The dollar decrease in royalties was primarily due to lower DSL royalties reported to us by both of our licensees.

Royalties increased 4% from $1.54 million in the first nine months of 2011 to $1.60 million in the same nine month period in 2012. As a percentage of total revenue, royalties were unchanged at 11% in the first nine months of 2011 and 2012. The dollar increase in royalties was primarily due to higher DSL royalties reported to us by one of our licensees, which was partially offset by lower royalties from our other licensee.

Our royalty revenue currently comes predominantly from DSL chipset sales by Ikanos Communications, Inc. ("Ikanos") and Lantiq Deutschland GmbH ("Lantiq"). The sale of our DSL silicon IP assets in November 2009 did not alter the royalty obligations of Ikanos or Lantiq, which we expect to continue per the existing agreements with those parties. We remain uncertain as to whether these licensees will be able to maintain their market shares and chipset prices in the face of intense competition, and whether our relationships with them will contribute meaningful royalties to us in the future. Accordingly, we are unable to predict whether royalties reported by our licensees will trend upward or downward in future periods.

Cost of Services. Cost of services consists of engineering costs to complete customer engineering projects. Such costs primarily include: i) engineering salaries, stock-based compensation, fringe benefits, and facilities; and ii) engineering consultants and contractors.

Cost of services increased 2% from $414,000 in the three months ended September 30, 2011 to $421,000 in the same three month period in 2012. Cost of services as a percentage of services increased from 43% in the third quarter of 2011 to 58% in the current quarter, which means that gross margins on services decreased from 57% to 42%.

For the three month period, the dollar increase in cost of services was primarily due to higher costs associated with delivering biometrics engineering services despite declining services revenue. Higher biometrics services costs were partially offset by lower DSL service assurance and legacy DSL silicon cost of services. Higher biometrics engineering services costs and the corresponding decrease in gross margins on services was primarily due to the mix of engineering service projects. The profitability of service revenue is affected by the size and profitability of individual customer projects.

Cost of services decreased 7% from $1.2 million in the nine months ended September 30, 2011 to $1.1 million in the same nine month period of 2012. Cost of services as a percentage of services increased from 38% in the first nine months of 2011 to 54% in the corresponding period of 2012, which means that gross margins on services decreased from 62% to 46%.

For the nine month period, the dollar decrease in cost of services was primarily due to a decrease in revenue from biometrics engineering, DSL service assurance, and legacy DSL silicon services as described in the Services section above. The decrease in gross margins on services was primarily due to the mix of engineering service projects. The profitability of service revenue is affected by the size and profitability of individual customer projects that comprise service revenue in any particular quarter.

Research and Development Expense. Research and development expense consists of costs for: i) engineering personnel, including salaries, stock-based compensation, fringe benefits, and facilities; ii) engineering consultants and contractors, and iii) other engineering expenses such as supplies, equipment depreciation, dues and memberships and travel. Engineering costs incurred to develop technology, products and patents related to our various product lines are classified as research and development expense. As described in the cost of services section, engineering costs incurred to provide engineering services for customer projects are classified as cost of services, and are not included in research and development expense.

The classification of total engineering costs to research and development expense and cost of services was (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Research and development expense	$ 1,466	$ 1,357	$ 4,431	$ 4,063
Cost of services	421	414	1,138	1,221
Total engineering costs	$ 1,887	$ 1,771	$ 5,569	$ 5,284

Research and development expense increased 8% from $1.4 million in the three months ended September 30, 2011 to $1.5 million in the same three month period in 2012. As a percentage of total revenue, research and development expense increased from 25% in the third quarter of 2011 to 28% in the corresponding period of 2012.

The dollar increase in research and development expense was primarily due to higher spending in our biometrics engineering organization. Higher biometrics engineering spending was the result of headcount additions and third party contractor expenses.

Research and development expense increased 9% from $4.1 million in the nine months ended September 30, 2011 to $4.4 million in the same nine month period in 2012. As a percentage of total revenue, research and development expense increased from 28% in the first nine months of 2011 to 31% in the corresponding period of 2012.

The dollar increase in research and development expense was primarily due to higher spending in our biometrics engineering organization; and ii) less engineering costs classified as cost of services as presented in the table above. Higher biometrics engineering spending was the result of headcount additions and third party contractor expenses. Less engineering costs were classified to cost of services because of a decrease in biometrics engineering services revenue.

Our research and development activities are focused primarily on developing biometrics and imaging software, and DSL service assurance software.

Selling and Marketing Expense. Selling and marketing expense primarily consists of costs for: i) sales and marketing personnel, including salaries, sales commissions, stock-based compensation, fringe benefits, travel, and facilities; and ii) advertising and promotion expenses.

