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

**FORM 10-KSB/A  
AMENDMENT NO. 1**

**[X] ANNUAL REPORT UNDER SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006**

**[ ] TRANSITION REPORT UNDER SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_**

**VALIDIAN CORPORATION**

(Name of small business issuer in its charter)

**NEVADA**

(State or other jurisdiction of incorporation or organization)

**000-28423**

Commission File No.

**58-2541997**

(I.R.S. Employer Identification Number)

**30 Metcalfe St., Suite 620, Ottawa, Ontario, Canada**

(Address of principal executive offices)

**K1P 5L4**

(Zip Code)

**Issuer's telephone number: 613-230-7211**

Securities registered under Section 12(b) of the Exchange Act: none

Securities registered under Section 12(g) of the Exchange Act: Common Stock, par value \$.001 per share.

Check whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act [ ]

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 [ ]

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. [ X ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [X]

State issuer's revenues for its most recent fiscal year. \$ NIL

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the average between the closing bid (\$0.04) and asked (\$0.04) price of the issuer's Common Stock as of April 19, 2007, was \$732,106, based upon the average between the closing bid and asked price (\$0.04) multiplied by the 18,302,640 shares of the issuer's Common Stock held by non-affiliates. (In computing this number, issuer has assumed all record holders of greater than 5% of the common equity and all directors and officers are affiliates of the issuer.)

The number of shares outstanding of each of the issuer's classes of common equity as of April 30, 2007: 45,720,403.

DOCUMENTS INCORPORATED BY REFERENCE: None.

Transitional Small Business Disclosure Format: Yes [ ] No [X]

## Explanatory Note

This Form Amendment No. 1 on 10-KSB/A is being filed to correct the following errors in “Item 7. Financial Statements”: the Report of Independent Registered Public Accounting Firm has been replaced with the correct version of the report; typographical errors in the following areas and line items have been corrected: (1) Other expenses, and Net Loss, for the period from August 3, 1999 to December 31, 2006 in the Consolidated Statements of Operations; (2) Net Loss for the period from August 3, 1999 to December 31, 2006 in the Consolidated Statement of Cash Flows; (3) Note 16. Financial Instruments. Additionally, typographical errors in “Item 6. Management’s Discussion and Analysis or Plan of Operations – Critical Accounting Policies” have been corrected.

VALIDIAN CORPORATION  
Form 10-KSB  
December 31, 2005

<b><u>Table of Contents</u></b>	<b><u>Page No.</u></b>
Cautionary Notice Regarding Forward-Looking Statements	4
<b>Part I</b>	
Item 1. Description of Business.	5
Item 2. Description of Properties.	19
Item 3. Legal Proceedings.	20
Item 4. Submission of Matters to a Vote of Security Holders.	20
<b>Part II</b>	
Item 5. Market for Common Equity and Related Stockholder Matters	21
Item 6. Management's Discussion and Analysis or Plan of Operation.	23
Item 7. Financial Statements.	33
Item 8. Changes In and Disagreement With Accountants on Accounting and Financial Disclosure.	80
Item 8A. Controls and Procedures.	80
Item 8B. Other Information	81
<b>Part III</b>	
Item 9. Directors, Executive Officers, Promoters and Control Persons: Compliance with Section 16(a) of the Exchange Act.	82
Item 10. Executive Compensation.	83
Item 11. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	85
Item 12. Certain Relationships and Related Transactions.	87
Item 13. Exhibits.	88
Item 14. Principal Accountant Fees and Services.	89
Signatures	90

## CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS

We caution readers that certain important factors may affect our actual results and could cause such results to differ materially from any forward-looking statements that we make in this report. For this purpose, any statements that are not statements of historical fact may be deemed to be forward-looking statements. This report contains statements that constitute "forward-looking statements." These forward-looking statements can be identified by the use of predictive, future-tense or forward-looking terminology, such as "believes," "anticipates," "expects," "estimates," "plans," "may," "will," or similar terms. These statements appear in a number of places in this report and include statements regarding our intent, belief or current expectations with respect to many things. Some of these things are:

- \* trends affecting our financial condition or results of operations for our limited history;
- \* our business and growth strategies;
- \* our technology;
- \* the Internet; and
- \* our financing plans.

We caution readers that any such forward-looking statements are not guarantees of future performance and involve significant risks and uncertainties. In fact, actual results most likely will differ materially from those projected in the forward-looking statements as a result of various factors. Some factors that could adversely affect actual results and performance include:

- \* our limited operating history;
- \* our lack of sales to date;
- \* our future requirements for additional capital funding;
- \* the failure of our technology and products to perform as specified;
- \* the discontinuance of growth in the use of the Internet;
- \* the enactment of new adverse government regulations; and
- \* the development of better technology and products by others.

The information contained in the following sections of this report identify important additional factors that could materially adversely affect actual results and performance:

- \* "Part I. Item 1. Description of Business" especially the disclosures set out under the heading "Risk Factors"; and
- \* "Part II. Item 6. Management's Discussion and Analysis or Plan of Operation"

You should carefully consider and evaluate all of these factors. In addition, we do not undertake to update forward-looking statements after we file this report with the SEC, even if new information, future events or other circumstances have made them incorrect or misleading.

## **PART I**

### **Item 1. Description of Business.**

#### **Summary**

Validian Corporation provides software products to assist public and private enterprises address the increasingly complex issues surrounding application security. Validian ASI™ is an application-security software system that helps to protect the exchange of information at the application layer, where the majority of breaches occur, and helps to protect mission-critical applications against hack attacks and unauthorized access, which often occur at the hardware and software perimeter. Validian ASI makes secure data exchange among applications, including distributed applications, straightforward and affordable for any organization, regardless of size and resources. Validian ASI facilitates security audit compliance and assurance, whether mandated by government, industry or internal policy; helps to prevent impersonation through application authentication and authorization; delivers confidentiality through application authentication and authorization; and delivers confidentiality through end-to-end encryption of all exchanges, so that data never travels “in the clear”. Incorporated in the United States, Validian has offices in the United States and Canada.

#### **Our Technology**

Our technology is based upon our intellectual property and was used to develop our products.

#### **Our Intellectual Property**

Our intellectual property includes an addressing scheme, an authentication process and a key exchange process for all parties to a communication, thus offering an authentication model for secure data exchanges. It also includes an encryption function using standard algorithms that encrypts data from within an originating application and decrypts the data within the receiving application.

Our technology provides benefits, by enabling users:

- \* to integrate security and transport in all communication and document exchanges through an integrated approach; and
- \* to develop and use existing interactive, distributed applications (like e-commerce, e-banking, e-health and e-loyalty) with an integrated security model.

Based on this technology, we have developed the products described below.

#### **Target Market**

Our business strategy is to license our technology either directly or through distribution channels to medium to large organizations that develop, market, sell, distribute or use software products where interaction with a distributed customer, employee and/or partner base is essential. This includes:

- \* IT departments that serve their organization with a variety of applications and implementation environments, according to the needs of the various internal departments. This implies writing applications to ensure the security of communication between applications and over distributed networks; and
- \* independent software vendors and developers serving a relatively large group of customers, on a regional or national basis and who must respond to a variety of conditions and platforms, as imposed by their customers in specific industrial sectors and secure the exchanges between their customers’ partners, suppliers and other participants.

Potential customer industrial sectors include, among others:

- \* post-production houses, studios and production companies in the digital media industry;
- \* transportation industry;
- \* manufacturers in supply management chains;
- \* health care providers and suppliers;
- \* governments;
- \* financial institutions and insurance companies; and
- \* software distribution services.

## **Marketing Strategy and Distribution Channels**

We have initiated a marketing program in North America to bring our products to the marketplace. This program has two components: direct and channel sales.

### *Direct Sales*

The direct sales approach entails making high-level contacts within the organizations of target customers to present the benefits and competitive advantages of our products. Leads to such presentations are generated through existing contacts of management and sales representatives, and through attendance at and participation in specialized e-commerce and computer security trade shows, and the presentation of the benefits of our products in technical seminars attended by personnel with a mandate for application security.

### *Channel Sales*

In order to penetrate the market for our products, we are attempting to partner with value-added resellers ("VARs"), independent marketing representatives ("IMRs"), system integrators ("SIs"), independent software vendors ("ISVs") and application service providers ("ASPs"). Potential partners are identified based upon their ability to penetrate specific markets more easily than we can. We believe major customers also will act as VARs in their sector.

Sales representatives and sales agents are promoting our products within these two channels. The representatives are responding to queries and expressions of interest from those interested in becoming early adopters of our working models. These early customers and distributors may have an impact on the product development schedule, as we will develop interfaces with users' existing systems in response to their feedback and individual requirements.

Currently, we have agreements with IMRs and SIs in the U.S.

### *Marketing Analysis*

During the year ended December 31, 2006, we utilized the services of industry specialists in the health care, government, supply chain management and entertainment sectors. Their mandate was to identify specific areas and a limited number of organizations where our products would facilitate secure communication and the implementation of a strong security infrastructure with ease of deployment and management.

To support our sales force and these specialists, we have developed technical literature on the following topics:

- \* security;
- \* features and benefits;

- \* integration into current systems;
- \* openness of the architecture;
- \* future developments; and
- \* implementation procedures.

### Estimated Sales Cycles

We expect that individual sales cycles will be from four to eight months in duration. The territories where most potential customers reside are expected to be in North America, Europe and Asia Pacific. We started building our sales team by retaining two sales representatives during the third quarter of 2002. At March 30, 2007 we had a vice president of sales and one sales representative.

### Marketing Expenses

The main expense factors for our marketing campaign are for:

- \* personnel, both internal and outside specialists;
- \* buying or renting lists of potential customers for direct marketing campaigns;
- \* direct marketing to potential customers;
- \* participation in trade shows;
- \* travel and living expenses;
- \* Web site development and maintenance; and
- \* literature preparation and distribution.

For more information, please see "Part II. Item 6. Management's Discussion and Analysis or Plan of Operation; Plan of Operations."

### **Our Products**

Currently, we offer three main products on a commercial basis.

#### Our Application Security Infrastructure (ASI)

Our ASI is an application security framework for securing data transport between distributed applications and Web services. ASI is specifically designed to secure communication between distributed applications and distributed networks. It automatically manages all critical security functions for any application, including authentication, encryption, key generation, key distribution, addressing and data transport. ASI delivers messages and files to, and only to, the target destination, and data never travels "in the clear" at any time between applications.

Supplemental to our ASI product, we offer a Software Development Kit (SDK), for rapidly and simply securing data transport between applications through ASI. The SDK includes a complete, integrated and built-in set of control, transport and security features, which are automatically inherited by any applications linked to ASI through the SDK. Application developers who use the Validian SDK do not have to learn and master any of the various transport and security products or mechanisms to implement security on their applications. Our SDK establishes low-level IP addresses and ports, and implements complex security features automatically. This provides the application with a complete communication security chain, as the ASI protection initiates from within the originating application and transports data to within the destination application. The SDK is offered free of charge to qualified developers and system integrators.

### Our Secure Send & Receive (SSR)

Our Secure Send & Receive (SSR) product transforms a user's desktop or mobile PC into a secure communication facility for uploading sensitive, proprietary information to a shared repository. The solution also transforms any server into an efficient download manager that simplifies the distribution of proprietary files to authorized users. Our SSR protects file exchanges against malicious interference, interception by rogue applications and unwanted leaks.

### Our Biometric Media Seal (BMS)

Our Biometric Media Seal (BMS) product is designed and developed specifically to prevent hacking, theft and piracy of digital media including films, videos, television programs and music during the production and post-production process.

Our BMS solution enables post-production houses, studios and production companies:

- \* to authenticate project workers using fingerprint signatures;
- \* to store media files in encrypted form on portable media storage drives
- \* to transfer encrypted media files of any size and any format between Authenticated workers and/or reviewers across the Internet;
- \* to track media file activity such as create, rename, modify, transfer and Delete, transparently and in real-time over the Internet; and
- \* to set universal policies which govern security and tracking levels applied on a per project basis.

## **Competition**

There are different competitors for the ASI, SSR and BMS markets.

### ASI competition

Our ASI product competes primarily with the products described below.

#### VPN

Virtual Private Networks (VPN) is a technology that ensures a secure communication link between two devices linked to the Internet or any communication network. This type of network security ensures that between those two hardware devices, the data cannot be intercepted and tampered with.

The main supplier of VPN is Check Point Software Technologies Ltd., but a number of suppliers are also offering competing products.

#### PKI

Public Key Infrastructure ("PKI") is a sophisticated method of authenticating communicating parties by providing each party with a set of two uniquely linked keys, one private key that is kept by the party and one public key that is published for every one to see. When communicating, messages are encrypted with the private key of the sender and decrypted by the receiver using the public key of the sender. Since both keys are mathematically linked, the receiver is assured that the message is coming from that sender and nobody else.



This exchange mechanism has been extended to protect more applications but we believe that its implementation on a large scale for distributed environment proves difficult and costly. The main suppliers of PKI include Entrust, Baltimore Technology and Verisign.

### SSL

Secure Socket Layer (“SSL”) is a browser level protection offered by Netscape and Microsoft and incorporated in most browsers. SSL establishes a secure connection from a server to a browser requesting access to an application on this server. SSL is an industry standard widely used across a large number of platforms and systems. However, we believe that it relies on a rather weak authentication model, because the browser is not authenticated by the server, which introduces a risk of impersonation.

### SSR Competition

File transfer protocol (FTP) is freeware available to organizations that don’t require security controls. Secure FTP provides minimal file protection. A number of companies compete in the growing secure file transfer market space, including Tumbleweed Communications, Proginet Corporation, Aspera, Inc. and Radiance Technologies.

### BMS Competition

To date, the only productized competition we are aware of in the digital media industry is the Aspera solution, which focuses on file transfer speed for large files. We are not aware of an integrated solution featuring biometric access control and file tracking and logging.

## **Research and Development**

We spent the following amounts during the periods mentioned on research and development activities:

<b>Year ended December 31,</b>	
<b>2006</b>	<b>2005</b>
<hr/>	
\$1,125,285	\$1,307,483

For more information, see: "Part II. Item 6. Management's Discussion and Analysis or Plan of Operation - Plan of Operations."

## **Intellectual Property Protection**

We rely on common law and statutory protection of trade secrets and confidentiality agreements. We claim copyright in specific software products and various elements of our core technology. We have registered trademarks in North America and in Europe to cover the Flash Communicator product and the generic term of “FlashWare”, as well as some graphic identification and the Validian name itself.

Our intellectual property includes an addressing scheme, an authentication process and a key exchange process for all parties to a communication, thus offering a strong trust model for secure exchanges. It also includes an encryption function using standard algorithms that encrypts data from within an originating application and decrypts within the receiving application.

We believe, but we cannot assure, that our technology and its implementation may be patentable. We have filed patent applications covering certain aspects of our products in the U.S., Canada and the European Union. Further applications may be made in other countries, as and when we penetrate new markets. We have defined migration paths for the various products and developed schedules for that migration. This

defines the requirement for additional patent, trademarks and copyright protection, which we plan to apply for as required in order to prevent unauthorized use of our technology.

We cannot assure that we will be able to obtain or to maintain the foregoing intellectual property protection. We also cannot assure that our technology does not infringe upon the intellectual property rights of others. In the event that we are unable to obtain the foregoing protection or our technology infringes intellectual property rights of others, our business and results of operations could be materially and adversely affected. For more information please see “Risk Factors - We may not be able to protect and enforce our intellectual property rights which could result in the loss of our right, loss of business or increase our costs.” and “Claims by third parties that we infringe upon their proprietary technology could hurt our financial condition,” below.

## **Employees**

As at December 31, 2006, we had nine full-time employees and contractual personnel, including two executive officers, four sales and marketing staff, one product development specialist, and two in administration. Eight are located in Ottawa, Canada, and one is located in Washington, DC. In addition, we contract with an independent software development group in Europe, which had twenty individuals deployed to our contract on a full-time basis as at December 31, 2006. We also regularly engage technical consultants and independent contractors to provide specific advice or to perform certain marketing or technical tasks.

## **Risk Factors**

Our business operations and our securities are subject to a number of substantial risks, including those described below. If any of these or other risks actually occur, our business, financial condition and operating results, as well as the trading price or value of our securities could be materially adversely affected.

### **Risks relating to our Business**

***We are a development stage company, and our limited operating history makes evaluating our business and prospects difficult.***

We are a development stage company, and our limited operating history makes it difficult to evaluate our current business and prospects or to accurately predict our future revenues or results of operations. The commercial acceptance of our products is unproven and therefore we may not be able to generate a sufficient number of revenue-paying customers to sustain operations. Our revenue and income potential are unproven, and our business plan is constantly evolving. The Internet is constantly changing and software technology is constantly improving, therefore we may need to continue to modify our business plan to adapt to these changes. As a result of our being in the early stages of development, particularly in the emerging technology industry, we are more vulnerable to risks, uncertainties, expenses and difficulties than more established companies. As a result, we may never achieve profitability and we may not be able to continue operations if we cannot successfully address the risks associated with early stage development companies in emerging technologies.

***We have a history of operating losses and we anticipate losses and negative cash flow for the foreseeable future. Unless we are able to generate profits and positive cash flow we may not be able to continue operations.***

We incurred a net loss of \$3,236,392 and negative cash flow from operations of \$1,976,022 during the year ended December 31, 2006. During the year ended December 31, 2005, we incurred a net loss of \$4,205,659 and negative cash flow from operations of \$3,035,255. We expect operating losses and negative cash flow from operations to continue for the foreseeable future.

We will need to generate significant revenues to achieve profitability. Consequently, we may never achieve profitability. Even if we do achieve profitability, we may not sustain or increase profitability on a quarterly or annual basis in the future. If we are unable to achieve or sustain profitability in the future, we may be unable to continue our operations. See "Management's Discussion and Analysis or Plan of Operations – Liquidity and Capital Resources."

***Our auditors have drawn readers' attention to the uncertainty of our ability to continue as a going concern.***

Our independent certified public accountants have added an explanatory paragraph to their audit opinion issued in connection with our consolidated financial statements. It states that our ability to continue as a going concern is uncertain due to our history of operating losses and difficulty in generating operating cash flows. Our consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty. These adjustments might include changes in the possible future recoverability and classification of assets or the amounts and classification of liabilities that might result from the outcome of this uncertainty.

***We will require additional capital to proceed with our business plan. If we are unable to obtain such capital, we will be unable to proceed with our business plan and we will be forced to limit or curtail our operations.***

We have an immediate requirement for additional working capital in order to proceed with our business plan. We are currently pursuing alternatives regarding the raising of additional capital to fund operations. For a discussion of our capital requirements, see the disclosure in "Part II. Item 6. Management's Discussion and Analysis or Plan of Operation; Plan of Operations." We do not currently have a commitment from any third party to provide financing and may be unable to obtain financing on reasonable terms or at all. Furthermore, if we raise additional working capital through equity, our shareholders will experience dilution. If we are unable to raise additional financing in the immediate future, and thereafter as required, we will be unable to grow or maintain our current level of business operations and, in fact, we will be forced to limit or curtail our operations.

***The loss of any of our key personnel would likely have an adverse effect on our business.***

Our future success depends, to a significant extent, on the continued services of our key personnel. Our loss of any of these key people most likely would have an adverse effect on our business. Competition for personnel throughout the industry is intense and we may be unable to retain our current personnel or attract, integrate or retain other highly qualified personnel in the future. If we do not succeed in retaining our current personnel or in attracting and motivating new personnel, our business could be materially adversely affected.

***The business environment is highly competitive and, if we do not compete effectively, we may experience material adverse effects on our operations.***

The market for Internet security products and services is intensely competitive and we expect competition to increase in the future. We compete with large and small companies that provide products and services that are similar to some aspects of our security services. Our competitors may develop new technologies in the future that are perceived as being more secure, effective or cost efficient than the technology underlying

our security services. In particular, the Internet security market has historically been characterized by low financial entry barriers.

Some of our competitors have longer operating histories, greater name recognition, access to larger customer bases and significantly greater financial, technical and marketing resources than we do. As a result, they may be able to adapt more quickly to new or emerging technologies and changes in customer requirements or to devote greater resources to the promotion and sale of their products than we will. We believe that there may be increasing consolidation in the Internet security market and this consolidation may materially adversely affect our competitive position. In addition, our competitors may have established or may establish financial or strategic relationships among themselves, with existing or potential customers, resellers or other third parties and rapidly acquire significant market share. If we cannot compete effectively, we may experience future price reductions, reduced gross margins and loss of market share, any of which will materially adversely affect our business, operating results and financial condition.