Sales and marketing expense increased 9% from $1.0 million for the three months ended September 30, 2011 to $1.1 million for the same three month period in 2012. As a percentage of total revenue, sales and marketing expense increased from 18% in the third quarter of 2011 to 20% in the corresponding period of 2012.

The dollar increase in sales and marketing expense was primarily due to higher spending in our biometrics sales organization. Higher biometrics and imaging sales spending was the result of headcount additions, higher commissions, and third party agents.

Sales and marketing expense increased 8% from $2.9 million for the nine months ended September 30, 2011 to $3.1 million for the same nine month period in 2012. As a percentage of total revenue, sales and marketing expense increased from 20% in the first nine months of 2011 to 22% in the corresponding period of 2012.

The dollar increase in sales and marketing expense was primarily due to: i) higher spending in our biometrics sales organization due to headcount additions, higher commissions and third party agents; and ii) higher employee and travel costs related to the sale of patents. Higher sales spending related to these two factors was partially offset by lower expenses in our DSL service assurance sales and marketing organization, which was primarily due to headcount attrition.

General and Administrative Expense. General and administrative expense consists primarily of costs for: i) officers, directors and administrative personnel, including salaries, bonuses, director compensation, stock-based compensation, fringe benefits, and facilities; ii) professional fees, including legal and audit fees; iii) public company expenses; and iv) other administrative expenses, such as insurance costs and bad debt provisions.

General and administrative expense decreased 21% from $1.1 million in the three months ended September 30, 2011 to $0.9 million in the same three month period in 2012. As a percentage of total revenue, general and administrative expense decreased from 20% in the third quarter of 2011 to 16% in the current year quarter.

For the three month period, the dollar decrease in general and administrative expense was primarily due to lower expenses related to: i) consulting expenses for our former CEO; and ii) salary and other expenses for our former Chairman. We entered into a consulting contract with our former CEO upon his exit from the Company in April 2011 that ended on September 30, 2011. There were costs associated with that consulting contract in 2011, but not in 2012. In the fourth quarter of 2011, our former Chairman's title and role were changed to focus his activities on selling our patents. As a result of that change, we began classifying his salary, stock-based compensation and other expenses to sales and marketing expense instead of general and administrative expense, which resulted in the exclusion of such costs in general and administrative expenses in 2012.

General and administrative expense decreased 28% from $4.1 million in the nine months ended September 30, 2011 to $2.9 million in the same nine month period in 2012. As a percentage of total revenue, general and administrative expense decreased from 28% in the first nine months of 2011 to 21% in the corresponding period of 2012.

For the nine month period, the dollar decrease in general and administrative expense was primarily due to: i) lower expenses related to our former CEO; ii) lower expenses related to our former Chairman; and iii) lower stock-based compensation expenses for other members of senior management and our administrative staff. Lower general and administrative expenses related to these three factors were partially offset by higher third party tax accounting fees to assist us with the tax accounting on gains on patent asset sales. The nine months ended September 30, 2011 included: i) $0.8 million of salary, severance, stock-based compensation, and consulting expenses for our former CEO; and ii) $0.5 million of salary, stock-based compensation, and other expenses for our former Chairman whose expenses were classified as sales and marketing expense commencing in the fourth quarter of 2011 when his title and role changed as described above.

Gain on Sale of Patent Assets. In the three months ended September 30, 2012, we recorded a $15.2 million gain from the sale of patents pertaining to DSL technology. Gross sale proceeds of $16.0 million were reduced by $0.8 million of transaction costs which consisted primarily of fees from the law firm that assisted us with the sale.

During the nine months ended September 30, 2012, we recorded $86.4 million of gains on the sale of patents. The total gain represented two separate patent sales, including the DSL patent sale described in the previous paragraph and a $71.2 million gain from the sale of patents pertaining to wireless technology that we recorded in the second quarter of 2012. Gross sale proceeds from the wireless patent sale were $75.0 million, which was reduced by $3.8 million of transaction costs which consisted primarily of fees from the law firm that assisted us with the sale.

Other Income. We recorded $85,000 of other income in the nine month period ended September 30, 2012. This amount represented realized gains on the sale of high yield bond investments.

Interest Income. Interest income increased 271% from $12,000 in three months ended September 30, 2011 to $45,000 in the same three month period in 2012. The dollar increase was primarily due to higher cash balances as a result of proceeds from patent sales in the second and third quarters of 2012.

Interest income increased 190% from $47,000 in the nine months ended September 30, 2011 to $137,000 in the same nine month period in 2012. The dollar increase was primarily due to: i) higher cash balances as a result of proceeds from patent sales in the second and third quarters of 2012; and ii) interest income from high yield bonds.

Income Taxes. The gains on sale of patent assets were primarily responsible for producing $89.2 million of income from continuing operations before taxes in the nine month period ended September 30, 2012. We used a significant portion our available deferred tax assets to reduce income taxes on year-to-date pre-tax earnings. Income taxes due on pre-tax earnings for the nine months ended of September 30, 2012 were $7.7 million. The $5.3 million income tax liability on our balance sheet at September 30, 2012 consisted of $3.8 million of federal income taxes and $1.5 million of state income taxes, after being reduced by $2.4 million of estimated taxes that we paid during the third quarter of 2012.

A substantial portion of the deferred tax assets we utilized comprised cumulative deductions for stock options in excess of book expense. Under income tax accounting rules, that portion of tax benefits attributable to such deductions must be recorded as an adjustment to equity versus a reduction of income tax expense. In the three and nine months ended September 30, 2012, the tax benefits from such stock-based awards were $3.1 million and $15.8 million, which we recorded as an equity adjustment to additional paid-in capital.

Total income tax expense for the three months ended September 30, 2012 was $6.7 million, including $6.6 million that was recorded in continuing operations and $0.1 million that was recorded in discontinued operations. Total income tax expense for the nine months ended September 30, 2012 was $23.5 million, including $23.2 million that was recorded in continuing operations and $0.3 million that was recorded in discontinued operations. The Company's actual tax liability for the first nine months of 2012 was $7.7 million as taxes that are currently payable were reduced by the $15.8 million equity adjustment mentioned above.

We continue to record a full valuation allowance against our remaining deferred tax assets because based on all the available evidence, we continue to believe that it is more likely than not that our deferred tax assets are not currently realizable. In reaching this determination, we evaluated our three-year cumulative results as well as the impact that current economic conditions may have on our future results.

Included in total deferred tax assets at September 30, 2012 is approximately $11.8 million of federal and state research credit carryforwards. As mentioned above, the Company has provided a full valuation allowance against these carryforwards, based on the uncertainty surrounding the realization of these assets. In addition, in connection with a detailed review of the prior year credits, the Company has determined that up to $7.7 million of these credit carryforwards represent an uncertain tax position.

We will continue to assess the level of valuation allowance required in future periods. Should more positive than negative evidence regarding the realizability of tax assets exist at a future point in time, the valuation allowance may be reduced or eliminated altogether.

Income (loss) from discontinued operations. Income (loss) from discontinued operations reflects operating results from our DSL service assurance hardware product line that we shutdown during 2012.

Liquidity and Capital Resources

At September 30, 2012, we had cash and cash equivalents of $114.6 million, which represented an increase of $68.0 million from December 31, 2011. The increase in cash was primarily due to: i) $86.4 million of net proceeds from the sale of patent assets; ii) $4.0 million of cash provided by operations; iii) $5.9 million of proceeds from the issuance of common stock as a result of stock option exercises; and iv) $0.9 million from the sale of investments. Increases in cash from these sources were partially offset by: i) a $25.5 million special dividend payment; ii) $2.4 million used to pay estimated taxes on patent sale gains; iii) $1.0 million used to purchase investments; iv) $90,000 used to purchase capital equipment; and v) $174,000 used to pay withholding taxes for employees who surrendered shares of common stock in connection with stock issuances.

Capital spending was primarily related to the purchase of computer hardware used principally in engineering activities.

In the nine months ended September 30, 2012, we issued stock in connection with officer and employee stock grants. We allowed grantees to surrender a portion of their shares of stock in return for the Company paying their related withholding taxes. As a result of this provision, grantees surrendered 33,441 shares of common stock, and we paid $174,000 of withholding taxes on their behalf.

While we cannot assure you that we will not require additional financing, or that such financing will be available to us, we believe that our cash and cash equivalents will be sufficient to fund our operations for at least the next twelve months.

Recent Accounting Pronouncements

See Note H to our Consolidated Financial Statements in Item 1.

ITEM 3:
Quantitative and Qualitative Disclosures about Market Risk

Our exposure to market risk relates primarily to our investment portfolio, and the effect that changes in interest rates would have on that portfolio. Our investment portfolio at September 30, 2012 consisted of two elements:

1. *Cash and cash equivalents.* As of September 30, 2012, our cash and cash equivalents of $114.6 million were primarily invested in money market funds. The money market funds were invested in high quality, short term financial instruments. Due to the nature, short duration, and professional management of these funds, we do not expect that a general increase in interest rates would result in any material loss.