***If we are unable to develop market recognition, we may be unable to generate significant revenues and our results of operations may be materially adversely affected.***

To attract customers we may have to develop a market identity and increase public awareness of our technology and products. To increase market awareness of our technology and our products, we will continue to make significant expenditures for marketing initiatives. However, these activities may not result in significant revenue and, even if they do, any revenue may not offset the expenses incurred in building market recognition. Moreover, despite these efforts, we may not be able to increase public awareness of our technology and our products, which would have a material adverse effect on our results of operations.

***We must establish and maintain strategic and other relationships.***

One of our significant business strategies has been to enter into strategic or other similar collaborative relationships in order to reach a larger customer base than we could reach through our direct sales and marketing efforts. We may need to enter into additional relationships to execute our business plan. We may not be able to enter into additional, or maintain our existing, strategic relationships on commercially reasonable terms. If we fail to enter into additional relationships, or maintain our existing relationships, we would have to devote substantially more resources to the distribution, sale and marketing of our security services and communications services than we would otherwise.

Our success in obtaining results from these relationships will depend both on the ultimate success of the other parties to these relationships and on the ability of these parties to market our products successfully.

Furthermore, our ability to achieve future growth will also depend on our ability to continue to establish direct seller channels and to develop multiple distribution channels. Failure of one or more of our strategic relationships to result in the development and maintenance of a market for our services could harm our business. If we are unable to maintain our relationships or to enter into additional relationships, this could harm our business.

***If we are unable to respond to rapid technological change and improve our products and services, our business could be materially adversely affected.***

The Internet security industry is characterized by rapid technological advances, changes in customer requirements, frequent new product introductions and enhancements and evolving industry standards in computer hardware and software technology. As a result, we must continually change and improve our products in response to changes in operating systems, application software, computer and communications

hardware, networking software, programming tools and computer language technology. The introduction of products embodying new technologies and the emergence of new industry standards may render existing products obsolete or unmarketable. In particular, the market for Internet and intranet applications is relatively new and is rapidly evolving. Our future operating results will depend upon our ability to enhance our current products and to develop and introduce new products on a timely basis that address the increasingly sophisticated needs of our end-users and that keep pace with technological developments, new competitive product offerings and emerging industry standards. If we do not respond adequately to the need to develop and introduce new products or enhancements of existing products in a timely manner in response to changing market conditions or customer requirements, our operating results may be materially diminished.

***New products and services developed or introduced by us may not result in any significant revenues.***

We must commit significant resources to developing new products and services before knowing whether our investments will result in products and services the market will accept. The success of new products and services depends on several factors, including proper new definition and timely completion, introduction and market acceptance. There can be no assurance that we will successfully identify new product and service opportunities, develop and bring new products and services to market in a timely manner, or achieve market acceptance of our products and services, or that products, services and technologies developed by others will not render our products, services or technologies obsolete or non-competitive. Our inability to successfully market new products and services may harm our business.

***We may not be able to protect and enforce our intellectual property rights, which could result in the loss of our rights, loss of business or increased costs.***

Our success depends to a significant degree upon the protection of our software and other proprietary technology. The unauthorized reproduction or other misappropriation of our proprietary technology would enable third parties to benefit from our technology without paying us for it. We rely on a combination of patent, trademark, trade secret and copyright laws, license agreements and non-disclosure and other contractual provisions to protect proprietary and distribution rights of our products. We have registered trademarks in the United States, Canada and the European Union, and we have filed one patent application for our technology in each of these jurisdictions. Although we have taken steps to protect our proprietary technology, they may be inadequate and the unauthorized use thereof could have a material adverse effect on our business, results of operations and financial condition. Existing trade secret, copyright and trademark laws offer only limited protection. Moreover, the laws of other countries in which we market our products may afford little or no effective protection of our intellectual property. If we resort to legal proceedings to enforce our intellectual property rights, the proceedings could be burdensome and expensive, even if we were to prevail.

***Claims by third parties that we infringe upon their proprietary technology could hurt our financial condition.***

If we discover that any of our products or technology we license from third parties violates third party proprietary rights, we may not be able to reengineer our product or obtain a license on commercially reasonable terms to continue offering the product without substantial reengineering. In addition, product development is inherently uncertain in a rapidly evolving technology environment in which there may be numerous patent applications pending for similar technologies, many of which are confidential when filed. Although we sometimes may be indemnified by third parties against claims that licensed third party technology infringes proprietary rights of others, this indemnity may be limited, unavailable or, where the third party lacks sufficient assets or insurance, ineffective. We currently do not have liability insurance to protect against the risk that our technology or future licensed third party technology infringes the

proprietary rights of others. Any claim of infringement, even if invalid, could cause us to incur substantial costs defending against the claim and could distract our management from our business. Furthermore, a party making such a claim could secure a judgment that requires us to pay substantial damages. A judgment could also include an injunction or other court order that could prevent us from selling our products. Any of these events could have a material adverse effect on our business, operating results and financial condition.

***If our electronic security technology were breached, our business would be materially adversely affected.***

A key element of our technology and products is our Internet security feature. If anyone is able to circumvent our security measures, they could misappropriate proprietary information or cause interruptions or problems with hardware and software of customers using our products. Any such security breaches could significantly damage our reputation. In addition, we could be liable to our customers for the damages caused by such breaches or we could incur substantial costs as a result of defending claims for those damages. We may need to expend significant capital and other resources to protect against such security breaches or to address problems caused by such breaches. Security measures taken by us may not prevent disruptions or security breaches. In the event that future events or developments result in a compromise or breach of the technology we use to protect a customer's personal information, our financial condition and business could be materially adversely affected.

***We face restrictions on the exportation of our encryption technology, which could limit our ability to market our products outside of the United States, Canada and Europe.***

Some of our Internet security products utilize and incorporate encryption technology. Exports of software products utilizing encryption technology are generally restricted by the United States and various non-United States governments, particularly in response to the terrorist acts of September 11, 2001. If we do not obtain the required approvals, we may not be able to sell some of our products in international markets, which could materially adversely affect our results of operations.

***Our operating results may prove unpredictable, and may fluctuate significantly.***

Our operating results are likely to fluctuate significantly in the future due to a variety of factors, many of which are outside of our control. Factors which may cause operating results to fluctuate significantly include the following:

- \* new technology or products introduced by us or by our competitors;
- \* the timing and uncertainty of sales cycles and seasonal declines in sales;
- \* our success in marketing and market acceptance of our products and services by our existing customers and by new customers;
- \* a decrease in the level of spending for information technology-related products and services by our existing and potential customers; and
- \* general economic conditions, as well as economic conditions specific to users of our products and technology.

Our operating results may be volatile and difficult to predict. As such, future operating results may fall below the expectations of securities analysts and investors. In this event, the trading price of our common stock may fall significantly.

***We expect to generate some revenues and incur some operating expenses outside of the United States. If applicable currency exchange rates fluctuate our revenues and results of operations may be materially and adversely affected.***

We expect that some portion of our revenues will be based on sales provided outside of the United States. In addition, a significant portion of our operating expenses are incurred outside of the United States, and we expect that this will continue to be the case. As a result, our financial performance will be affected by fluctuations in the value of the U.S. dollar to foreign currency. At the present time, we have no plan or policy to utilize forward contracts or currency options to minimize this exposure, and even if these measures are implemented there can be no assurance that such arrangements will be available, be cost effective or be able to fully offset such future currency risks.

***Other risks associated with international operations could adversely affect our business operations and our results of operations.***

There are certain risks inherent in doing business on an international level, such as:

- \* unexpected changes in regulatory requirements, export and import restrictions;
- \* controls relating to encryption technology that may limit sales sometime in the future;
- \* legal uncertainty regarding liability and compliance with foreign laws;
- \* competition with foreign companies or other domestic companies entering into the foreign markets in which we operate;
- \* tariffs and other trade barriers and restrictions;
- \* difficulties in staffing and managing foreign operations;
- \* longer sales and payment cycles;
- \* problems in collecting accounts receivable;
- \* political instability;
- \* fluctuations in currency exchange rates;
- \* software piracy;
- \* seasonal reductions in business activity during the summer months in Europe and elsewhere;
- and
- \* potentially adverse tax consequences.

Any of these factors could adversely impact the success of our international operations. One or more of such factors may impair our future international operations and our overall financial condition and business prospects.

**Risks relating to our Common Stock**

***Our common stock price may be volatile.***

The market prices of securities of Internet and technology companies are extremely volatile and sometimes reach unsustainable levels that bear no relationship to the past or present operating performance of such companies. Factors that may contribute to the volatility of the trading price of our common stock include, among others:

- \* our quarterly results of operations;
- \* the variance between our actual quarterly results of operations and predictions by stock analysts;
- \* financial predictions and recommendations by stock analysts concerning Internet companies and companies competing in our market in general, and concerning us in particular;
- \* public announcements of technical innovations relating to our business, new products or technology by us or our competitors, or acquisitions or strategic alliances by us or our competitors;
- \* public reports concerning our products or technology or those of our competitors; and

- \* the operating and stock price performance of other companies that investors or stock analysts may deem comparable to us.

In addition to the foregoing factors, the trading prices for equity securities in the stock market in general, and of Internet-related companies in particular, have been subject to wide fluctuations that may be unrelated to the operating performance of the particular company affected by such fluctuations. Consequently, broad market fluctuations may have an adverse effect on the trading price of our common stock, regardless of our results of operations.

***There is a limited market for our common stock. If a substantial and sustained market for our common stock does not develop, our shareholders' ability to sell their shares may be materially and adversely affected.***

Our common stock is tradable in the over-the-counter market and is quoted on the OTC Bulletin Board. Many institutional and other investors refuse to invest in stocks that are traded at levels below the Nasdaq Small Cap Market which could make our efforts to raise capital more difficult. In addition, the firms that make a market for our common stock could discontinue that role. OTC Bulletin Board stocks are often lightly traded or not traded at all on any given day. We cannot predict whether a more active market for our common stock will develop in the future. In the absence of an active trading market:

- \* investors may have difficulty buying and selling or obtaining market quotations;
- \* market visibility for our common stock may be limited; and
- \* a lack of visibility for our common stock may have a depressive effect on the market price for our common stock.

***Shares issuable upon the exercise of options, warrants and convertible debentures, or under anti-dilution provisions in certain agreements, could dilute stock holdings and adversely affect our stock price.***

We have issued options and warrants to acquire common stock to our employees and certain other persons at various prices, some of which have, or may in the future have, exercise prices at or below the market price of our stock. As of April 30, 2007, we have outstanding options and warrants to purchase a total of 11,949,635 shares of our common stock, all of which have exercise prices above the recent market price of \$0.04 per share (as of April 19, 2007). If exercised, these options and warrants will cause immediate and possibly substantial dilution to our stockholders.

We have two existing stock option plans, one of which had 2,315,000 shares remaining for issuance as of April 30, 2007, the second of which had 1,679,698 shares remaining for issuance as of April 30, 2007. Future options issued under these plans may have further dilutive effects.

Issuance of shares pursuant to the exercise of options, warrants, or anti-dilution provisions, could lead to subsequent sales of the shares in the public market, which could depress the market price of our stock by creating an excess in supply of shares for sale. Issuance of these shares and sale of these shares in the public market could also impair our ability to raise capital by selling equity securities.

***A large number of shares will be eligible for future sale and may depress our stock price.***

As of April 30, 2007, we had outstanding 45,720,403 shares of common stock, of which approximately 27,417,763 shares were "restricted securities" as that term is defined under Rule 144 promulgated under the Securities Act of 1933. These restricted shares are eligible for sale under Rule 144 at various times, upon the expiry of the applicable holding period. No prediction can be made as to the effect, if any, that sales of shares of common stock or the availability of such shares for sale will have on the market prices prevailing from time to time. Nevertheless, the possibility that substantial amounts of our common stock may be sold



in the public market may adversely affect prevailing market prices for the common stock and could impair our ability to raise capital through the sale of our equity securities.

***We will have to increase our authorized common shares in order to raise a significant amount of equity capital.***

Our authorized common stock is limited to 100,000,000. We currently have the following issued and reserved for issuance (as at April 30, 2007):

Common stock outstanding	45,720,403
Common stock reserved for stock option plans	7,000,000
Common stock reserved for exercise of warrants	8,944,333
Common stock reserved for conversion of 10% convertible notes	25,833,333
	<u>87,498,069</u>

If we do not increase our authorized common shares we will be limited in how much equity capital or convertible debt securities we can issue. In the event that we do increase our authorized common stock, our existing stockholders may experience dilution and the value of our common stock may decrease.

***We do not intend to pay dividends in the near future.***

Our board of directors determines whether to pay dividends on our issued and outstanding shares. The declaration of dividends will depend upon our future earnings, our capital requirements, our financial condition and other relevant factors. Our board does not intend to declare any dividends on our shares for the foreseeable future.

***Our common stock may be deemed to be a "penny stock." As a result, trading of our shares may be subject to special requirements that could impede our shareholders' ability to resell their shares.***

Our common stock may be deemed to be a "penny stock" as that term is defined in Rule 3a51-1 of the Securities and Exchange Commission. Penny stocks include stocks:

- \* that are not traded on a national securities exchange that has been continuously registered since April 20, 1992 and has maintained quantitative initial and continued listing standards that are substantially similar to or stricter than the listing standards in place at January 8, 2004;
- \* that are not traded on a securities exchange, a "junior tier" of an exchange or an automated quotation system sponsored by a registered national securities association that has established initial listing standards that meet or exceed specified criteria and maintains similar quantitative continued listing standards; or
- \* whose prices are not quoted on the NASDAQ automated quotation system ; or
- \* of issuers with net tangible assets less than:
  - \* \$2,000,000 if the issuer has been in continuous operation for at least three years; or
  - \* \$5,000,000 if in continuous operation for less than three years, or
  - \* of issuers with average revenues of less than \$6,000,000 for the last three years.

Section 15(g) of the Exchange Act, and Rule 15g-2 of the Securities and Exchange Commission, require broker-dealers dealing in penny stocks to provide potential investors with a document disclosing the risks of penny stocks not less than two business days before a transaction is effected, and to obtain a manually signed and dated written receipt of the document before effecting any transaction in a penny stock for the

investor's account. Moreover, Rule 15c-9 of the Securities and Exchange Commission requires broker-dealers in penny stocks to approve the account of any investor for transactions in such stocks before selling any penny stock to that investor. This procedure requires the broker-dealer:

- \* to obtain from the investor information concerning his or her financial situation, investment experience and investment objectives;
- \* to determine reasonably, based on that information, that transactions in penny stocks are suitable for the investor and that the investor has sufficient knowledge and experience as to be reasonably capable of evaluating the risks of penny stock transactions;
- \* to provide, not less than two business days before a transaction is effected, the investor with a written statement setting forth the basis on which the broker-dealer made the determination in the second bullet above; and
- \* to receive a signed and dated copy of such statement from the investor, confirming that it accurately reflects the investor's financial situation, investment experience and investment objectives.

Compliance with these requirements may make it more difficult for holders of our common stock to resell their shares to third parties or to otherwise dispose of them.

***Our current executive officers, directors and major stockholders own a significant percentage of our voting stock. As a result, they exercise significant control over our business affairs and policy.***

As of April 30, 2007, our current executive officers, directors and holders of 5% or more of our outstanding common stock together beneficially owned approximately 30% of the outstanding common stock if they exercised all of the options and warrants held by them. These stockholders are able to significantly influence all matters requiring approval by stockholders, including the election of directors and the approval of significant corporate transactions. This concentration of ownership may also have the effect of delaying, deterring or preventing a change in control and may make some transactions more difficult or impossible to complete without the support of these shareholders.

***Our restated articles of incorporation contain provisions that could discourage an acquisition or change of control of our company.***

Our restated articles of incorporation authorize our board of directors to issue preferred stock without stockholder approval. Provisions of our certificate of incorporation, such as the provision allowing our board of directors to issue preferred stock with rights more favorable than our common stock, could make it more difficult for a third party to acquire control of us, even if that change of control might benefit our stockholders.

***We currently do not have an effective system of internal controls, and therefore we may not be able to detect fraud or report our financial results accurately, which could harm our business.***

Effective internal controls are necessary for us to provide reliable financial reports and to detect and prevent fraud. We periodically assess our system of internal controls to review their effectiveness and identify potential areas of improvement. These assessments may conclude that enhancements, modifications or changes to our system of internal controls are necessary. Performing assessments of internal controls, implementing necessary changes, and maintaining an effective internal controls process is expensive and requires considerable management attention. Internal control systems are designed in part upon assumptions regarding the likelihood of future events, and all such systems, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. A consequence of these and other inherent limitations of control systems is that there can be no

assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote. If we fail to implement and maintain an effective system of internal controls or prevent fraud, we could suffer losses, could be subject to costly litigation, investors could lose confidence in our reported financial information, and our image and operating results could be harmed, which could have a negative effect on the trading price of our common stock.

In connection with the audit of our consolidated financial statements for the year ended December 31, 2006, our independent registered public accounting firm advised the Board of Directors and management of certain significant internal control deficiencies that they consider to be, in aggregate, a material weakness. In particular, our independent registered public accounting firm identified the following weaknesses in our internal control system: (1) a lack of segregation of duties; and (2) the lack of timely preparation of certain back up schedules. Due to the size and resources of our company we may not be able to remediate in the foreseeable future all of the deficiencies identified. If we are unable to remediate the identified material weaknesses, there is a more than remote likelihood that a material misstatement to our SEC reports will not be prevented or detected, in which case investors could lose confidence in the accuracy and completeness of our financial reports, which could have an adverse effect on our ability to raise additional capital and could also have an adverse effect on our stock price.

***We may have difficulty implementing in a timely manner the internal controls procedures necessary to allow our management to report on the effectiveness of our internal controls, and we may incur substantial costs in order to comply with the requirements of the Sarbanes-Oxley Act of 2002.***

The Sarbanes-Oxley Act of 2002 has introduced many new requirements applicable to us regarding corporate governance and financial reporting. Among many other requirements is the requirement under Section 404 of the Act for management to report on our internal controls over financial reporting and for our registered public accountant to attest to this report. We are required to comply with Section 404 effective the fiscal year ending December 31, 2007. Although our management has begun the necessary processes and procedures for issuing its report on our internal controls, we cannot be certain that we will be successful in complying with Section 404. We expect to devote substantial time and incur costs during fiscal 2007 and 2008 to implement appropriate controls and procedures to ensure compliance. If we are not able to timely comply with the requirements set forth in Section 404, we might be subject to sanctions or investigations by regulatory authorities. Any such action could adversely affect our business and financial results.

## **Our Corporate History**

We were incorporated in Nevada on April 12, 1989 as CCC Funding Corp. to seek out one or more potential business ventures. On January 28, 2003, we changed our name from Sochrys.com Inc. to Validian Corporation.

### **Item 2. Description of Properties.**

Our Canadian office is located at 30 Metcalfe St., Suite 620, Ottawa, Canada, K1P 5L4. The telephone number is (613) 230-7211. Our United States office is located at 4651 Roswell Road, Suite B-106, Atlanta, Georgia 30342, telephone number (404) 256-1963.

Our Ottawa office is leased from a non-affiliated party under a long-term operating lease. Until April 30, 2007, the lease provided shared access to and use of 5,576 square feet. Effective May 1, 2007, we reduced the amount of space we occupy in our Ottawa location to 3,526 square feet. Our Atlanta office is leased from a non-affiliated party per oral arrangement on a month-by-month basis. The lease provides shared access to and use of 1,000 square feet.

**Item 3. Legal Proceedings.**

On December 31, 2006, Dr. Andre Maisonneuve retired from the Corporation. On December 21, 2006, Dr. Maisonneuve commenced legal action against the Corporation at Ontario Superior Court of Justice in Ottawa, Canada, seeking approximately \$42,905 in unpaid salary claimed to be owed to him at the date of his retirement, plus costs with respect to collecting the amount due. We are contesting this action, but have included \$42,905 in accrued liabilities in the consolidated financial statements at December 31, 2006. Additional costs which may become payable in relation to this claim cannot be reasonably estimated at this time; we will record such costs, if any, when they become known to us.