2. *Investments.* As of September 30, 2012, our investments of $1.0 million were invested in high yield bonds with a single corporate debt issuer. These bonds mature in 2015. While we are exposed to default risk, the high current yield of these bonds largely mitigates interest rate risk. Therefore, due to the high current yield and approximate 3 year life of these instruments, we do not believe that a general increase in interest rates would result in any material loss.

We do not use derivative financial instruments for speculative or trading purposes.

ITEM 4:
Controls and Procedures

Our management, including our co-chief executive officers and chief financial officer, has evaluated our disclosure controls and procedures as of the end of the quarterly period covered by this Form 10-Q and has concluded that our disclosure controls and procedures are effective. They also concluded that there were no changes in our internal control over financial reporting that occurred during the quarterly period covered by this Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1:
Legal Proceedings

From time to time we are involved in litigation incidental to the conduct of our business. We are not party to any lawsuit or proceeding that, in our opinion, is likely to seriously harm our business.

ITEM 1A:
Risk Factors

The risks described in Item 1A, Risk Factors, in our Annual Report on Form 10-K for the year ended December 31, 2011, could materially and adversely affect our business, financial condition and results of operations. The risk factors discussed in that Form 10-K do not identify all risks that we face because our business operations could also be affected by additional factors that are not presently known to us or that we currently consider to be immaterial to our operations. No material change in the risk factors discussed in that Form 10-K has occurred.

ITEM 4:
Mine Safety Disclosures

Not applicable.

ITEM 6:

Exhibits

(a) Exhibits

Exhibit 2.1	DSL Patent Purchase Agreement, dated as of August 22, 2012, by and between Aware, Inc. and TQ Delta, LLC (filed as Exhibit 2.1 to the Company's Form 8-K filed with the Securities and Exchange Commission on August 24, 2012 and incorporated herein by reference).
Exhibit 31.1	Certification of co-Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 31.2	Certification of co-Chief Executive Officer and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
Exhibit 101*	The following financial statements from Aware, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2012, formatted in XBRL (eXtensible Business Reporting Language), as follows: (i) Consolidated Balance Sheets as of September 30, 2012 and December 31, 2011, (ii) Consolidated Statements of Comprehensive Income for the Three and Nine Months Ended September 30, 2012 and September 30, 2011, (iii) Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2012 and September 30, 2011, and (iv) Notes to Consolidated Financial Statements.

* Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files in Exhibit 101 hereto shall not be deemed filed for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, or Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under those sections.

SIGNATURES

Pursuant to the requirements 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.

AWARE, INC.

Date: October 31, 2012

By: /s/ Kevin T. Russell
Kevin T. Russell
co-Chief Executive Officer & co-President
General Counsel

Date: October 31, 2012

By: /s/ Richard P. Moberg
Richard P. Moberg
co-Chief Executive Officer & co-President
Chief Financial Officer (Principal Financial and Accounting Officer)

Exhibit 31.1

CERTIFICATION OF co-CHIEF EXECUTIVE OFFICER

I, Kevin T. Russell, co-Chief Executive Officer of Aware, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Aware, Inc.;

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

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

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

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

   b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

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

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

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

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

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

Date: October 31, 2012

/s/ Kevin T. Russell
Kevin T. Russell
co-Chief Executive Officer & co-President

Exhibit 31.2

CERTIFICATION OF co-CHIEF EXECUTIVE OFFICER and CHIEF FINANCIAL OFFICER

I, Richard P. Moberg, co-Chief Executive Officer and Chief Financial Officer of Aware, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Aware, Inc.;

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

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

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

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

   b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

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

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

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

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

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

Date: October 31, 2012

/s/ Richard P. Moberg

Richard P. Moberg
co-Chief Executive Officer & co-President
Chief Financial Officer

Exhibit 32.1

**CERTIFICATION PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002
(18 U.S.C. SECTION 1350)**

In connection with the Quarterly Report on Form 10-Q of Aware, Inc. (the "Company") for the quarter ended September 30, 2012, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), each of the undersigned Chief Executive Officer and Chief Financial Officer of the Company, certifies, to the best knowledge and belief of the signatory, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

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

/s/ Kevin T. Russell
co-Chief Executive Officer & co-President

Date: October 31, 2012

/s/ Richard P. Moberg
co-Chief Executive Officer & co-President
Chief Financial Officer

Date: October 31, 2012

The certification set forth above is being furnished as an exhibit solely pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and is not being filed as part of the Form 10-Q or as a separate disclosure document of the Company or the certifying officers.