**Item 4. Submission of Matters to a Vote of Security holders.**

There have been no matters submitted to a vote of our shareholders since February 25, 2005.

## **PART II**

### **Item 5. Market for Common Equity and Related Stockholder Matters.**

(a) Market Information -- The principal U.S. market in which our common stock, all of which are of one class, \$.001 par value per share, is traded is in the over-the-counter market. Our stock is quoted on the OTC Bulletin Board under the symbol "VLDI".

The following table sets forth the range of high and low bid quotes of our common stock for the periods noted as reported by the OTC Bulletin Board. These quotes reflect inter-dealer prices without retail mark-up, markdown or commission and may not necessarily represent actual transactions.

#### **MARKET PRICE OF COMMON STOCK**

<b>Quarter Ending</b>	<b>BID</b>	
	<b>High</b>	<b>Low</b>
<b>2005</b>		
January 1 to March 31	\$0.78	\$0.39
April 1 to June 30	0.70	0.40
July 1 to September 30	0.60	0.38
October 1 to December 31	0.45	0.18
<b>2006</b>		
January 1 to March 31	0.37	0.11
April 1 to June 30	0.30	0.11
July 1 to September 30	0.17	0.08
October 1 to December 31	0.10	0.07
<b>2007</b>		
January 1 to March 30	0.12	0.04

On April 19, 2007, the closing price of our common stock was \$0.04 per share.

(b) Holders -- There were approximately 178 holders of record of our common stock as of March 30, 2007, inclusive of those brokerage firms and/or clearing houses holding our securities for their clientele, with each such brokerage house and/or clearing house being considered as one holder. The aggregate number of shares of common stock outstanding as of March 30, 2007 was 45,720,402 shares.

(c) Dividends -- We have not paid or declared any dividends upon our common stock since inception and, by reason of our present financial status and our contemplated financial requirements, we do not contemplate or anticipate paying any dividends in the foreseeable future (see Part I; Item 1: Risk Factors).

(d) Sales of Unregistered Securities--During the three months ended December 31, 2006, we issued the following:

- \* 118,378 shares of our common stock to holders of our 10% senior convertible notes, in settlement of \$13,638 in accrued interest on the notes;

- \* 500,000 shares of our common stock, valued at \$47,500, to an accredited investor in consideration for consulting services rendered during the three months ended December 31, 2006, and to be rendered during the three months ended March 31, 2007;
- \* 1,000,000 shares of our common stock pursuant to the terms of \$500,000 in principal amount of our 10% senior convertible notes, which were issued October 5, 2006 to an accredited investor;
- \* 600,000 shares of our common stock to an accredited investor pursuant to the terms of \$150,000 in principal amount of our 10% senior secured convertible notes, which were issued December 21, 2006;
- \* 412,000 shares of our common stock to an accredited investor, in settlement of financing fees payable with respect to the 10% senior convertible notes and 10% senior secured promissory notes issued during the period;
- \* 650,000 Series J warrants, in exchange for the cancellation of 520,000 Series E warrants and 1,005,000 stock options on the retirement of one of our directors.
- \* 500,000 shares of our common stock to the holder of our 10% promissory note, in settlement of a penalty for failing to repay the entire balance of the note plus accrued interest prior to October 11, 2006.

During the period from January 1 to May 15, 2007, we issued the following:

- \* 659,000 shares of our common stock to the holders of our 10% senior secured convertible notes and our 10% senior convertible notes, in satisfaction of \$44,342 of accrued interest on the notes;
- \* 3,000,000 shares of our common stock to accredited investors in consideration for consulting services to be rendered over a six-month period;
- \* 1,000,000 shares of our common stock to an accredited investor pursuant to an agreement to provide investor relations services over a six month period;
- \* 600,000 shares of its common stock to an accredited investor in settlement of \$60,000 in fees payable;
- \* 775,000 shares of its common stock to an accredited investor in settlement of financing fees payable;
- \* 400,000 shares of its common stock pursuant to the terms of \$200,000 in principal amount of our 10% senior secured convertible notes;
- \* 49,333 shares of its common stock to an accredited investor in settlement of finance fees payable with respect to the 10% senior secured convertible note issued during the period;
- \* 25,000 shares of our common stock to an accredited investor in consideration for consulting services to be rendered over a one month period commencing March 14, 2007;
- \* 750,000 shares of our common stock to an accredited investor pursuant to the terms of \$250,000 in principal amount of our 10% senior convertible notes.

The foregoing securities were issued in reliance upon the exemption provided by Sections 3(a)(9) or 4(2) under the Securities Act of 1933 and the rules promulgated thereunder.

## **Item 6. Management's Discussion and Analysis or Plan of Operations.**

### **General**

In this section, we explain our consolidated financial condition and results of operations for the years ended December 31, 2006 and December 31, 2005. As you read this section, you may find it helpful to refer to our Consolidated Financial Statements in Item 7 of this annual report.

Until we acquired our former subsidiary, Graph-O-Logic, S.A. in August 1999, we had no material or substantive business operations. Since then, our business has been as more fully described in "Part I, Item 1: Description of Business". Accordingly, in this section we focus solely on the historical business operations of the subsidiary and our current business plan and operations.

### **Critical Accounting Policies**

We prepare our financial statements in accordance with generally accepted accounting principles in the United States of America. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and related disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Significant accounting policies and methods used in preparation of the financial statements are described in note 2 to our 2006 Consolidated Financial Statements included with this Annual Report on Form 10-KSB for the year ended December 31, 2006. We evaluate our estimates and assumptions on a regular basis, based on historical experience and other relevant factors. Actual results could differ materially from these estimates and assumptions. The following critical accounting policies are impacted by judgments, assumptions and estimates used in preparation of our December 31, 2006 Consolidated Financial Statements.

#### *Revenue recognition:*

For sales of product licenses, the Corporation recognizes revenue in accordance with Statement of Position 97-2, "Software Revenue Recognition" ("SOP 97-2"), as amended by Statement of Position 98-9, "Software Revenue Recognition with Respect to Certain Transactions", issued by the American Institute of Certified Public Accountants. Revenue from sale of product licenses is recognized when all of the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collectibility is probable.

Revenue from product support contracts is recognized ratably over the life of the contract. Revenue from services is recognized at the time such services are rendered.

For contracts with multiple elements such as product licenses, product support and services, the Corporation follows the residual method. Under this method, the total fair value of the undelivered elements of the contract, as indicated by vendor specific objective evidence, is deferred and subsequently recognized in accordance with the provisions of SOP 97-2. The difference between the total contract fee and the amount deferred for the undelivered elements is recognized as revenue related to the delivered elements. Vendor specific objective evidence for support and consulting services is obtained from contracts where these elements have been sold separately. Where the Corporation cannot determine the fair value of all of the undelivered elements, revenue is deferred until such time as it can be determined, or until all of the elements are delivered.

### *Long-Lived assets:*

We perform impairment tests on our long-lived assets if events or changes in circumstances indicate that an impairment loss may have occurred. We estimate the useful lives of capital assets and deferred charges based on the nature of the asset, historical experience and the terms of any supplier contracts. The valuation of long-lived assets is based on the amount of future net cash flows these assets are estimated to generate. Revenue and expense projections are based on management's estimates, including estimates of current and future industry conditions. A significant change to these assumptions could impact the estimated useful lives or valuation of long-lived assets resulting in a change to depreciation or amortization expense and impairment charges.

### *Research and development expenses:*

We expense all of our research and development expenses in the period in which they are incurred. At such time as our products are determined to be commercially available, we will capitalize those development expenditures that are related to the maintenance of the commercial products, and amortize these capitalized expenditures over the estimated life of the commercial product. The estimated life of the commercial product will be based on management's estimates, including estimates of current and future industry conditions. A significant change to these assumptions could impact the estimated useful life of our commercial products resulting in a change to amortization expense and impairment charges.

### *Stock-based compensation:*

Effective January 1, 2006, the Corporation adopted the provisions of Financial Accounting Standards Board Statement No. 123R "Share-Based Payment – a revision of FAS 123" (SFAS 123R) to account for its stock-based payments. SFAS 123R requires all share-based payments, including stock options granted by the Corporation to its employees, to be recognized as expenses, based on the fair value of the share-based payments at the date of grant. For purposes of estimating the grant date fair value of stock-based compensation, the Corporation uses the Black Scholes option-pricing model, and has elected to treat awards with graded vesting as a single award. The fair value of awards granted is recognized as compensation expense on a straight-line basis over the requisite service period, which in the Corporation's circumstances is the stated vesting period of the award.

In adopting SFAS 123R, the Corporation has applied the modified-prospective transition method. Under this method, the Corporation will recognize compensation costs for all share-based payments granted, modified, or settled after January 1, 2006, as well as for any awards that were granted prior to January 1, 2006 for which the requisite service had not been provided as of that date (unvested awards). Under the modified prospective method, prior periods are not adjusted, and the Corporation continues to provide pro forma disclosure for these periods, as presented below.

For reporting periods ending on or before December 31, 2005, the Corporation applied the intrinsic value-based method of accounting prescribed by Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees", and related interpretations including FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation an interpretation of APB Opinion No. 25" issued in March 2000, to account for its stock options for employees. Under this method, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation," established accounting and disclosure requirements using a fair value-based method of accounting for stock-based employee compensation plans. These provisions are required to be applied to stock compensation granted to non-employees. As allowed by SFAS No. 123, the



Corporation elected to apply the intrinsic value-based method of accounting described above for awards granted to employees, and adopted the disclosure requirements of SFAS No. 123.

Had compensation costs in respect of options granted to employees been determined using the fair value based method at the grant date, the Corporation's pro forma net loss and basic and diluted loss per share for the year ended December 31, 2005 would have been as follows:

Net loss, as reported	\$(4,205,659)
Deduct total stock-based employee compensation expense determined under the fair value-based method for all awards	<u>(1,071,008)</u>
Pro forma net loss	<u><u>\$(5,222,667)</u></u>
Loss per share:	
Basic and diluted – as reported	\$(0.13)
Basic and diluted – pro-forma	\$(0.17)

### **Plan of Operations**

We are a development stage enterprise. As such, our historical results of operations are unlikely to provide a meaningful understanding of the activities expected to take place during the period through December 31, 2007. Our major initiatives through December 31, 2007 are:

- \* obtaining commercial sales of our products, and continuing our current marketing program;
- \* developing and improving product agents to perform specialized functions common to many e-commerce sites; and
- \* furthering the development of our products.

For more information, please see “Part 1. Item 1: Description of Business - Technology.”

**Sales and Marketing Plans:** We started our marketing process during the second quarter of 2000, with our original focus being potential customers located in the United States and Western Europe. The potential customers and our current marketing program are more fully described in “Part 1. Item 1: Description of Business - The Target Market.”

We will continue to focus our marketing efforts on identifying potential customers by presenting technical seminars, participating in trade shows, using the services of public relations firms, market research, the creation and dissemination of technical and commercial collateral materials, the maintenance and periodic re-design of our website, and the placement of advertisements in print and electronic publications. Subject to our ability to obtain adequate funding, we plan on spending \$200,000 on our marketing efforts during the year ending December 31, 2007.

Our sales representatives, who are compensated on a base compensation plus commission basis, will follow up with potential customers identified through our marketing efforts, with the objective of more fully explaining the benefits of our products and negotiating the terms of the licensing of our products. Subject to our ability to obtain adequate funding, we expect to spend approximately \$873,000 on our sales initiatives, including compensation and travel expenses, during the year ending December 31, 2007.

Subject to our ability to obtain adequate funding, our sales and marketing expenditures for the year ending December 31, 2007 are expected to total \$1,073,000.

**Cost of Sales and Services:** In the event that our sales efforts are successful, we will need to assist our customers in the implementation of our products. Depending on the success of our sales efforts, and subject to our ability to obtain adequate funding, we expect to spend \$50,000 on compensation, training and related activities during the year ending December 31, 2007.

**Product Development:** We plan on continuing to fund third parties to develop our key technology and related products, under the direction and management of our product management group and our senior management. For more information please see “Part 1. Item 1. Description of Business - Our Technology”.

We will improve and further develop our products based on responses from potential customers. The cost associated with our product development activities are primarily those currently planned and thus are subject to a high degree of control. Subject to our ability to obtain adequate funding, we estimate that the cost of our product development program during the year ending December 31, 2007 will be \$1,150,000.

**General and Administrative Expenses:** Subject to our ability to obtain adequate funding, we expect to spend \$850,000 on general and administrative activities during the year ending December 31, 2007.

During the year ending December 31, 2007, provided we are able to obtain adequate funding, we expect to spend a total of \$3,123,000, subject to our ability to generate revenues from the licensing of our products and our ability to raise additional capital.

Since entering the development stage, we have obtained financing through the private placement of debt, convertible debentures, common stock and warrants, and through the exercise of some of these warrants. Until such time as we generate sufficient revenues from the licensing of our software applications, we will continue to be dependent on raising substantial amounts of additional capital through any one of a combination of debt offerings or equity offerings, including but not limited to:

- \* debt instruments, including demand notes and convertible debentures similar to those discussed below in “Liquidity and Capital Resources”;
- \* private placements of common stock;
- \* exercise of stock options at an average exercise price of \$0.50 per share;
- \* exercise of Series ‘E’ warrants at an exercise price of \$0.33 per share;
- \* exercise of Series ‘F’ warrants at an exercise price of \$0.50 per share;
- \* exercise of Series ‘I’ warrants at an exercise price of \$0.03 per share;
- \* exercise of Series “J” warrants at an exercise price of \$0.15 per share; or
- \* funding from potential clientele or future industry partners.

### **Selected Financial Data**

The selected financial data set forth below with respect to our consolidated statements of operations for each of the two fiscal years ended December 31, 2006 and with respect to the consolidated balance sheets as at December 31, 2006 and 2005, are derived from our audited consolidated financial statements included at the end of this report. The following selected financial data should be read in conjunction with our consolidated financial statements and the notes thereto.

	<b>Year Ended December 31</b>	
	<b>2006</b>	<b>2005</b>
<b>Operations Data</b>		
Selling, general and administrative	\$ 1,890,887	\$ 2,213,403
Research and development	1,125,285	1,307,483
Depreciation of property and equipment	61,897	83,856
Other expenses, net	309,222	600,917
Net loss	<u>\$ 3,387,291</u>	<u>\$ 4,205,659</u>

	<b>Year Ended December 31</b>	
	<b>2006</b>	<b>2005</b>
<b>Cash Flows Data</b>		
Net cash used in operating activities	\$ (1,976,022)	\$ (3,035,255)
Net cash used in investing activities	--	(41,274)
Net cash provided by financing activities	1,912,609	399,747
Net decrease in cash and cash equivalents	<u>\$ (63,413)</u>	<u>\$ (2,676,782)</u>

<b>Balance Sheet Data</b>		
Cash	\$ 7,780	\$ 71,193
Total current assets	177,082	394,105
Property and equipment (net)	34,971	96,868
Deferred financing costs	169,403	--
Deferred consulting services	--	50,349
Total assets	381,456	541,322
Total current liabilities	1,979,526	835,120
Capital lease obligation	6,550	10,578
Stockholders' deficiency	\$ (2,306,339)	\$ (300,345)

### **Results of Operations**

In this section, we discuss our earnings for the periods indicated and the factors affecting them that resulted in changes from one period to the other.

#### **The fiscal year ended December 31, 2006 compared to the fiscal year ended December 31, 2005**

**Revenue:** We completed our first commercial sale during the third quarter of 2005, however we were unable to recognize revenue in connection with this sale, as all of the criteria required for us to do so as set out in our accounting policies were not met. During April 2006 we determined that collection of the amount invoiced in connection with this sale was in jeopardy, and have recorded an allowance against the entire amount, as an offset against deferred revenue.

On January 1, 2006 we entered into an agreement with a Value Added Reseller ("VAR"), pursuant to which we granted the VAR a license to sell our software to the VAR's customers for a period of three years. Our fee for this license, excluding applicable sales taxes, was \$155,000, of which \$151,650 had been received as of the financial statement date. We will recognize revenue in connection with this sale once all of the criteria required for us to do so as set out in our accounting policies, have been met.

Since August 1999, we have directed all of our attention towards the completion, and sales and marketing of, our software applications. We believe that if we are successful in our development and sales and marketing efforts, we will generate a source of revenue in the future from sales and/or licensing of our software applications.

**Selling, general and administrative expenses:** Selling, general and administrative expenses consist primarily of personnel costs, professional fees, insurance, communication expenses, occupancy costs and other miscellaneous costs associated with supporting our research and development and sales and marketing activities. During the year ended December 31, 2006 we incurred a total of \$1,890,887, including \$1,533,660 in cash-based expenses and \$357,227 in stock-based expenses, as compared to \$2,213,403, of which \$1,920,742 was cash-based and \$292,661 was stock-based expenses, during the year ended December 31, 2005. There was an overall decrease in selling, general and administrative expenses of \$322,516 (15%), comprised of a \$387,082 (20%) decrease in the cash-based component of this expense, which was partially offset by a \$64,566 (22%) increase in stock-based expenses. The decrease in the cash-based component of selling, general and administrative expenses occurred primarily as a result of a reduction in the level of activity of our sales and marketing departments, as compared to the level of activity of these departments during the year ended December 31, 2005, during which we were in the process of scaling back our sales and marketing efforts in response to a delay in the expected release date of one of our products. During 2006, we made efforts to further reduce costs in these departments through measures such as reducing the number of sales personnel, discontinuing the services of our public relations firm, reducing the number of trade shows in which we participate, and delaying production of new promotional material. We will continue to carefully monitor these costs as we work within current budgetary limits leading up to the full commercial release of our products.

In addition to the reduction in cash-based costs incurred by our sales and marketing departments, cash-based administrative expenses also decreased during the year ended December 31, 2006 as compared with the year ended December 31, 2005, primarily as a result of a reduction in professional fees, which occurred due to lower ongoing reporting costs relating to our private debt and equity placements which took place during the fourth quarter of 2003 and the first quarter of 2004. We also incurred \$26,000 during the year ended December 31, 2005 in relation to our annual general meeting, for which there was no comparable expense during the year ended December 31, 2006. These reductions were partially offset by increases in cash-based investor relation consultants' fees and travel costs, due to our efforts to raise additional capital.

Much of our selling, general and administrative expenses are incurred in Canadian dollars. As such, the decreased costs in these departments were partially offset by the higher average exchange rate between the Canadian dollar and the United States dollar experienced during the year ended 2006, as compared with the year ended December 31, 2005 (\$0.882 in 2006; \$0.826 in 2005).

The stock-based component of selling, general and administrative expenses for the year ended December 31, 2006 consisted of \$221,727 in amortization of prepaid consulting fees recognized on the issuance of warrants during 2003, and on the extension, during August 2005, of the expiry date of these warrants from August 31, 2005 to December 31, 2006; \$60,000 in fair value of common stock issued as compensation for investor relations services rendered; \$18,750 in fair value of unvested employee stock options earned during the period, reduced by a reversal of the fair value of unvested employee stock options forfeited during the period; \$11,500 in fair value of 100,000 common shares issued as compensation for the extension of the repayment period of investor relations fees owing; and \$45,000 in fair value of 500,000 common shares issued as a penalty for failing to repay our 10% promissory note within the initial period set out under the terms of the note. The \$292,661 in the stock-based component of this expense for the year ended December 31, 2005 consisted of \$136,130 in amortization of prepaid consulting fees recognized on the issuance of warrants during 2003, and on the extension, during August 2005, of the expiry date of

warrants issued during 2003; and \$156,531 recognized as the fair value of stock options issued to a consultant during the second quarter of 2005 as compensation for services rendered.

**Research and development expenses:** Research and development expenses consist primarily of personnel costs and consulting expenses directly associated with the development of our software applications. During the year ended December 31, 2006, we spent \$1,125,285, developing our software applications, which represent a decrease of \$182,198 (14%) from the \$1,307,483 we incurred during the year ended December 31, 2005. This decrease is due primarily to a reduction in the size of the Europe-based contract development group from an average of 26 personnel during the year ended December 31, 2005, to an average of 20 personnel during the year ended December 31, 2006. Additionally, we engaged external consultants to perform technical writing and testing of our products during the year ended December 31, 2005, for which there were no comparable costs during the year ended December 31, 2006. In an effort to reduce overall expenses, we also incurred lower travel costs relating to meetings with our Europe-based contract development group during the year ended December 31, 2006 as compared with the year ended December 31, 2005.

**Interest and financing costs:** Interest and financing costs during the year ended December 31, 2006 consisted of interest and financing costs associated with our 10% senior secured convertible notes, our 10% senior convertible notes, our 10% and 12% promissory notes and interest on the capital lease. During the year ended December 31, 2005, interest and financing costs included interest and financing costs associated with our 4% senior convertible debentures, interest on our 12% promissory notes and interest on the capital lease. During the year ended December 31, 2006, we incurred \$382,817 in interest and financing costs, a decrease of \$232,469 (38%) over the \$615,286 in interest and financing costs incurred during the year ended December 31, 2005.

Of the \$382,817 in interest and financing costs we incurred during the year ended December 31, 2006, \$62,729 relates to our 10% senior secured convertible notes, \$186,654 relates to our 10% senior convertible notes, \$71,247 relates to our 10% promissory notes, \$59,983 relates to our 12% promissory notes and \$2,204 relates to the capital lease. The \$62,729 in interest and financing costs relating to our 10% senior secured convertible notes is comprised of: \$10,900 of accrued interest charges; \$45,992 of accretion of the principal through charges to interest expense; and \$5,837 of amortization of deferred financing costs. The 10% senior secured convertible notes were issued during the year ended December 31, 2006, therefore there is no comparable cost for the year ended December 31, 2005.

The \$186,654 in interest and financing costs relating to our 10% senior convertible notes is comprised of: \$38,620 of accrued interest charges; \$118,607 of accretion of the principal through charges to interest expenses; and \$29,427 of amortization of deferred financing costs. The 10% senior convertible notes were issued during 2006, therefore there is no comparable cost for the year ended December 31, 2005.

The \$71,247 in interest and financing costs relating to our 10% promissory notes is comprised of: \$11,027 of accrued interest charges; \$44,956 of accretion of the principal through charges to interest expenses; and \$15,264 of amortization of deferred costs. The 10% promissory notes were issued during 2006, therefore there is no comparable cost for 2005.

Of the \$615,286 in interest and financing costs we incurred during 2005, \$576,844 related to our 4% senior convertible debentures, which matured on December 31, 2005, resulting in there being no comparable cost during the year ended December 31, 2006. The remaining \$38,442 in interest and financing costs for the year ended December 31, 2005 consisted of \$35,556 in interest on our 12% promissory notes payable, and \$2,886 related to the capital lease.

Interest on our 12% promissory notes increased by \$24,427 (69%), from \$35,556 during the year ended December 31, 2005, to \$59,983 during the year ended December 31, 2006. This increase occurred as a result of a net increase of \$307,607 in the principal outstanding on the notes during the year ended December 31, 2006, which increased the balance on which interest was charged for 2006 as compared with the year ended December 31, 2005. There was a decrease of \$682 in the amount of interest incurred on our capital lease, as a result of a reduction in the principal outstanding.

**Gain on extinguishment of debt:** During the year ended December 31, 2006, we recorded \$79,303 in net gains on extinguishment of debt. The terms of our 10% senior secured promissory notes were modified; a gain of \$38,097 was recorded on this transaction. Also during 2006, we exchanged our 10% promissory note for a 10% senior secured convertible note; a gain of \$44,956 was recorded on this transaction. These gains were partially offset by a loss of \$3,750 on the issuance of 250,000 common shares of the Corporation, valued at \$28,750, in satisfaction of accounts payable totaling \$25,000. There were no comparable transactions during the year ended December 31, 2005.

**Depreciation of property and equipment:** Depreciation of property and equipment was \$61,897 during the year ended December 31, 2006, a decrease of \$21,959 (26%), over the \$83,856 charged to depreciation expense during the year ended December 31, 2005. This decrease occurred as a result of there being a lower value on which depreciation was charged during 2006, due to some of our property and equipment becoming fully depreciated during 2005 and 2006, with no offsetting acquisitions during the year.

**Net Loss:** We incurred a loss of \$3,387,291 (\$0.09 per share) for the year ended December 31, 2006, compared to a loss of \$4,205,659 (\$0.13 per share) for the year ended December 31, 2005. Our revenues and future profitability and future rate of growth are substantially dependent on our ability to:

- \* license the software applications to a sufficient number of clients;
- \* to be cash-flow positive on an ongoing basis;
- \* modify the successful software applications, over time, to provide enhanced benefits to existing users; and
- \* successfully develop related software applications.

## **Liquidity and Capital Resources**

**General:** Since inception, we have funded our operations from private placements of debt and equity securities. In addition, until September 1999, we derived revenues from consulting contracts with affiliated parties, the proceeds of which were used to fund operations. Until such time as we are able to generate adequate revenues from the licensing of our software applications, we cannot assure that that we will be successful in raising additional capital, or that cash from the issuance of debt securities, the exercise of existing warrants and options, and the placements of additional equity securities, if any, will be sufficient to fund our long-term research and development and selling, general and administrative expenses.

At December 31, 2006, we had \$7,780 in cash and cash equivalents, and at December 31, 2005, we had \$71,193 in cash and cash equivalents. Our cash and cash equivalents decreased during 2006 primarily reflecting our net loss of \$3,387,291 and the resulting cash used in operations of \$1,976,022. Our cash and cash equivalents decreased in 2005 primarily reflecting our net loss of \$4,205,659 and the resulting cash used in operations of \$3,035,255. In the period from January 1 to March 31, 2007 we raised \$59,897 through the issuance of our 12% notes, and \$200,000 through the issuance of our 10% senior secured convertible promissory notes.

As discussed elsewhere in this report, our independent registered public accountants have added an explanatory paragraph to their audit opinion issued in connection with our consolidated financial

statements. It states that the following conditions exist, which raise substantial doubt regarding our ability to continue as a going concern: our lack of revenues to date; our negative working capital of \$1,802,444 and our accumulated a deficit of \$24,492,283 as at December 31, 2006; our net loss of \$3,387,291 and negative cash flow from operations of \$1,976,022 for the year then ended; our expectation of continued operating losses for the foreseeable future; and the fact that we have no lines of credit or other financing facilities in place.

We achieved our first commercial sale during the third quarter of 2005, however we were unable to recognize revenue in connection with this sale, as all of the criteria required for us to do so as set out in our accounting policies were not met. During April 2006 we determined that collection of the amount invoiced in connection with this was unlikely, and have recorded an allowance against the entire amount, as an offset against deferred revenue. On January 1, 2006 we entered into an agreement with a Value Added Reseller (“VAR”), pursuant to which we granted the VAR a license to sell our software to the VAR’s customers for a period of three years. Our fee for this license, excluding applicable sales taxes, was \$155,000, of which \$151,650 had been received as of December 31, 2006. We will recognize revenue in connection with this sale once all of the criteria required for us to do so as set out in our accounting policies, have been met.

We anticipate additional commercial sales during the second quarter of 2007, however we cannot be assured that this will be the case. During the year ended December 31, 2006, we hired one new full-time employee and had three full-time employees and two full-time consultants leave the Corporation. We do not expect to hire any additional personnel during the next six months. We have not made, nor do we expect to make, any material commitments for capital equipment expenditures during the next twelve months.

We have an immediate requirement for additional working capital in order to proceed with our business plan. We review our cash needs and sources on a month-to-month basis and we are currently pursuing appropriate opportunities to raise additional capital to fund operations. Additional sources of capital could involve issuing equity or debt. In January and in March 2007, we engaged financial advisers to provide advice to us with respect to capital raising. However, additional funding may not be available to us on reasonable terms, if at all. The perceived risk associated with the possible sale of a large number of shares could cause some of our stockholders to sell their stock, thus causing the price of our stock to decline. In addition, actual or anticipated downward pressure on our stock price due to actual or anticipated sales of stock could cause some institutions or individuals to engage in short sales of our common stock, which may itself cause the price of our stock to decline. We may be unable to raise additional capital if our stock price is too low. A sustained inability to raise capital could force us to limit or curtail our operations.

We expect the level of our future operating expenses to be driven by the needs of our research and development and marketing programs offset by the availability of funds. In addition, we have since inception made an effort to keep our expenses relatively low and conserve available cash until we begin generating sufficient operating cash flow.

**Sources of Capital:** Our principal sources of capital for funding our business activities have been the private placements of debt and equity securities. During the year ended December 31, 2006, our sources of capital included the following, which generated cash for funding operations:

- the issuance of 10% senior secured convertible notes for cash proceeds of \$650,000;
- the issuance of 10% senior convertible notes for cash proceeds of \$750,000;
- the issuance of 10% promissory notes for cash proceeds of \$250,000;
- the issuance of 12% promissory notes, net of repayments, for cash proceeds of \$307,607; and
- the exercise of 20,000 series H warrants for cash proceeds of \$10,000.

In addition, the following stock-based transactions reduced our requirements for cash:

- the issuance of 800,000 common shares, valued at \$107,500, in consideration for consulting services rendered and to be rendered;
- the issuance of 740,000 common shares, valued at \$76,400, in consideration for finance fees;
- the issuance of 100,000 common shares, valued at \$11,500, in consideration for the deferral of payment of fees owing;
- the issuance of 250,000 common shares, valued at \$28,750, in settlement of accounts payable in the amount of \$25,000;
- the issuance of 118,378 common shares, valued at \$13,638, in satisfaction of interest payable on our 10% senior convertible notes;
- the issuance of 500,000 common shares, valued at \$45,000, pursuant to the terms of our 10% promissory note, for failure to repay all principal and interest outstanding prior to October 11, 2006.

The Corporation has not entered into any off-balance sheet arrangement which would have provided the Corporation with a source of capital.

**Uses of Capital:** Over the past several years, we have scaled our development activities to the level of available cash resources. Research and development expenses for the year ended December 31, 2006 decreased by approximately 14% as compared to the year ended December 31, 2005, as a result of cash conservation efforts. Selling, general and administrative expenses for the year ended December 31, 2006 decreased by approximately 15% as compared to the year ended December 31, 2005, due to several factors, including the reduction of our sales and marketing efforts, and as explained more fully under “Results of Operation.”

During the fourth quarter of 2004, and continuing through the latter part of the third quarter of 2005, we scaled back our sales and marketing program, in order to maintain a sustainable level for sales and marketing expenditures leading up to the first commercial release of our products. We hired one additional full-time employee in our sales department during September, 2005, in anticipation of imminent commercial sales, the first of which took place during September 2005. During the year ended December 31, 2006, we hired one new full-time employee and had three full-time employees and two full-time consultant leave the Corporation. Our plans with respect to future staffing will be dependant upon our ability to raise additional capital. We have not entered into any off-balance sheet arrangements which would have resulted in our use of capital.

The cost to implement appropriate controls and procedures to ensure compliance with Section 404 of the Act is included in our budget for 2007.

**Commitments:** We have entered into an operating lease agreement for office space which expires on April 30, 2010. Future minimum lease payments including operating costs are approximately as follows:

Year	Amount
2007	\$ 84,859
2008	67,694
2009	67,694
2010	22,565
	<u>\$ 242,812</u>



**Item 7. Financial Statements.**

Consolidated Financial Statements of

**VALIDIAN CORPORATION**

(A Development Stage Enterprise)

Years ended December 31, 2006 and 2005

	<u>Page</u>
Auditors' Report to the Board of Directors and Stockholders	35
Consolidated Balance Sheets as at December 31, 2006 and 2005	36
Consolidated Statements of Operations for the years ended December 31, 2006 and 2005 and for the period from August 3, 1999 to December 31, 2006	37
Consolidated Statements of Changes in Stockholders' Equity (Deficiency) and Comprehensive Loss for the eight years ended December 31, 2006	38
Consolidated Statements of Cash Flows for the years ended December 31, 2006 and 2005 and for the period from August 3, 1999 to December 31, 2006	44
Notes to Consolidated Financial Statements	45



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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders  
Validian Corporation

We have audited the accompanying consolidated balance sheets of Validian Corporation and subsidiaries (a Development Stage Enterprise) as of December 31, 2006 and 2005, and the related consolidated statements of operations, changes in stockholders' deficiency and comprehensive loss and cash flows for each of the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Validian Corporation and subsidiaries (a Development Stage Enterprise) as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the years then ended, in conformity with U.S. generally accepted accounting principles.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2(a) to the consolidated financial statements, the Company has negative working capital at December 31, 2006 and has incurred recurring losses, as well as recurring negative cash flow from operating activities. The Company has an accumulated deficit which results in a deficiency in stockholders' equity. Its economic viability is dependent on its ability to generate additional sales and finance operational expenses which raises substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in note 2(a). The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As discussed in note 2 to the consolidated financial statements, in 2006 the Company changed its method of accounting for share-based payments.

Chartered Accountants, Licensed Public Accountants

Ottawa, Canada

April 5, 2007, except for note 20, as to which  
the date is May 15, 2007

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Consolidated Balance Sheets

December 31, 2006 and 2005  
(In U.S. dollars)

	2006	2005
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 7,780	\$ 71,193
Accounts receivable	14,628	75,995
Prepaid expenses	154,674	246,917
	177,082	394,105
Property and equipment (note 3)	34,971	96,868
Deferred financing costs (note 4)	169,403	—
Deferred consulting services	—	50,349
	\$ 381,456	\$ 541,322
<b>Liabilities and Stockholders' Deficiency</b>		
Current liabilities:		
Accounts payable	\$ 590,233	\$ 331,462
Accrued liabilities (note 13)	625,281	178,306
Deferred revenue	155,000	25,000
Promissory notes payable (notes 5 and 13)	603,928	296,321
Current portion of capital lease obligation (note 6)	5,084	4,031
	1,979,526	835,120
10% Senior secured convertible notes (note 7)	296,134	—
10% Senior convertible notes (note 8)	410,669	—
Capital lease obligation (note 6)	1,466	6,547
Stockholders' deficiency:		
Common stock (\$0.001 par value. Authorized 100,000,000 shares; Issued and outstanding 39,212,069 shares in 2006 and 32,883,691 shares in 2005 (note 9(a))	39,212	32,883
Preferred stock (\$0.001 par value. Authorized 7,000,000 shares; issued and outstanding Nil shares in 2006 and 2005)	—	—
Additional paid-in capital	22,326,065	20,951,097
Deficit accumulated during the development stage	(24,643,182)	(21,255,891)
Retained earnings prior to entering development stage	21,304	21,304
Treasury stock (7,000 shares in 2006 and 2005 at cost)	(49,738)	(49,738)
	(2,306,339)	(300,345)
Future operations (note 2(a))		
Guarantees and commitments (note 14)		
Contingent liability (note 15)		
Subsequent events (note 20)		
	\$ 381,456	\$ 541,322

See accompanying notes to consolidated financial statements.

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Consolidated Statements of Operations

Years ended December 31, 2006 and 2005 and the period from August 3, 1999 to December 31, 2006  
(In U.S. dollars)

	2006	2005	Period from August 3, 1999 to December 31, 2006
Expenses:			
Selling, general and administrative (note 13)	\$ 1,890,887	\$ 2,213,403	\$11,374,338
Research and development	1,125,285	1,307,483	8,100,712
Depreciation of property and equipment	61,897	83,856	386,586
Write-off of prepaid services	—	—	496,869
Write-off of deferred consulting services	—	—	1,048,100
Gain on sale of property and equipment	—	—	(7,442)
Write-off of accounts receivable	—	—	16,715
Write-off of due from related party	—	—	12,575
Loss on cash pledged as collateral for operating lease	—	—	21,926
Write-down of property and equipment	—	—	14,750
	3,078,069	3,604,742	21,465,129
Loss before the undernoted	(3,078,069)	(3,604,702)	(21,465,129)
Other income (expenses):			
Interest income	413	25,991	61,235
Gain on extinguishment of debt (note 11)	79,303	—	172,810
Interest and financing costs (notes 10 and 13)	(382,817)	(615,286)	(3,354,720)
Other	(6,121)	(11,622)	(57,378)
	(309,222)	(600,917)	(3,178,053)
Net loss	\$ (3,387,291)	\$ (4,205,659)	\$ (24,643,182)
Loss per common share – basic and diluted (note 12)	\$ (0.09)	\$ (0.13)	
Weighted average number of common shares outstanding	35,141,775	31,589,587	

See accompanying notes to consolidated financial statements.

# VALIDIAN CORPORATION

(A Development Stage Enterprise)

Consolidated Statements of Changes in Stockholders' Equity (Deficiency) and Comprehensive Loss

For the eight years ended December 31, 2006

(In U.S. dollars)

	Number	Common stock amount	Additional paid-in capital	Retained earnings prior to entering development stage	Deficit accumulated during development stage	Accumulated other compre- hensive income (loss)	Treasury stock	Total
Balances at December 31, 1998	61,333	\$ 61	\$ 23,058	\$ 30,080	\$ —	\$ (7,426)	\$ —	\$ 45,773
Issued for mining claims	92,591	92	27,408	—	—	—	—	27,500
Issued for cash	3,000,000	3,000	27,000	—	—	—	—	30,000
Reverse acquisition	8,459,000	8,459	21,541	—	—	—	—	30,000
Fair value of warrants issued to unrelated parties	—	—	130,000	—	—	—	—	130,000
Shares issued upon exercise of warrants	380,000	380	759,620	—	—	—	—	760,000
Share issuance costs	—	—	(34,750)	—	—	—	—	(34,750)
Comprehensive loss:								
Net loss	—	—	—	(8,776)	(743,410)	—	—	(752,186)
Currency translation adjustment	—	—	—	—	—	11,837	—	11,837
Comprehensive loss								(740,349)
Balances at December 31, 1999	11,992,924	11,992	953,877	21,304	(743,410)	4,411	—	248,174
Shares issued upon exercise of warrants	620,000	620	1,239,380	—	—	—	—	1,240,000
Share issuance costs	—	—	(62,000)	—	—	—	—	(62,000)
Acquisition of common stock	—	—	—	—	—	—	(49,738)	(49,738)
Comprehensive loss:								
Net loss	—	—	—	—	(2,932,430)	—	—	(2,932,430)
Currency translation adjustment	—	—	—	—	—	(40,401)	—	(40,401)
Comprehensive loss								(2,972,831)
Balances at December 31, 2000	12,612,924	12,612	2,131,257	21,304	(3,675,840)	(35,990)	(49,738)	(1,596,395)
Shares issued in exchange for debt	2,774,362	2,774	2,216,715	—	—	—	—	2,219,489
Fair value of warrants issued to unrelated parties	—	—	451,500	—	—	—	—	451,500
Comprehensive loss:								
Net loss	—	—	—	—	(1,448,485)	—	—	(1,448,485)
Currency translation adjustment	—	—	—	—	—	62,202	—	62,202
Comprehensive loss								(1,386,283)
Balances at December 31, 2001	15,387,286	\$15,386	\$4,799,472	\$21,304	\$(5,124,325)	\$26,212	\$(49,738)	\$(311,689)

See accompanying notes to consolidated financial statements.

# VALIDIAN CORPORATION

(A Development Stage Enterprise)

Consolidated Statements of Changes in Stockholders' Equity (Deficiency) and Comprehensive Loss

For the eight years ended December 31, 2006

(In U.S. dollars)

	Number	Common stock amount	Additional paid-in capital	Retained earnings prior to entering develop- ment stage	Deficit accumulated during development stage	Accumulated other compre- hensive income (loss)	Treasury stock	Total
Balances at December 31, 2001	15,387,286	\$ 15,386	\$ 4,799,472	\$ 21,304	\$ (5,124,325)	\$ 26,212	\$ (49,738)	\$ (311,689)
Shares issued in consideration of consulting services	340,500	340	245,810	—	—	—	—	246,150
Comprehensive loss:								
Net loss	—	—	—	—	(906,841)	—	—	(906,841)
Currency translation adjustment on liquidation of investment in foreign subsidiary	—	—	—	—	—	(26,212)	—	(26,212)
Comprehensive loss								(933,053)
Balances at December 31, 2002	15,727,786	15,726	5,045,282	21,304	(6,031,166)	—	(49,738)	(998,592)
Shares issued in exchange for debt	4,416,862	4,417	1,453,147	—	—	—	—	1,457,564
Shares issued in consideration of consulting and financing services	422,900	423	230,448	—	—	—	—	230,871
Fair value of warrants issued to unrelated parties for services	—	—	2,896,042	—	—	—	—	2,896,042
Fair value of stock purchase options issued to unrelated parties for services	—	—	597,102	—	—	—	—	597,102
Relative fair value of warrants issued to investors in conjunction with 4% senior subordinated convertible debentures	—	—	355,186	—	—	—	—	355,186
Intrinsic value of beneficial conversion feature on 4% convertible debentures issued to unrelated parties	—	—	244,814	—	—	—	—	244,814
Net loss and comprehensive loss	—	—	—	—	(3,001,900)	—	—	(3,001,900)
Balances at December 31, 2003	20,567,548	\$ 20,566	\$10,822,021	\$ 21,304	\$ (9,033,066)	\$ —	\$ (49,738)	\$ 1,781,087

See accompanying notes to consolidated financial statements.

# VALIDIAN CORPORATION

(A Development Stage Enterprise)

Consolidated Statements of Changes in Stockholders' Equity (Deficiency) and Comprehensive Loss

For the eight years ended December 31, 2006

(In U.S. dollars)

	Number	Common stock amount	Additional paid-in capital	Retained earnings prior to entering development stage	Deficit accumulated during development stage	Accumulated other compre- hensive income (loss)	Treasury stock	Total
Balances at December 31, 2003	20,567,548	\$ 20,566	\$10,822,021	\$ 21,304	\$ (9,033,066)	\$ —	\$ (49,738)	\$ 1,781,087
Shares issued in exchange for debt	464,000	464	429,536	—	—	—	—	430,000
Shares issued on conversion of 4% senior subordinated convertible debentures	2,482,939	2,483	1,238,986	—	—	—	—	1,241,469
Deferred financing costs transferred to additional paid in capital on conversion of 4% senior subordinated convertible debentures into common shares	—	—	(721,097)	—	—	—	—	(721,097)
Shares issued pursuant to private placement of common shares and warrants	6,666,666	6,667	5,993,333	—	—	—	—	6,000,000
Cost of share issuance pursuant to private placement	—	—	(534,874)	—	—	—	—	(534,874)
Shares issued in consideration of consulting and financing services	70,000	70	72,730	—	—	—	—	72,800
Shares issued in consideration of penalties on late registration of shares underlying the 4% senior subordinated convertible debentures	184,000	184	110,216	—	—	—	—	110,400
Fair value of stock purchase warrants issued to unrelated parties for services	—	—	809,750	—	—	—	—	809,750

See accompanying notes to consolidated financial statements.



# VALIDIAN CORPORATION

(A Development Stage Enterprise)

Consolidated Statements of Changes in Stockholders' Equity (Deficiency) and Comprehensive Loss

For the eight years ended December 31, 2006

(In U.S. dollars)

	Number	Common stock amount	Additional paid-in capital	Retained earnings prior to entering development stage	Deficit accumulated during development stage	Accumulated other comprehensive income (loss)	Treasury stock	Total
Relative fair value of warrants issued to investors in conjunction with 4% senior subordinated convertible debentures	—	\$ —	\$ 861,522	\$ —	\$ —	\$ —	\$ —	\$ 861,522
Intrinsic value of beneficial conversion feature on 4% convertible debentures issued to unrelated parties	—	—	538,478	—	—	—	—	538,478
Net loss and comprehensive loss	—	—	—	—	(8,017,166)	—	—	(8,017,166)
Balances at December 31, 2004	30,435,153	30,434	19,620,601	21,304	(17,050,232)	-	(49,738)	2,572,369
Shares issued on conversion of 4% senior subordinated convertible debentures (note 8(a))	1,157,866	1,158	577,774	—	—	—	—	578,932
Shares issued in settlement of 4% senior subordinated convertible debentures at maturity (note 8(a))	485,672	486	242,349	—	—	—	—	242,835
Deferred financing costs transferred to additional paid in capital on conversion of 4% senior subordinated convertible debentures into common shares (notes 4 and 9(a))	—	—	(163,980)	—	—	—	—	(163,980)
Fair value of stock options issued to consultants for services rendered (note 9(c))	—	—	211,496	—	—	—	—	211,496
Fair value of modifications to stock purchase warrants previously issued to unrelated parties (note 9(b))	—	—	61,162	—	—	—	—	61,162
Shares issued on the exercise of stock purchase warrants (note 9 (b))	805,000	805	401,695	—	—	—	—	402,500

See accompanying notes to consolidated financial statements.

# VALIDIAN CORPORATION

(A Development Stage Enterprise)

Consolidated Statements of Changes in Stockholders' Equity (Deficiency) and Comprehensive Loss

For the eight years ended December 31, 2006

(In U.S. dollars)

	Number	Common stock amount	Additional paid-in capital	Retained earnings prior to entering development stage	Deficit accumulated during development stage	Accumulated other comprehensive income (loss)	Treasury stock	Total
Net loss and comprehensive loss	—	—	—	—	(4,205,659)	—	—	(4,205,659)
Balances at December 31, 2005	32,883,691	32,883	20,951,097	21,304	(21,255,891)	—	(49,738)	(300,345)
Shares issued in consideration of consulting services (note 9(a))	800,000	800	106,700	—	—	—	—	107,500
Fair value of unvested employee stock options earned during period (note 9(c))	—	—	28,689	—	—	—	—	28,689
Reversal of fair value of unvested employee stock options recognized in the current and prior periods, on forfeiture of the options (note 9(c))	—	—	(9,939)	—	—	—	—	(9,939)
Shares issued on the exercise of stock purchase warrants (note 9(a))	20,000	20	9,980	—	—	—	—	10,000
Shares issued pursuant to the terms of the 10% senior secured convertible notes (note 9(a))	1,600,000	1,600	213,202	—	—	—	—	214,802
Shares issued pursuant to the terms of the 10% senior convertible notes (note 9(a))	1,200,000	1,200	188,400	—	—	—	—	189,600
Shares issued pursuant to the terms of the 10% promissory note (note 9(a))	1,000,000	1,000	149,000	—	—	—	—	150,000
Shares issued pursuant to the terms of an agreement to extend the payment terms of finance fees payable (note 9(a))	100,000	100	11,400	—	—	—	—	11,500
Intrinsic value of the beneficial conversion feature on the 10% senior secured convertible notes (note 7)	—	—	465,850	—	—	—	—	465,850

See accompanying notes to consolidated financial statements.

# VALIDIAN CORPORATION

(A Development Stage Enterprise)

Consolidated Statements of Changes in Stockholders' Equity (Deficiency) and Comprehensive Loss

For the eight years ended December 31, 2006

(In U.S. dollars)

	Number	Common stock amount	Additional paid-in capital	Retained earnings prior to entering development stage	Deficit accumulated during development stage	Accumulated Other comprehensive income (loss)	Treasury stock	Total
Intrinsic value of the beneficial conversion feature on the 10% senior convertible notes (note 8)	—	—	49,447	—	—	—	—	49,447
Shares issued in satisfaction of interest payable (note 9(a))	118,378	119	13,519	—	—	—	—	13,638
Shares issued in satisfaction of finance fees payable, which were included in accrued liabilities (note 9(a))	250,000	250	28,500	—	—	—	—	28,750
Shares issued in satisfaction of penalty for non-timely payment of the 10% promissory note (notes 5 and 9(a))	500,000	500	44,500	—	—	—	—	45,000
Shares issued in consideration for finance fees related to the issuance of convertible and promissory notes (note 9(a))	740,000	740	75,720	--	--	--	--	76,460
Net loss and comprehensive loss	—	—	—	—	(3,387,291)	—	—	(3,387,291)
Balances at December 31, 2006	39,212,069	\$ 39,212	\$ 22,326,065	\$ 21,304	\$ (24,643,182)	\$ —	\$ (49,738)	\$ (2,306,333)

See accompanying notes to consolidated financial statements.

# VALIDIAN CORPORATION

(A Development Stage Enterprise)

Consolidated Statements of Cash Flows

Years ended December 31, 2006 and 2005 and the period from August 3, 1999 to December 31, 2006

(In U.S. dollars)

	2006	2005	Period from August 3, 1999 to December 31, 2006
Cash flows from operating activities:			
Net loss	\$ (3,387,291)	\$ (4,205,659)	\$ (24,643,182)
Items not involving cash:			
Depreciation of property and equipment	61,897	83,856	386,586
Non-cash compensation expense (note 9(d))	300,727	292,661	2,539,574
Non-cash interest expense	380,224	612,400	3,350,717
Non-cash penalties	56,500	—	166,900
Gain on extinguishment of debt	(79,303)	—	(172,810)
Write-off of prepaid services	—	—	496,869
Write-off of deferred consulting services	—	—	1,048,100
Currency translation adjustment on liquidation of investment in foreign subsidiary	—	—	(26,212)
Gain on sale of property and equipment	—	—	(7,442)
Write-off of accounts receivable	—	—	16,715
Write-off of due from related party	—	—	12,575
Loss on cash pledged as collateral for operating lease	—	—	21,926
Write-down of property and equipment	—	—	14,750
Change in non-cash operating working capital (note 18)	691,224	181,487	2,587,977
Net cash used in operating activities	(1,976,022)	(3,035,255)	(14,206,957)
Cash flows from investing activities:			
Additions to property and equipment	—	(41,274)	(526,543)
Proceeds on sale of property and equipment	—	—	176,890
Cash pledged as collateral for operating lease	—	—	(21,926)
Net cash used in investing activities	—	(41,274)	(371,579)
Cash flows from financing activities:			
Issuance of promissory notes	586,597	—	3,695,328
Repayment of promissory notes	(28,990)	—	(44,990)
Capital lease repayments	(4,028)	(2,753)	(8,216)
Issuance of 10% senior secured convertible notes (note 7)	650,000	—	650,000
Issuance of 10% senior convertible notes (note 8)	750,000	—	750,000
Debt issuance costs	(50,970)	—	(282,749)
Exercise of stock purchase warrants	10,000	402,500	412,500
Issuance of 4% senior subordinated convertible debentures	—	—	2,000,000
Increase in due from related party	—	—	12,575
Issuance of common stock	—	—	8,030,000
Share issuance costs	—	—	(631,624)
Acquisition of common stock	—	—	(49,738)
Net cash provided by financing activities	1,912,609	399,747	14,533,086
Effects of exchange rates on cash and cash equivalents	—	—	18,431
Net decrease in cash and cash equivalents	(63,413)	(2,676,782)	(27,019)
Cash and cash equivalents, beginning of period	71,193	2,747,975	34,799
Cash and cash equivalents, end of period	\$ 7,780	\$ 71,193	\$ 7,780

See accompanying notes to consolidated financial statements.

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 1. General:

Validian Corporation (the "Corporation") was incorporated in the State of Nevada on April 12, 1989 as CCC Funding Corp. The Corporation underwent several name changes before being renamed to Validian Corporation on January 28, 2003.

Since August 3, 1999, the efforts of the Corporation have been devoted to the development of a high speed, highly secure method of transacting business using the internet, and to the sale and marketing of the Corporations' products. Prior to August 3, 1999, the Corporation provided consulting services for web site implementation, multimedia CD design, computer graphic publication, as well as implementation of dedicated software solutions used in connection with the French Minitel and the internet. As the Corporation commenced development activities on this date, it is considered for financial accounting purposes to be a development stage enterprise, and August 3, 1999 is the commencement of the development stage.

## 2. Summary of significant accounting policies:

### (a) Future operations:

The consolidated financial statements have been prepared assuming that the Corporation will continue as a going concern. The Corporation has no revenues, has negative working capital of \$1,802,444, has accumulated a deficit of \$24,643,182 as at December 31, 2006, and has incurred a loss of \$3,387,291 and negative cash flow from operations of \$1,976,022 for the year then ended. In addition, the Corporation expects to continue to incur operating losses for the foreseeable future, and has no lines of credit or other financing facilities in place.

If the Corporation obtains further financing and generates revenue, it expects to incur operating expenditures of approximately \$3.1 million for the year ending December 31, 2007. In the event the Corporation cannot raise the funds necessary to finance its research and development and sales and marketing activities, it may have to cease operations.

All of the factors above raise substantial doubt about the Corporation's ability to continue as a going concern. Management's plans to address these issues include raising capital through the private placement of equity, the exercise of previously-issued equity instruments and through the issuance of additional promissory notes.

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 2. Summary of significant accounting policies (continued):

### (a) Future operations (continued):

The Corporation's ability to continue as a going concern is subject to management's ability to successfully implement these plans. Failure to do so could have a material adverse effect on the Corporation's position and or results of operations and could also result in the Corporation's ceasing operations. The consolidated financial statements do not include adjustments that would be required if the assets are not realized and the liabilities settled in the normal course of operations.

Even if successful in obtaining financing in the near term, the Corporation cannot be certain that cash generated from its future operations will be sufficient to satisfy its liquidity requirements in the longer term, and it may need to continue to raise capital by issuing additional equity or by obtaining credit facilities. The Corporation's future capital requirements will depend on many factors, including, but not limited to, the market acceptance of its products and the level of its promotional activities and advertising required to generate product sales. No assurance can be given that any such additional funding will be available or that, if available, it can be obtained on terms favorable to the Corporation.

### (b) Principles of consolidation:

These consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States of America and include the accounts of Validian Corporation and its wholly-owned subsidiaries, Sochrys Technologies Inc. and Evolusys S.A. All intercompany balances and transactions have been eliminated.

### (c) Cash and cash equivalents:

Cash and cash equivalents include liquid investments with original maturity dates of three months or less.

### (d) Property and equipment:

Property and equipment is stated at cost less accumulated depreciation, and includes computer hardware and software, furniture and equipment, equipment under capital lease and leasehold improvements. These assets are being depreciated on a straight-line basis over their estimated useful lives, as follows: computer hardware, furniture and equipment: 3 years; equipment under capital lease: over the term of the lease, being 4 years; computer software: 1 year; leasehold improvements: over the term of the lease, being 2 years.

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 2. Summary of significant accounting policies (continued):

### (e) Leases:

Leases are classified as either capital or operating in nature. Capital leases are those which substantially transfer the benefits and risk of ownership to the Corporation. Assets acquired under capital leases are depreciated as described in note 1(d). Obligations recorded under capital leases are reduced by the principal portion of lease payments. The imputed interest portion of lease payments is charged to expense.

### (f) Deferred financing costs:

Deferred financing costs represent the costs associated with arranging the 10% senior convertible notes and the 10% senior secured convertible notes. The costs are being amortized over the term of the notes.

### (g) Prepaid expenses and deferred consulting services:

Deferred consulting services represent the portion of prepaid non-cash consulting fees for services to be rendered in periods in excess of twelve months from the balance sheet date. Prepaid non-cash consulting fees related to services to be rendered within twelve months from the balance sheet date are included in prepaid expenses on the balance sheet. These costs will be charged to expenses as the services are rendered. If for any reason circumstances arise which would indicate that the services will not be performed in the future, any remaining balance included in prepaid expenses and deferred consulting services will be charged to expense immediately.

### (h) Income taxes:

Deferred income taxes are determined using the asset and liability method, whereby deferred income tax is recognized on temporary differences using enacted tax rates that are expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Temporary differences between the carrying values of assets or liabilities used for tax purposes and those used for financial reporting purposes arise in one period and reverse in one or more subsequent periods. In assessing the realizability of deferred tax assets, management considers known and anticipated factors impacting whether some portion or all of the deferred tax assets will not be realized. To the extent that the realization of deferred tax assets is not considered to be more likely than not, a valuation allowance is provided.

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 2. Summary of significant accounting policies (continued):

### (i) Revenue recognition:

For sales of product licenses, the Corporation recognizes revenue in accordance with Statement of Position 97-2, "Software Revenue Recognition" ("SOP 97-2"), as amended by Statement of Position 98-9, "Software Revenue Recognition with Respect to Certain Transactions", issued by the American Institute of Certified Public Accountants. Revenue from sale of product licenses is recognized when all of the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collectibility is probable.

Revenue from product support contracts is recognized ratably over the life of the contract. Revenue from services is recognized at the time such services are rendered.

For contracts with multiple elements such as product licenses, product support and services, the Corporation follows the residual method. Under this method, the total fair value of the undelivered elements of the contract, as indicated by vendor specific objective evidence, is deferred and subsequently recognized in accordance with the provisions of SOP 97-2. The difference between the total contract fee and the amount deferred for the undelivered elements is recognized as revenue related to the delivered elements. Vendor specific objective evidence for support and consulting services is obtained from contracts where these elements have been sold separately. Where the Corporation cannot determine the fair value of all of the undelivered elements, revenue is deferred until such time as it can be determined, or until all of the elements are delivered.

### (j) Research and development:

Costs related to research, design and development of software products are charged to research and development expenses as incurred. Software development costs are capitalized beginning when a product's technological feasibility has been established, which generally occurs upon completion of a working model, and ending when a product is available for general release to customers, and is generating significant revenue.

### (k) Foreign currency translation:

The functional currency for the financial statements of the Corporation is the United States dollar. Exchange gains or losses are realized due to differences in the exchange rate at the transaction date versus the rate in effect at the settlement or balance sheet date.



# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 2. Summary of significant accounting policies (continued):

### (l) New accounting policy - stock-based compensation:

Effective January 1, 2006, the Corporation adopted the provisions of Financial Accounting Standards Board Statement No. 123R "Share-Based Payment – a revision of FAS 123" (SFAS 123R) to account for its stock-based payments. SFAS 123R requires all share-based payments, including stock options granted by the Corporation to its employees, to be recognized as expenses, based on the fair value of the share-based payments at the date of grant. For purposes of estimating the grant date fair value of stock-based compensation, the Corporation uses the Black Scholes option-pricing model, and has elected to treat awards with graded vesting as a single award. The fair value of awards granted is recognized as compensation expense on a straight-line basis over the requisite service period, which in the Corporation's circumstances is the stated vesting period of the award.

In adopting SFAS 123R, the Corporation has applied the modified-prospective transition method. Under this method, the Corporation will recognize compensation costs for all share-based payments granted, modified, or settled after January 1, 2006, as well as for any awards that were granted prior to January 1, 2006 for which the requisite service had not been provided as of that date (unvested awards). Under the modified prospective method, prior periods are not adjusted, and the Corporation continues to provide pro forma disclosure for these periods, as presented below.

For reporting periods ending on or before December 31, 2005, the Corporation applied the intrinsic value-based method of accounting prescribed by Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees", and related interpretations including FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation an interpretation of APB Opinion No. 25" issued in March 2000, to account for its stock options for employees. Under this method, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation," established accounting and disclosure requirements using a fair value-based method of accounting for stock-based employee compensation plans. These provisions are required to be applied to stock compensation granted to non-employees. As allowed by SFAS No. 123, the Corporation elected to apply the intrinsic value-based method of accounting described above for awards granted to employees, and adopted the disclosure requirements of SFAS No. 123.

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 2. Summary of significant accounting policies (continued):

### (l) New accounting policy - stock-based compensation (continued):

Had compensation costs in respect of options granted to employees been determined using the fair value based method at the grant date, the Corporation's pro forma net loss and basic and diluted loss per share for the year ended December 31, 2005 would have been as follows:

Net loss, as reported	\$(4,205,659)
Deduct total stock-based employee compensation expense determined under the fair value-based method for all awards	<u>(1,071,008)</u>
Pro forma net loss	<u><u>\$(5,222,667)</u></u>
Loss per share:	
Basic and diluted – as reported	\$(0.13)
Basic and diluted – pro-forma	\$(0.17)

### (m) Impairment or disposal of long-lived assets:

The Corporation accounts for long-lived assets in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". This Statement requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

### (n) Use of estimates:

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, as well as disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results may differ from those estimates.

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 2. Summary of significant accounting policies (continued):

- (o) New accounting policy – income tax consequences of issuing convertible debt with a beneficial conversion feature:

In September 2005, the FASB ratified the consensus reached by the Emerging Issues Task Force (“EITF”) on Issue 05-8, “Income Tax Consequences of Issuing Convertible Debt with a Beneficial Conversion Feature” (“EITF 05-8”). The Task Force reached the following consensus:

- The issuance of convertible debt with a beneficial conversion feature results in a basis difference in applying FASB Statement of Financial Accounting Standards (“SFAS”) No. 109, “Accounting for Income Taxes.” Recognition of such a feature effectively creates a debt instrument and a separate equity instrument for reporting purposes, whereas the convertible debt is treated entirely as a debt instrument for income tax purposes;
- The resulting basis difference should be deemed a temporary difference because it will result in a taxable amount when the recorded amount of the liability is recovered or settled;
- Recognition of deferred income tax for the temporary difference should be reported as an adjustment to additional paid-in capital;

The foregoing consensus is effective for reporting periods commencing after December 15, 2005, and is required to be applied retrospectively to all debt instruments containing beneficial conversion features that are subject to EITF 00-27, “Application of Issue No. 98-5 to Certain Convertible Debt Instruments,” and thus is applicable to debt instruments converted or extinguished in prior periods but which are still presented in the financial statements. In situations in which establishment of this deferred tax liability requires the reduction of a valuation allowance on existing deferred tax assets, such reduction should also be allocated to additional paid-in capital.

The adoption of this new accounting policy has had no impact on the Corporation’s consolidated financial statements, as the reduction of the valuation allowance offsets the recognition of the deferred tax liability.

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 3. Property and equipment:

	Cost	Accumulated depreciation	2006 Net book value
Computer hardware and software	\$ 137,478	\$ 116,336	\$ 21,142
Furniture and equipment	66,319	57,104	9,215
Leasehold improvements	13,006	13,006	--
Equipment under capital lease	14,766	10,152	4,614
	<u>\$ 231,569</u>	<u>\$ 196,598</u>	<u>\$ 34,971</u>

  

	Cost	Accumulated depreciation	2005 Net book value
Computer hardware and software	\$ 137,478	\$ 82,760	\$ 54,718
Furniture and equipment	66,319	35,563	30,756
Leasehold improvements	13,006	9,918	3,088
Equipment under capital lease	14,766	6,460	8,306
	<u>\$ 231,569</u>	<u>\$ 134,701</u>	<u>\$ 96,868</u>

During the year ended December 31, 2006, property and equipment were acquired at an aggregate cost of \$nil (2005 - \$41,274), of which \$nil (2005 - \$41,274) was acquired through cash purchases.

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 4. Deferred financing costs:

The following table sets forth the cost and accumulated amortization of the deferred financing costs:

	2006	2005
Balance beginning of year	\$ --	\$ 281,224
Additions		
Fees paid or payable in cash	143,470	--
Fair value of fees paid through the issuance of 740,000 common shares of the Corporation	76,460	--
	219,930	--
Amortization		
Amortization of fees payable in cash	(35,501)	(19,329)
Amortization of fees paid in common stock of the Corporation	(15,026)	(97,915)
	(50,527)	(117,244)
Financing costs transferred to additional paid in capital on conversion of \$555,000 in principal value of the 4% Senior subordinated convertible debentures into common shares of the Corporation	--	(163,980)
Balance end of year	\$ 169,403	\$ --

During the year ended December 31, 2006, the Corporation issued a total of \$650,000 in principal amount of 10% senior secured convertible notes (note 7), \$750,000 in principal amount of 10% senior convertible notes (note 8), and \$250,000 in principal amount of 10% promissory notes (note 5). In connection with the placement of these notes, the Corporation incurred costs totaling \$219,930, of which \$143,470 was paid or payable in cash and \$76,460 was paid through the issuance of 740,000 common shares of the Corporation. These costs are being amortized on an effective interest-rate basis over the term of the respective notes.

Amortization of the deferred financing costs is included in interest and financing costs.

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 5. Promissory notes payable:

	2006	2005
Promissory notes payable, bearing interest at 12% due on demand, unsecured:		
Principal balance, beginning of year	\$ 296,321	\$ 296,321
Additional notes issued during year	336,597	--
Notes repaid during year	(28,990)	--
Principal balance, end of year	603,928	296,321
Promissory notes payable, bearing interest at 10%, due July 13, 2007; unsecured:		
Note issued during year	250,000	--
Principal converted to 10% senior secured convertible note (note 7)	(250,000)	--
Principal balance, end of year	--	--
Promissory notes payable end of year	\$ 603,928	\$ 296,321

On July 13, 2006, in conjunction with the modification of the 10% senior secured promissory notes (note 7), the Corporation issued \$250,000 in principal amount of its 10% promissory notes. The note had a maturity date of July 13, 2007, and was unsecured. Under the terms of the note, the Corporation could pre-pay all or any portion of the balance outstanding on the note without penalty or bonus; interest was payable at maturity. A condition of the 10% promissory note was that in the event the note was not repaid on or before October 11, 2006 from the proceeds of a pre-identified \$500,000 financing, the Corporation would be required to issue 500,000 common shares to the holder of the note as a penalty. The Corporation did not meet this condition, and as a result, 500,000 common shares, valued at \$45,000 were issued to the holder on October 11, 2006. This penalty has been included in selling, general and administrative expenses for the year ended December 31, 2006.

The holder of the note was granted 1,000,000 common shares of the Corporation upon issuance of the note. In accordance with APB 14, "Accounting for Convertible Debt and Debt issued with Stock Purchase Warrants," \$150,000, representing the relative fair value of the shares at the issuance date, was allocated to the common shares. The 10% promissory note was being accreted to its face value on the effective interest method, through periodic charges to interest expense over the term of the note.

During the period from July 13 to December 21, 2006, the Corporation accreted the note payable through charges to interest expense totaling \$44,956.

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 5. Promissory notes payable (continued):

The following table sets forth the financial statement presentation of the note proceeds on issuance:

Note proceeds	\$ 250,000
Allocated to common stock and additional paid-in capital for market value of stock issued to the holder of the note:	
Allocated to common stock	(1,000)
Allocated to additional paid-in capital	(149,000)
	<u>(150,000)</u>
Proceeds allocated to 10% promissory note upon issuance	<u>\$ 100,000</u>

The 10% promissory note was amended and replaced by a 10% senior secured convertible note (note 7) on December 21, 2006. The new note is "substantially different" from the original note, as that term is defined in EITF 96-19: "Debtor's Accounting for a Modification or Exchange of Debt Instruments". Accordingly, the Corporation has accounted for the modification as an extinguishment of the original debt, which resulted in a gain of \$44,956 on the extinguishment (note 11).

The following table sets forth the changes in the financial statement presentation of the balance allocated to the 10% promissory note at December 31, 2006:

Proceeds allocated to 10% promissory note upon issuance	\$ 100,000
Accretion of the 10% promissory note as a charge to interest and financing costs during the period from July 13 to December 21, 2006	44,956
Reduction of the 10% promissory note through gain on extinguishment of debt (note 11) at date of modification	(44,956)
Reduction of the 10% promissory note through transfer to 10% senior secured convertible notes (note 7) at date of modification	<u>(100,000)</u>
Proceeds allocated to 10% promissory note December 31, 2006	<u>\$ --</u>

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 6. Capital lease obligation:

Future minimum payments remaining under a capital lease obligation relating to office equipment acquired during 2004 are approximately as follows:

	2006	2005
Year ended December 31:		
2006	\$ --	\$ 6,215
2007	6,216	6,215
2008	1,554	1,554
Total minimum lease payments	7,770	13,984
Less amount representing interest, at 23.9%	(1,220)	(3,406)
Present value of minimum lease payments	6,550	10,578
Current portion of capital lease obligation	5,084	4,031
	\$ 1,466	\$ 6,547

## 7. 10% Senior secured convertible notes:

On June 1, 2006, the Corporation issued a total of \$500,000 of its 10% senior secured convertible notes. The notes were secured by a first position lien on all of the assets of the Corporation and had a maturity date of June 1, 2007. Under the terms of the notes, the holders were permitted, at any time, to convert all or a portion of the outstanding principal plus accrued interest into common stock of the Corporation at a ratio of one common share for each \$0.10 of debt and accrued interest converted; the Corporation had the option of pre-paying all or any portion of the balance outstanding on the notes at any time, without penalty or bonus; and interest was payable quarterly, in arrears. Additionally, the holders could demand repayment of 50% of the principal of the note, at such time as the Corporation completed an equity financing of \$500,000 or more.

Holders of the notes were also granted 1,000,000 common shares of the Corporation upon issuance of the notes. In accordance with APB 14, "Accounting for Convertible Debt and Debt issued with Stock Purchase Warrants," \$170,000, representing the relative fair value of the shares at the issuance date, was allocated to the common shares par value and additional paid in capital.

At the date of issuance, the conversion feature of the notes was "in-the-money". The intrinsic value of this beneficial conversion feature was \$330,000. In accordance with EITF 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratio" and EITF 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments," this amount was recorded as additional paid-in capital.



# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 7. 10% Senior secured convertible notes (continued):

On December 21, 2006, the Corporation issued \$150,000 of its 10% senior secured convertible notes. The notes are secured by a first position lien on all of the assets of the Corporation, and have a maturity date of July 1, 2008. Under the terms of the notes, the holders are permitted, at any time, to convert all or a portion of the outstanding principal plus accrued interest into common stock of the Corporation at a ratio of one common share for each \$0.10 of debt and accrued interest converted; the Corporation has the option of pre-paying all or any portion of the balance outstanding on the notes at any time, without penalty or bonus; and interest is payable quarterly, in arrears.

Holders of the notes were also granted 600,000 common shares of the Corporation upon issuance of the notes. In accordance with APB 14, "Accounting for Convertible Debt and Debt issued with Stock Purchase Warrants," \$44,802, representing the relative fair value of the common shares at the issuance date, was allocated to the common shares par value and additional paid-in capital.

At the date of issuance, the conversion feature of the notes was not "in-the-money", and accordingly, none of the principal balance was allocated to additional paid-in capital.

The following table sets forth the financial statement presentation of the 10% senior secured convertible note proceeds on issuance:

Note proceeds	\$ 650,000
Allocated to common stock and additional paid-in capital for market value of stock issued to the holders of the notes:	
Allocated to common stock	(1,600)
Allocated to additional paid-in capital	(213,202)
	<u>(214,802)</u>
Allocated to additional paid-in capital for the intrinsic value of the beneficial conversion feature	(330,000)
Proceeds allocated to 10% senior secured convertible notes upon issuance	<u>\$ 105,198</u>

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 7. 10% Senior secured convertible notes (continued):

On July 11, 2006, in conjunction with the issuance of \$250,000 in promissory notes (note 5), \$500,000 of the 10% senior secured convertible notes were amended and restated as follows: the first position lien on all of the assets of the Corporation was removed; the date of maturity was extended by one year to June 1, 2008; the Corporation was given the option of paying the quarterly interest either in cash or in common shares of the Corporation; the provision allowing the holder to demand immediate repayment of 50% of the face value of the note in the event of an equity financing by the Corporation of at least \$500,000 was removed. These amendments collectively resulted in the new notes being "substantially different" from the original notes, as that term is defined in EITF 96-19: "Debtor's Accounting for a Modification or Exchange of Debt Instruments". Accordingly the Corporation accounted for the modification as an extinguishment of the original debt, which resulted in a gain on the extinguishment of \$38,097; the accounting values relating to the modified 10% senior secured convertible notes were reclassified to 10% convertible notes at the date of modification.

On December 21, 2006, the 10% promissory note (note 5) was amended and replaced by a 10% senior secured convertible note. Accordingly, the modified 10% promissory note has been reclassified as a 10% senior secured convertible note as of the date of the modification.

Also on December 21, 2006, in conjunction with the modification of the 10% promissory note (note 5), \$500,000 in principal amount of the 10% senior convertible notes (note 8) were amended and replaced by 10% senior secured convertible notes. Accordingly, the modified 10% senior convertible notes have been reclassified as 10% senior secured convertible notes as of the date of the modification.

The 10% senior secured convertible notes are being accreted to their face value on an effective yield basis, through periodic charges to interest expense over the term of the notes.

The following table sets forth the changes in the financial statement presentation of the balance allocated to 10% senior secured convertible notes at December 31, 2006:

Proceeds allocated to 10% senior secured convertible notes upon issuance	\$ 105,198
Accretion of the 10% senior secured convertible notes as a charge to interest and financing costs during the period	45,992
Addition to 10% senior secured convertible notes as a result of the modification of the 10% promissory note (note 5)	100,000
Addition to 10% senior secured convertible notes as a result of the modification of \$500,000 in principal amount of 10% senior convertible notes (note 8)	83,041
Reduction of the 10% senior secured convertible notes through gain on extinguishment of debt at date of modification	(38,097)
Balance December 31, 2006	<u>\$ 296,134</u>

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 8. 10% Senior convertible notes:

On various dates between June 30 and December 21, 2006, the Corporation issued an aggregate of \$750,000 of its 10% senior convertible notes. \$250,000 of the notes mature on July 1, 2008; \$500,000 mature on October 1, 2008. The notes are unsecured. Under the terms of the notes, the holders are permitted, at any time, to convert all or a portion of the outstanding principal plus accrued interest into common stock of the Corporation at a ratio of one common share for each \$0.10 of debt converted; the Corporation may pre-pay all or any portion of the balance outstanding on the notes at any time, without penalty or bonus; interest is payable quarterly, and may, at the Corporation's option, be paid either in cash or in common shares of the Corporation. If interest is paid in common shares, the number of shares required for settlement will be calculated using a 10% discount to the average closing price of the common stock, as listed on the exchange where the Corporation's common stock is traded, for the ten days prior to the date the interest is due to the holder.

Holders of the notes were also granted an aggregate of 1,200,000 common shares of the Corporation upon issuance of the notes. In accordance with APB 14, "Accounting for Convertible Debt and Debt issued with Stock Purchase Warrants," \$189,600, representing the relative fair value of the common shares at the issuance date, was allocated to the common shares par value and additional paid-in capital.

At the date of issuance, the conversion feature relating to \$600,000 in principal amount of the notes was "in-the-money". The intrinsic value of this beneficial conversion feature was \$185,297. In accordance with EITF 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ration" and EITF 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments," this amount was recorded as additional paid-in capital.

The 10% senior convertible notes are being accreted to their face value on the effective interest method, through periodic charges to interest expense over the term of the notes.

On December 21, 2006, in conjunction with the modification of the 10% promissory note (note 5), \$500,000 in principal amount of the 10% senior convertible notes were amended and restated as follows: a general security agreement, covering all the assets of the Corporation, was registered in favor of the holders. This amendment did not result in the new notes being "substantially different" from the original notes, as that term is defined in EITF 96-19 "Debtor's Accounting for a Modification or Exchange of Debt Instruments". Accordingly, the modified notes have been reclassified as 10% senior secured convertible notes as of the date of the modification; no gain or loss has been recorded on the transaction.

# VALIDIAN CORPORATION

(A Development Stage Enterprise)

Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005

(In U.S. dollars)

## 8. 10% Senior convertible notes (continued):

The following table sets forth the financial statement presentation of the 10% senior convertible note proceeds on issuance, and the subsequent changes to the principal balance presented in the financial statements:

Note proceeds	\$ 750,000
Allocated to common stock and additional paid-in capital for market value of stock issued to the holders of the notes:	
Allocated to common stock	(1,200)
Allocated to additional paid-in capital	(188,400)
	<u>(189,600)</u>
Allocated to additional paid-in capital for the intrinsic value of the beneficial conversion feature	(185,297)
 Proceeds allocated to 10% senior convertible notes upon issuance	 <u>375,103</u>
Accretion of the 10% senior convertible notes as a charge to interest and financing costs during the period	118,607
Reduction of the 10% senior convertible notes through transfer to 10% senior secured convertible notes (note 7) at date of modification	(83,041)
Balance allocated to the 10% senior convertible notes, December 31, 2006	<u>\$ 410,669</u>

## 9. Stockholders' equity:

### (a) Common stock transactions:

During the year ended December 31, 2006, the Corporation issued a total of 800,000 shares of its common stock, valued at \$107,500 in consideration for consulting services rendered and to be rendered. In relation to these transactions, an expense of \$83,750 has been included in selling, general and administrative expenses for the year ended December 31, 2006. The remaining \$23,750 has been included in prepaid expenses, and will be expensed over the remaining three months of the contract term.

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 9. Stockholders' equity (continued):

### (a) Common stock transactions (continued):

During the year ended December 31, 2006, the Corporation issued 20,000 shares of its common stock in connection with the exercise of 20,000 Series H stock purchase warrants for cash proceeds of \$10,000.

In connection with the issuance of the Corporation's 10% senior secured convertible notes on June 1 and December 21, 2006 (note 7), the Corporation issued a total of 1,600,000 shares of its common stock, valued at \$214,802, to the holders of the notes.

In connection with the issuance of the Corporation's 10% senior convertible notes on various dates between June 30 and October 5, 2006 (note 8), the Corporation issued a total of 1,200,000 shares of its common stock, valued at \$189,600, to the holders of the notes.

In connection with the issuance of the Corporation's 10% promissory note on July 13, 2006 (notes 5 and 7), the Corporation issued 1,000,000 shares of its common stock, valued at \$150,000 to the holder of the note. In accordance with the terms of the note, a further 500,000 shares of the Corporation's common stock, valued at \$45,000, were issued to the holder of the note on October 11, 2006, as a penalty for failing to repay the full value of the note, plus accrued interest thereon, prior to that date.

During the year ended December 31, 2006, the Corporation issued 740,000 shares of its common stock, valued at \$76,460, in consideration for finance fees relating to the issuance of the Corporation's 10% senior secured convertible notes, 10% senior convertible notes and 10% promissory notes.

During the year ended December 31, 2006, the Corporation issued 100,000 shares of its common stock, valued at \$11,500, in exchange for the deferral of payment of finance fees owing, which are included in accrued liabilities.

During the year ended December 31, 2006, the Corporation issued 250,000 shares of its common stock, valued at \$28,750, in settlement of finance fees payable in the amount of \$25,000 (note 11).

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 9. Stockholders' equity (continued):

### (a) Common stock transactions (continued):

During the year ended December 31, 2006, the Corporation issued 118,378 shares of its common stock in settlement of \$13,637 in accrued interest on the 10% senior convertible notes.

During the year ended December 31, 2005, the Corporation issued 1,157,866 shares of its common stock to holders of its 4% senior subordinated convertible debentures, in connection with the conversion of \$578,932 of debenture principal and accrued interest.

On December 31, 2005, the Corporation issued 485,672 shares of its common stock to holders of its 4% senior subordinated convertible debentures, in settlement of \$225,000 in principal, plus \$17,835 in accrued interest on maturity of the debentures.

During the year ended December 31, 2005, the Corporation issued 805,000 shares of its common stock in connection with the exercise of 805,000 stock purchase warrants for cash proceeds of \$402,500.

### (b) Transactions involving stock purchase warrants:

On April 20, 2006, holders of the Series H warrants exercised 20,000 warrants, and purchased 20,000 shares of the Corporation's common stock for cash proceeds of \$10,000.

Effective June 1, 2006, the exercise price of the Corporation's Series I warrants was adjusted from \$0.90 to \$0.10, in accordance with the terms of the warrant agreements, which call for the conversion rate to be adjusted at such time as the Corporation issues debt or equity instruments having a conversion rate lower than \$0.90. On June 1, 2006, the Corporation issued senior secured convertible notes (note 7), which have a conversion rate of \$0.10.

On December 31, 2006, in connection with the resignation of one of the Corporation's directors, 520,000 Series E warrants and 1,005,000 stock options (note 9(c)) were surrendered in exchange for the issuance of 650,000 Series J warrants. The Series J warrants entitle the holder to purchase a total of 650,000 common shares of the Corporation at an exercise price of \$0.15 per share, are exercisable at any time, and expire on June 30, 2008. At the date of issuance, the fair value of the Series J warrants was \$18,307, which was lower than the aggregate fair value of the Series E warrants and the stock options surrendered (\$9,314 and \$17,688, respectively). Accordingly, the Corporation did not record an expense in relation to this transaction. The fair value of the Series J and Series E warrants, and the stock options, were calculated using the Black Scholes option pricing model with the following assumptions: expected dividend yield 0%; risk-free interest rate of 4.9%; expected volatility ranging from 136% to 143%; and an expected life ranging from 1.3 to 1.5 years.

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 9. Stockholders' equity (continued):

(b) Transactions involving stock purchase warrants (continued):

On December 31, 2006, 400,000 Series G warrants and 2,652,500 Series H warrants expired.

On August 31, 2005, the 400,000 Series G warrants were amended to extend the expiry date from September 3, 2005 to December 31, 2006, as consideration for consulting services to be rendered during the period for which the extension was granted. \$15,292, representing the fair value of the extension granted in exchange for services rendered to December 31, 2005, was included in selling, general and administrative expenses for the year then ended; \$45,870, representing the fair value of the extension granted in exchange for services to be rendered during the next twelve months, was included in prepaid expenses at December 31, 2006, and has been included in selling, general and administrative expenses for the year ended December 31, 2006. The fair value of the extension was calculated using the Black Scholes option pricing model, with the following weighted average assumptions: expected dividend yield 0%; risk-free interest rate of 3.71%; expected volatility of 94%; and an expected life of 1.33 years.

On November 7, 2005, holders of the Series H warrants exercised a total of 55,000 warrants, and purchased 55,000 shares of the Corporation's common stock for cash proceeds of \$27,500.

On November 8, 2005, holders of the Series F warrants exercised a total of 750,000 warrants, and purchased 750,000 shares of the Corporation's common stock for cash proceeds of \$375,000.

Following is a summary of stock purchase warrants outstanding at December 31, 2006 and 2005:

	Exercise Price	Expiry	Outstanding 2006	Outstanding 2005
Series E	\$0.33	December, 2007	1,635,000	2,155,000
Series F	0.50	May, 2007	3,146,000	3,146,000
Series G	0.75	December, 2006	--	400,000
Series H	0.50	December, 2006	--	2,672,500
Series I	0.10	March, 2009	3,513,333	3,513,333
Series J	0.15	June, 2008	650,000	--
			8,944,833	11,886,833

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 9. Stockholders' equity (continued):

### (c) Transactions involving stock options:

The Corporation has two incentive equity plans, under which a maximum of 7,000,000 options to purchase 7,000,000 common shares may be granted to officers, employees and consultants of the Corporation. The granting of options, and the related terms, are determined at the discretion of the board of directors. As of December 31, 2006, there were a total of 3,447,302 options granted under these plans, with exercise prices ranging from \$0.33 to \$0.67, and expiry dates ranging from May 7, 2008 to January 1, 2011. 3,272,302 of these options vested immediately upon issuance; 25,000 vested on November 14, 2006; and 150,000 vest on dates ranging from January 1, 2007 to November 14, 2008. 3,552,698 options remained available for grant under these plans as of December 31, 2006.

During the year ended December 31, 2006, the Corporation granted 100,000 stock options to an employee as an incentive to enter into full-time employment with the Corporation. The options vest on various dates between January 1, 2007 and January 1, 2009; have an exercise price of \$0.67; and an expiry date for unexercised options of January 12, 2001, with provision for early forfeiture in the event the holder ceases to be employed by the Corporation prior to the stated expiry date. The fair value of these options at date of grant was \$19,556, determined using the following assumptions: expected dividend yield 0%; risk-free interest rate of 4.39%; expected volatility of 158%; an expected life of 5 years; and an expected forfeiture rate of 1.5%.

In accordance with the Corporation's accounting policy in respect of stock options granted to employees (note 2(f)), the Corporation has included \$6,618, representing the fair value of the options earned during the year ended December 31, 2006, in selling general and administrative expenses for the year then ended. The related employment agreement was terminated effective March 30, 2007, at which time 66,667 of the 100,000 options originally granted to this employee remained unvested. Accordingly, there will be no further expense recognized in relation to these options.

During the year ended December 31, 2006, the Corporation also included in expenses the following amounts related to options granted to employees during 2005, which were unvested as at December 31, 2005: \$14,391 was included in selling, general and administrative expense; and \$9,939 was included in research and development expense. \$6,653, representing the fair value of the options attributable to the period remaining until the options are fully vested, will be recognized as expense on a straight-line basis over the remaining service period, which ends on November 14, 2008. During the year ended December 31, 2006, 250,000 of the options granted to employees during 2005, which were unvested as at December 31, 2005, were forfeited as a result of the termination of the related employment agreements. In order to reflect these forfeitures, the fair value of the unvested options recognized during the year was reversed, as follows: \$2,259 previously recognized as selling, general and administrative expense was reversed; and \$9,939 previously recognized as research and development expense was reversed.



# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 9. Stockholders' equity (continued):

### (c) Transactions involving stock options (continued):

On December 31, 2006, in connection with the resignation of one of the Corporation's directors, 1,005,000 stock options and 520,000 Series E warrants were surrendered in exchange for the issuance of 650,000 Series J warrants (note 9(b)).

During the year ended December 31, 2005, the Corporation granted a total of 2,750,000 stock options to employees and consultants under the Corporation's 2004 Incentive Equity Plan. 400,000 of these options were granted to consultants in respect of services provided, and 2,350,000 options were granted to employees.

150,000 of the options granted to consultants during 2005 were in respect of services provided during 2004, for which a liability was accrued during 2004. 75,000 of these options were forfeited during the year ended December 31, 2005 as a result of the termination of the related consulting agreements.

The remaining 250,000 options granted to a consultant during 2005 vested immediately upon issuance, and gave the holder the right to purchase a total of 250,000 common shares at an exercise price of \$0.67. The expiry date for unexercised options is June 30, 2010, with provision for early forfeiture in the event the holder ceases to be engaged by the Corporation prior to the stated expiry date. In connection with these options, an expense of \$156,531, representing the fair value of the options at their grant date, was included in selling, general and administrative expenses for the year ended December 31, 2005. The fair value was calculated using the Black Scholes option pricing model, with the following assumptions: expected dividend yield 0%; risk-free interest rate of 3.76%; expected volatility of 161%; and an average expected life of 5.02 years.

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 9. Stockholders' equity (continued):

### (c) Transactions involving stock options (continued):

There were 350,000 options granted to employees on March 8, 2005, which included the following provisions: all of the options vested immediately upon issuance; 250,000 have an exercise price of \$0.90; 100,000 have an exercise price of \$0.50; the expiry dates for unexercised options range from March 31, 2009 to December 31, 2009, with provision for early forfeiture in the event the holder ceases to be employed by the Corporation prior to the stated expiry date. The fair value of these options at date of grant was \$161,585, determined using the Black Scholes option pricing model, with the following weighted average assumptions: expected dividend yield 0%; risk-free interest rate of 3.44%; expected volatility of 170%; and an average expected life of 4.29 years. 25,000 of these options were forfeited during the year ended December 31, 2005 as a result of the termination of the related employment agreement.

300,000 options, of which 150,000 vested immediately upon issuance and 150,000 were to vest upon the achievement of predefined goals, were granted to an employee on April 22, 2005. All of these options had an exercise price of \$0.50 and an expiry date for unexercised options of April 22, 2010, with provision for early forfeiture in the event the holder ceases to be employed by the Corporation prior to the stated expiry date. The fair value of the vested and unvested options at date of grant was \$134,530, determined using the Black Scholes option pricing model, with the following weighted average assumptions: expected dividend yield 0%; risk-free interest rate of 2.97%; expected volatility of 162%; and an average expected life of 5 years.

The Corporation granted 400,000 options to employees on June 22, 2005, and a further 900,000 on June 30, 2005. All of these options vested immediately upon issuance, had an exercise price of \$0.67, and an expiry date of June 30, 2010 for unexercised options, with provision for early forfeiture in the event the holder ceases to be employed by the Corporation prior to the stated expiry date. The fair value of these options at their grant dates was \$726,660, determined using the Black Scholes option pricing model, with the following weighted average assumptions: expected dividend yield 0%; risk-free interest rate of 3.76%; expected volatility of 161%; and an average expected life ranging from 5 to 5.02 years.

400,000 options, of which 225,000 vested immediately upon issuance and 175,000 had various vesting dates during the period from November 1, 2006 to November 14, 2008, were granted to employees on November 18, 2005. All of these options had an exercise price of \$0.67; expiry dates for unexercised options range from November 1 to December 31, 2010, with provision for early forfeiture in the event the holder ceases to be employed by the Corporation prior to the stated expiry date. The fair value of the vested and unvested options at date of grant was \$100,183, determined using the Black Scholes option pricing model, with the following weighted average assumptions: expected dividend yield 0%; risk-free interest rate of 4.45%; expected volatility of 158%; and an average expected life of 5 years.

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 9. Stockholders' equity (continued):

### (c) Transactions involving stock options (continued):

In accordance with the Corporation's accounting policy in respect of stock options granted to employees prior to January 1, 2006 (note 2(l)), there was no compensation expense recorded in connection with the 2,350,000 options granted to employees during the year ended December 31, 2005, as the market value of the underlying stock at the grant dates did not exceed their exercise price.

During the year ended December 31, 2005, 1,310,000 of the 3,912,302 stock options granted to non-employees during 2003 were forfeited as a result of the termination of the related consulting agreements.

A summary of stock options outstanding at December 31, 2006 and 2005 is as follows; the 2005 comparative figures have been restated to correct an error in an exercise price previously reported:

	2006		2005	
	# of Options	Weighted average Exercise price	# of Options	Weighted average Exercise price (restated)
Options outstanding, beginning of year	5,252,302	\$ 0.50	3,912,302	\$ 0.33
Granted	100,000	0.67	2,750,000	0.68
Expired	1,655,000	0.51	1,410,000	0.37
Forfeited	250,000	0.57	--	--
Options outstanding, end of year	3,447,302	\$ 0.50	5,252,302	\$ 0.50
Options exercisable, end of year	3,297,302	\$ 0.49	4,927,302	\$ 0.50

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 9. Stockholders' equity (continued):

(c) Transactions involving stock options (continued):

The following table summarizes information regarding stock options outstanding and exercisable at December 31, 2006:

Options Outstanding				Options Exercisable	
Exercise price	Number outstanding at 12/31/06	Weighted average remaining contractual life	Weighted average exercise price	Number outstanding at 12/31/06	Weighted average exercise price
\$ 0.33	1,597,302	2.4 years	\$ 0.33	1,597,302	\$ 0.33
0.50	225,000	3.7 years	0.50	225,000	0.50
0.67	1,625,000	3.6 years	0.67	1,325,000	0.67
	3,447,302	3.1 years	\$ 0.50	3,297,302	\$ 0.49

(d) Summary of stock-based compensation:

The following table presents the total of stock-based compensation included in the expenses of the Corporation for the years ended December 31, 2006 and 2005:

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 9. Stockholders' equity (continued):

(d) Summary of stock-based compensation (continued):

	2006	2005
Selling, general and administrative expenses:		
Relating to the amortization of prepaid consulting fees recorded in 2003 and 2005 on the issuance of warrants and on the extension of the expiry date of previously-issued warrants, respectively, in exchange for services to be rendered	\$ 166,708	\$ 136,130
Relating to the amortization of prepaid consulting fees recorded in 2006 on the issuance of common stock as fees for services to be rendered during 2006 and 2007	23,750	--
Relating to the issuance of common stock as compensation for services rendered	60,000	--
Fair value of consulting services rendered during the period from October 1 to December 31, 2006, which were settled through the issuance of 1,000,000 shares of the Corporation's common stock on January 16, 2007	31,519	--
Fair value of unvested employee stock options earned during the year (note 9(c))	21,009	--
Reversal of fair value of unvested employee stock options recognized during the year, in respect of unvested options forfeited during the year (note 9(c))	(2,259)	--
Fair value of stock options issued to consultants during the year	--	156,531
Total stock-based compensation included in selling, general and administrative expenses	<u>300,727</u>	<u>292,661</u>
Research and development:		
Fair value of unvested employee stock options earned during the year (note 9(c))	9,939	--
Reversal of fair value of unvested employee stock options recognized during the year, in respect of unvested options forfeited during the year (note 9(c))	(9,939)	--
Total stock-based compensation included in research and development expenses	<u>--</u>	<u>--</u>
Total stock-based compensation included in expenses	\$ <u>300,727</u>	\$ <u>292,661</u>

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 10. Interest and financing costs:

The following table sets forth the charges to interest and financing costs during the years ended December 31, 2006 and 2005:

	2006	2005
Interest and financing costs relating to the 10% senior secured convertible notes:		
Accrued interest	\$ 10,900	\$ --
Accretion of the notes payable (note 7)	45,992	--
Amortization of deferred financing costs (note 4)	5,837	--
	<u>62,729</u>	<u>--</u>
Interest and financing costs relating to the 10% senior convertible Notes:		
Accrued interest	38,620	--
Accretion of the notes payable (note 7)	118,607	--
Amortization of deferred financing costs (note 3)	29,427	--
	<u>186,654</u>	<u>--</u>
Interest and financing costs relating to the 10% promissory notes:		
Accrued interest	11,027	--
Accretion of the notes payable (note 7)	44,956	--
Amortization of deferred financing costs (note 3)	15,264	--
	<u>71,247</u>	<u>--</u>
Interest and financing costs relating to the 4% senior convertible debentures:		
Accrued interest	--	11,673
Accretion of the debentures payable	--	447,927
Amortization of deferred financing costs	--	117,244
	<u>--</u>	<u>576,844</u>
Accrued interest on the 12% promissory notes	59,983	35,556
Interest portion of capital lease payments	2,204	2,886
	<u></u>	<u></u>
Total interest and financing costs	\$ 382,817	\$ 615,286

## 11. Gain on extinguishment of debt:

	2006	2005
Gain on extinguishment of 10% promissory note (note 5)	\$ 44,956	\$ --
Gain on extinguishment of 10% senior secured convertible notes (note 7)	38,097	--
Loss on issuance of 250,000 common shares, valued at \$28,750, in satisfaction of accounts payable totaling \$25,000 (note 9(a))	(3,750)	--
	<u>\$ 79,303</u>	<u>\$ --</u>

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 12. Loss per share:

As the Corporation incurred a net loss during the years ended December 31, 2006 and 2005, the loss and diluted loss per common share are based on the weighted-average common shares outstanding during the year. The following outstanding instruments could potentially dilute loss per share for the periods presented:

	2006	2005
Stock options	3,447,302	5,252,302
Series E stock purchase warrants	1,635,000	2,155,000
Series F stock purchase warrants	3,146,000	3,146,000
Series G stock purchase warrants	--	400,000
Series H stock purchase warrants	--	2,672,500
Series I stock purchase warrants	3,513,333	3,513,333
Series J stock purchase warrants	650,000	--
	12,391,635	17,139,135

## 13. Related party transactions:

Included in accrued liabilities is \$128,715 (December 31, 2005: \$nil) in accrued salaries payable to the directors and a former director of the Corporation.

Included in 12% promissory notes payable (note 5) is \$7,902 payable to a company controlled by a director of the Corporation, and \$18,438 payable to a director. \$221 in accrued interest charges relating to these notes is included in accrued liabilities and interest and finance costs.

As discussed in note 14(b), the Corporation also entered into an agreement to sublease excess office space to a related company.

## 14. Guarantees and Commitments:

### a) Guarantees

The Corporation has entered into agreements which contain features which meet the definition of a guarantee under FASB Interpretation No. 45 ("FIN 45"). FIN 45 defines a guarantee to be a contract that contingently requires the Corporation to make payments (either in cash, financial instruments, other assets, common stock of the Corporation or through the provision of services) to a third party based on changes in an underlying economic characteristic (such as interest rates or market value) that is related to an asset, liability or an equity security of the other party.

The Corporation has the following guarantees which are subject to the disclosure and measurement requirements of FIN 45:

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 14. Guarantees and Commitments (continued):

### a) Guarantees (continued)

(i) In the normal course of business, the Corporation entered into a lease agreement for facilities. As the lessee, the Corporation agreed to indemnify the lessor for liabilities that may arise from the use of the leased facility. The maximum amount potentially payable under the foregoing indemnity cannot be reasonably estimated. The Corporation has liability insurance that relates to the indemnification described above.

(ii) The Corporation includes standard intellectual property indemnification clauses in its software license and service agreements. Pursuant to these clauses, the Corporation holds harmless and agrees to defend the indemnified party, generally the Corporation's business partners and customers, in connection with certain patent, copyright or trade secret infringement claims by third parties with respect to the Corporation's products. The term of the indemnification clauses is generally perpetual any time after execution of the software license and service agreement. In the event an infringement claim against the Corporation or an indemnified party is successful, the Corporation, at its sole option, agrees to do one of the following: (i) procure for the indemnified party the right to continue use of the software; (ii) provide a modification to the software so that its use becomes non-infringing; (iii) replace the software with software which is substantially similar in functionality and performance; or (iv) refund the residual value of the software license fees paid by the indemnified party for the infringing software. The Corporation believes the estimated fair value of these intellectual property indemnification clauses is minimal.

Historically, the Corporation has not made any significant payments related to the above-noted indemnities and accordingly, no liability related to the contingent features of these guarantees has been accrued in the financial statements.

### b) Commitment

During April, 2004, the Corporation entered into a lease agreement for office space. In July 2005, and in April 2007, the lease period was extended for periods of one and three years, respectively. Minimum annual rent, including operating costs, payable under this contract is approximately as follows:

2007	\$	84,900
2008		67,700
2009		67,700
2010		22,600
Total	\$	242,900



# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 14. Guarantees and Commitments (continued):

### b) Commitment (continued)

Effective July 1, 2004, the Corporation also entered into an agreement to sublease excess office space to a related company. The companies are related by virtue of an officer and director of the Corporation being also an officer and director of the other company. Included in accounts receivable is \$nil (2005 - \$5,508) in rent receivable pursuant to this sublease agreement. The transaction has been recorded at the exchange amount. Rental expense for the year ended December 31, 2005, which is included in selling, general and administrative expenses, has been reduced by sublease income of \$31,808 (2005 - \$29,709). The anticipated remaining sublease income is approximately as follows: 2007 - \$10,297.

Rent expense incurred under the operating lease for the year ended December 31, 2005, net of sublease income, was \$118,647 (2005 - \$113,882).

## 15. Contingent liability:

On December 21, 2006, a former director of the Corporation commenced legal action against the Corporation with respect to approximately \$42,905 in unpaid salary owing to the former director at the date of his retirement, plus costs with respect to collecting the amount due. The Corporation is contesting this action; however a liability for unpaid salary in the amount of \$42,905 has been included in accrued liabilities at December 31, 2006. As of the date of the financial statements, additional costs which may become payable in relation to this claim cannot be reasonably estimated; as such, no provision has been made in the accounts for any such additional costs.

## 16. Financial instruments:

The carrying value of cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities, capital lease obligation and promissory notes payable approximates fair value due to the short term to maturity of these instruments. The 10% senior secured convertible notes, and the 10% convertible notes, were recorded at their relative fair value at the date of issuance, and are being accreted to their face value over the term of the notes.

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 17. Income taxes:

Deferred income taxes reflect the impact of temporary differences between amounts of assets and liabilities as reported for financial reporting purposes and such amounts as measured by tax laws. The tax effects of temporary differences that gave rise to significant portions of the deferred tax asset and deferred tax liability are as follows:

	2006	2005
Deferred tax asset:		
Net operating loss carryforwards	\$ 5,041,000	\$ 3,991,000
Capital loss carryforwards	1,050,000	1,050,000
Financing fees	--	4,000
Total gross deferred tax asset	6,091,000	5,045,000
Valuation allowance	(6,091,000)	(5,045,000)
Net deferred taxes	\$ --	\$ --

Income tax expense attributable to loss before income taxes was \$nil (2005 - \$nil) and differed from the amounts computed by applying the U.S. federal income tax rate of 34% (2004 - 34%) to the net loss as a result of the following:

	2006	2005
Expected tax rate	34%	34%
Expected tax recovery applied to net loss before income taxes	\$ (1,151,679)	\$ (1,429,924)
Increase (decrease) in taxes resulting from:		
Change in valuation allowance	1,046,000	1,141,000
Compensation expense	63,000	99,500
Interest and financing costs	71,000	184,500
Gain on extinguishment of debt	(27,000)	--
Other	(1,321)	4,924
	\$ --	\$ --

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 17. Income taxes (continued):

The Corporation has net operating losses of \$14,829,000 (2005 - \$11,741,000) which are available to reduce U.S. taxable income and which expire as follows:

2019	\$ 391,000
2020	675,000
2021	521,000
2022	897,000
2023	1,671,000
2024	4,205,000
2025	3,381,000
2026	3,088,000
	<u>\$ 14,829,000</u>

## 18. Change in non-cash operating working capital:

	2006	2005
Accounts receivable	\$ 61,367	\$ (33,477)
Prepaid expenses	(366)	40,403
Accounts payable	258,771	176,840
Accrued liabilities	241,452	(27,279)
Deferred revenue	130,000	25,000
	<u>\$ 691,224</u>	<u>\$ 181,847</u>

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 19. Supplementary cash flow information:

The Corporation paid no income taxes during the year ended December 31, 2006, nor during the year ended December 31, 2005. Interest paid in cash during the years ended December 31, 2006 and December 31, 2005 were \$2,593 and \$2,886, respectively.

Non-cash financing activities are excluded from the consolidated statement of cash flows. The following is a summary of such activities:

	2006	2005
Debt issuance costs	\$ 178,960	\$ --
Issuance of 250,000 shares of the Corporation's common stock, valued at \$28,750, in satisfaction of accounts payable in the amount of \$25,000	28,750	--
Issuance of 118,378 shares of the Corporation's common stock in settlement of \$13,638 in accrued interest on the 10% senior convertible notes	13,638	--
Conversion of 4% senior subordinated convertible debentures and accrued interest, net of deferred financing costs of \$163,980 (2004 - \$721,097) (notes 4 and 6)	--	414,952
Granting of 650,000 series J warrants in exchange for the surrender of 520,000 series E warrants and 1,005,000 stock options, in connection with the resignation of one of the Corporation's directors	--	242,835
Total	\$ 221,348	\$ 657,787

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 20. Subsequent events:

On January 1, 5 and 11, 2007, the Corporation issued an aggregate of 659,001 shares of its common stock to the holders of the 10% senior secured convertible notes and the 10% senior secured notes, in satisfaction of \$44,342 of accrued interest on the notes.

On January 12, 2007, the Corporation issued an aggregate of 3,000,000 shares of its common stock pursuant to the terms of two contracts with unrelated parties to provide investor relations services to the Corporation for a period of six months, commencing January 17, 2007.

On January 16, 2007, the Corporation issued 1,000,000 shares of its common stock pursuant to the terms of a contract with an unrelated party to provide investor relations services for the period from October 1, 2006 to January 16, 2007. \$31,519, representing the fair of the stock relating to services provided under this contract to December 31, 2006, was included in accrued liabilities and selling, general and administrative expenses at December 31, 2006.

Also on January 16, 2007, the Corporation issued 600,000 shares of its common stock to an unrelated party in settlement of \$60,000 in fees payable, which was included in accrued liabilities at December 31, 2006.

On January 16, 2007, the Corporation issued 775,000 shares of its common stock in settlement of \$77,500 in fees relating to the placement of the Corporation's 10% senior secured convertible notes and 10% senior convertible notes. \$67,500 in fees settled was included in accrued liabilities at December 31, 2006; \$10,000 was incurred subsequent to December 31, 2007.

On various dates during the period from January 23 to February 23, 2007, the Corporation received an aggregate of \$59,897 from the issuance of its 12% promissory notes to unrelated parties.

On March 9, 2007, the Corporation amended the terms of its 10% senior secured convertible notes, as follows: the rate at which the holder is entitled to convert principal and interest outstanding on the notes was changed from one common share for every \$0.10 of debt converted, to one common share for every \$0.06 of debt converted.

As a result of the amendment to the Corporation's 10% senior secured convertible notes on March 9, 2007, the exercise price of the Series I warrants was also adjusted from \$0.10 to \$0.06 effective February 9, 2007.

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## 20. Subsequent events (continued):

Also on March 9, 2007, the Corporation received \$200,000 in cash proceeds from the issuance of its 10% senior secured convertible notes. The notes mature on June 1, 2008, and are secured by a general assignment of all assets of the Corporation. Under the terms of the note, the holder is permitted, at any time, to convert all or a portion of the outstanding principal plus accrued interest into common stock of the Corporation at a ration of one common share for each \$0.06 of debt converted; the Corporation may pre-pay all or any portion of the balance outstanding on the notes at any time, without penalty or bonus; interest is payable quarterly, and may, at the Corporation's option, be paid either in cash or in common shares of the Corporation. If interest is paid in common shares, the number of shares required for settlement will be calculated using a 10% discount to the average closing price of the common stock, as listed on the exchange where the Corporation's common stock is traded, for the ten days prior to the date the interest is due to the holder. The Corporation issued 400,000 shares of its common stock to the holder pursuant to the terms of the note.

On March 9, 2007, the Corporation issued 49,333 shares of its common stock in satisfaction of finance fees relating to the \$200,000 in senior convertible notes issued on the same date.

On March 14, 2007, the Corporation issued 25,000 shares of its common stock pursuant to the terms of a contract with an unrelated party to provide investor relations services to the Corporation for a one month period.

In April, 2007, the Corporation negotiated an agreement with respect to a three year extension of its lease, for 3,287 square feet of office space, a reduction of 2,289 square feet from the 5,576 square feet it currently occupies.

On May 15, 2007, the Corporation received \$250,000 in cash proceeds from the issuance of its 10% senior secured convertible notes. The notes mature on May 31, 2009, and are unsecured. Under the terms of the note, the holder is permitted, at any time, to convert all or a portion of the outstanding principal plus accrued interest into common stock of the Corporation at a ration of one common share for each \$0.03 of debt converted; the Corporation may pre-pay all or any portion of the balance outstanding on the notes, without penalty or bonus, provided the holder grants permission to do so. Interest is not payable until such time as payment is requested by the holder, and may, at the Corporation's option, be paid either in cash or in common shares of the Corporation. If interest is paid in common shares, the number of shares required for settlement will be calculated using a 10% discount to the average closing price of the common stock, as listed on the exchange where the Corporation's common stock is traded, for the ten days prior to the date the interest is due to the holder. The Corporation issued 750,000 shares of its common stock to the holder pursuant to the terms of the note.

# VALIDIAN CORPORATION

(A Development Stage Enterprise)  
Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005  
(In U.S. dollars)

## **20. Subsequent events (continued):**

As a result of the \$250,000 of the Corporation's 10% senior secured convertible notes on May 15, 2007, the exercise price of the Series I warrants was adjusted from \$.06 to \$0.03 effective May 15, 2007.

## **Item 8. Changes In and Disagreements With Accountants on Accounting and Financial Disclosures.**

There have been no changes in or disagreements with accountants with respect to accounting and/or financial statements.

### **Item 8A. Controls and Procedures.**

The term “disclosure controls and procedures” is defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, or the Exchange Act. This term refers to the controls and procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission.

In connection with the audit of our consolidated financial statements for the years ended December 31, 2006 and 2005, our independent registered public accounting firm advised the Board of Directors and management of certain significant internal control deficiencies that they considered to be, in the aggregate, a material weakness. These internal control deficiencies were first identified by our independent registered public accounting firm in connection with the audit of our consolidated financial statements for the year ended December 31, 2004. In particular, our independent registered public accounting firm identified the following weaknesses in our internal control system: (1) a lack of segregation of duties; and (2) the lack of timely preparation of certain back up schedules. The independent registered public accounting firm indicated that they considered these deficiencies to be reportable conditions as that term is defined under the standards established by the American Institute of Certified Public Accountants. A material weakness is a significant deficiency in one or more of the internal control components that alone or in the aggregate precludes our internal controls from reducing to an appropriately low level of risk that material misstatements in our financial statements will not be prevented or detected on a timely basis. We considered these matters in connection with the period-end closing of accounts and preparation of the related consolidated financial statements and determined that no prior period financial statements were materially affected by such matters. Notwithstanding the material weakness identified by our independent registered public accountants, we believe that the financial statements, and other financial information included in this report, fairly present in all material respects, the financial condition, results of operation and cash flows of the Corporation as of, and for, the periods represented in this report.

Our size has prevented us from being able to employ sufficient resources at this time to enable us to have an adequate level of supervision and segregation of duties within our internal control system. We will continue to monitor and assess the costs and benefits of additional staffing within the Company.

We were unable to eliminate the identified weaknesses with respect to the period covered by this report. However, we began to implement some of the steps identified below to remediate the material weakness to the extent that our size and resources allowed us during 2004. Set forth below is a discussion of the significant internal control deficiencies that have not been remediated.

**Lack of segregation of duties.** Since commencing the development phase of our operations in August 1999, our size has prevented us from being able to employ sufficient resources to enable us to have an adequate level of supervision and segregation of duties within our internal control system. Until the beginning of the fourth quarter of 2005, we had only three people involved in the processing of accounting entries: the Office Administrator, the Controller and the Chief Financial Officer. It was therefore difficult to effectively segregate accounting duties. During the fourth quarter of 2005, we retained the services of a part-time independent consultant to assist in performing routine, month end accounting procedures. This consultant left the Corporation effective May, 2005, however, and has not been replaced. While we strive to segregate duties as much as practicable, there is insufficient volume of transactions to justify additional full time staff.



As a result, this significant internal control deficiency had not been remediated as of the end of the period covered by this report, nor do we know if we will be able to remediate this weakness in the foreseeable future. However, we will continue to monitor and assess the costs and benefits of additional staffing.

**Lack of timely preparation of back up schedules.** Throughout 2005 and until the third quarter of 2006, we were able to complete most of our back up schedules prior to the arrival of our independent registered public accountants' audit staff. However, we did not file our Form 10-QSB for the quarter ended September 30, 2006 until November 24, 2006, partially as a result of our lack timely preparation of back up schedules; the audit of our 10-KSB for the year ended December 31, 2006 was also delayed for this reason. As such, we believe that this material weakness had not been remediated as of the end of the period covered by this report, although progress in remediation had been made. One of our objectives in hiring the part-time consultant during the fourth quarter of 2005 to perform routine, month end accounting procedures, was to improve the timeliness of preparation of back up schedules and thus permit us to complete our financial reporting on a more timely basis. This individual provided some assistance in these areas, however the arrangement did not work out as anticipated, and the consultant was no longer engaged by us as of May 2006. Effective during the quarter ended March 31, 2007, we have commenced the process of reviewing and expanding our formal month-end procedures, with the objective of improving the timeliness of the preparation of future quarterly reports and related back up schedules.

If we are unable to remediate the identified material weakness, there is a more than remote likelihood that a material misstatement to our SEC reports will not be prevented or detected, in which case investors could lose confidence in the accuracy and completeness of our financial reports, which could have an adverse effect on our ability to raise additional capital and could also have an adverse effect on our stock price.

As required by the SEC rules, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this Report. This evaluation was performed under the supervision and with the participation of our management, including the President and Chief Executive Officer and Chief Financial Officer and Treasurer. Based upon that evaluation, our President and Chief Executive Officer and Chief Financial Officer and Treasurer have concluded that our controls and procedures were not effective as of the end of the period covered by this Report due to existence of the significant internal control deficiencies described above.

There has been no change in internal control over financial reporting, other than the measures noted above, during the year ended December 31, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Item 8B. Other Information.**

None.

### **PART III**

#### **Item 9. Directors, Executive Officers, Promoters and Control Persons: Compliance with Section 16(a) of the Exchange Act.**

The following table sets forth certain information concerning our directors and executive officers as of December 31, 2006:

<u>Name</u>	<u>Age</u>	<u>Position</u>
Bruce I. Benn	53	Director, President, Chief Executive Officer, Executive Vice President and Secretary

Effective May 6, 2005, the Board of Directors of the Company appointed Bruce I. Benn to the positions of President and Chief Executive Officer of the Company. Mr. Benn has served as a Director, Executive Vice President and Secretary of the Company since February 2004. From 1999 until February 2004, he provided services to the Company through Capital House Corporation. Mr. Benn plays a major role in making key management and strategic decisions and oversees all aspects of corporate finance for the Company. He has been principally responsible for arranging the \$16 million of capital investment for the Company from 1999 to date. Since 1989, Mr. Benn has been the President, Director and co-founder of Capital House Corporation, a boutique investment bank that has provided and/or arranged early and mid stage venture capital and hands-on managerial assistance to a portfolio of leading technology software companies. Mr. Benn was also a founder, Director and Officer of DevX Energy, Inc. from 1995 until October 2000. From 1980 to 1993, he was with Corporation House Ltd., where he was a Vice President and a Director from 1985 to 1993. He is an attorney and holds a Masters of Law degree from the University of London, England, a Baccalaureate of Laws from the University of Ottawa, Canada, and a Bachelor of Arts in Economics from Carleton University in Ottawa, Canada.

<u>Name</u>	<u>Age</u>	<u>Position</u>
Ronald I. Benn	52	Director, Chief Financial Officer and Treasurer

Ron Benn was appointed a Director, Chief Financial Officer and Treasurer of the Company in February 2004. He is a co-founder, Officer and Director of Capital House Corporation since 1989. He was recently Chief Financial Officer of Coast Software Inc., a position he held from September 2000 to February 2004 and where he was directly involved in raising more than \$7 million in capital. Since 1995, he also has been a Director of Telemus Electronics. From 1995 until 2000 he was Chief Financial Officer of DevX Energy, Inc., a publicly traded company on the NASDAQ exchange. He has 22 years' experience in senior finance positions, having begun his career in 1980 with Clarkson Gordon (now Ernst & Young) in the audit department. He holds a Chartered Accountant designation with the Institute of Chartered Accountants of Ontario (1982), and Bachelor of Commerce (Honours) degree from the University of Windsor, in Windsor, Canada and Bachelor of Science degree from Carleton University in Ottawa, Canada. Ron Benn is the brother of Bruce Benn.

#### **Audit Committee Financial Expert**

The SEC has adopted rules to implement certain requirements of the Sarbanes-Oxley Act of 2002 pertaining to public company audit committees. One of the rules adopted by the SEC requires a company to disclose whether it has an "audit committee financial expert" serving on its audit committee. Our board of directors has not yet established an audit committee and as a result provides the functions of an audit committee. As such, our board has not yet appointed an audit committee financial expert. We believe that our board of directors, taken as a whole, has the financial, accounting and other relevant education and experience necessary to

qualify as an audit committee financial expert under Item 401(e) of Regulation S-B. At this time, our board of directors believes it would be desirable to have an audit committee, and for the audit committee to have an audit committee financial expert serving on the committee. While informal discussions as to potential candidates have occurred, at this time no formal search process has commenced.

#### Code of Ethics Policy

We have not yet adopted a code of ethics policy because we are a development stage company, in the early stages of operations. We intend to adopt a code of ethics policy in the future.

#### Compliance with Section 16(a) of The Securities Exchange Act of 1934

To our knowledge, based solely on a review of such materials as are required by the Securities and Exchange Commission, none of our officers, directors or beneficial holders of more than ten percent of our issued and outstanding shares of common stock failed to timely file with the Securities and Exchange Commission any form or report required to be so filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, during the year ended December 31, 2005.

#### **Item 10. Executive Compensation.**

The following table shows all the cash compensation paid or to be paid by us or our subsidiaries, as well as certain other compensation paid or accrued, during the fiscal years indicated, to our chief executive officer and other executive officers who received total annual salary and bonus in excess of \$100,000 during the past fiscal year in all capacities in which the person served.

## Summary Compensation Table

(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
Name and Principal Position	Year	Salary (\$)	Bonus (\$)	Stock Awards (\$)	Option Awards (\$)	Non-Equity Incentive Plan Compensation (\$)	Nonqualified Deferred Compensation Earnings(\$)	All Other Compensation	Total \$
Benn, Bruce (1)	2006	105,847	0	0	0	0	0	0	105,847
	2005	99,146	0	0	500,000	0	0	0	599,146
Benn, Ronald (2)	2006	105,847	0	0	0	0	0	0	105,847
Maisonneuve, André	2006	105,847	0	0	0	0	0	0	105,847
	2005	103,848	0	0	0	0	0	0	103,848
Director,	2004	100,353	0	0	0	0	0	0	100,353
Chairman, and	2003	79,500	0	0	230,578	0	0	0	310,078
Vice President-Strategic Marketing (2)	2002	70,375	0	0	0	0	0	0	70,375

(1) Became Director, President, Chief Executive Officer, Executive Vice President and Secretary in May 2005. In addition, Mr. Benn served as Executive Vice President and Secretary from February 2004 to May 2005.

(2) Became Director, Chief Financial Officer and Treasurer in February, 2004.

(3) Became Director, Executive Vice President and Secretary in July, 2001. In addition, Mr. Maisonneuve served as Chairman, President, Chief Executive Officer, and Chief Financial Officer from January, 2002 to February, 2004, and as Chairman, President, Chief Executive Officer from January 2002 until May 2005. Retired effective December 31, 2006.

## .Outstanding Equity Awards at Fiscal Year-End

Option/SSAR Awards						Stock Awards			
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
Name	Number of Securities Underlying Unexercised Options Exercisable (#)	Number of Securities Underlying Unexercised Option Unexercisable (#)	Equity Incentive plan awards:	Option Exercise Price (\$)	Option Expiration Date	Number of Shares or Units of Stock That Have not Vested (#)	Market Value of Shares or Units of Stock That have not vested (\$)	Equity Incentive Plan Awards:	Equity Incentive Plan Awards Market Payout Value of Unearned Shares, Units or other Rights that have not vested \$
			Number of securities underlying unexercised options (#)				Number of unearned= (#)		
Benn, Bruce	500,000		0	0	\$0.67	2010/06/30	0	0	0
Benn, Ronald	400,000		0	0	\$0.67	2010/06/30	0	0	0
Maisonneuve, André	0		0	0	0	0	0	0	0

(1) Calculated based on \$0.21 per share of common stock, the closing bid price of our common stock on December 31, 2006.

## Long-Term Incentive Plans – Awards In Last Fiscal Year

There were no awards under our long-term incentive plans during the last fiscal year to the executive officers listed above.

Directors are not compensated for acting in their capacity as directors. Directors are reimbursed for their accountable expenses incurred in attending meetings and conducting their duties.

## **Item 11. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

The following table sets forth information as of April 30, 2007, with respect to any person known by us to own beneficially more than 5% of our common stock; common stock beneficially owned by each of our officers and directors named in Item 10; and the amount of common stock beneficially owned by our officers and directors as a group.

<u>Name &amp; Address of Beneficial Owner</u>	<u>Number of Shares Beneficially Owned</u>	<u>Approximate Percent of Common Stock Outstanding (1)</u>
Leonid Frenkel (4) 401 City Avenue Suite 800 Bala Cynwyd, PA 19004	3,816,938	8.3%
Bruce Benn* (2) (6) (7)	3,580,000	7.7%
Waycross Corp. (3) 29 Rue des Deux Communes 1226 Thonex-Geneva Switzerland	3,400,000	10.4%
Valdosta Corp. (2) P.O. Box 30592 Cayside, 2nd Floor, Harbour Drive Georgetown, Grand Cayman Cayman Islands, BWI	3,400,000	7.4%
Robert B. Prag (5) 12220 El Camino Real Suite 400 San Diego, CA 92130	2,554,825	5.6%
Ronald Benn* (2) (6) (8)	975,500	2.1%
All Executive Officers and Directors As a Group	4,455,500 (11)	9.6%

\*Executive Officer and/or a Director.

- (1) Based upon 45,720,403 shares of common stock issued and outstanding as of April 30, 2007 and includes for each person the shares issuable upon exercise of the options and warrants owned by them.
- (2) Valdosta Corp. is a portfolio management corporation incorporated under the laws of the Cayman Islands. Bruce Benn has a beneficial interest in 2,650,000 of the shares owned of record by Valdosta Corporation. Accordingly, 2,650,000 shares of the 3,400,000 shares owned of record by Valdosta Corporation have been included as beneficially owned by him. Ronald Benn has a beneficial interest in 250,000 of the shares owned of record by Valdosta Corporation. Accordingly, 250,000 shares of the 3,400,000 shares owned of record by Valdosta Corporation have been included as beneficially owned by him.
- (3) Waycross Corp. is a portfolio management corporation incorporated under the laws of the Cayman Islands.
- (4) Includes (a) 2,654,106 shares of common stock held by Leonid Frenkel, and (b) 1,162,832 shares held by Triag Capital L.F group, LLC, an investment limited liability corporation in which Mr. Frenkel exercises shared voting and dispositive power. Based on information contained in Schedule 13G as filed by Mr. Frenkel and Triag Capital L.F group, LLC on December 31, 2006.
- (5) Includes (a) 654,825 shares of common stock held by Robert B. Prag, and (b) 1,900,000 shares of common stock held by The Del Mar Consulting Group, an investment company over which Mr. Prag exercises voting and dispositive power. Based on information contained within the Schedule Schedule 13G, as Filed by Mr. Prag and the Del Mar Consulting Group Inc. on January 16, 2007.
- (6) Capital House Corporation is incorporated under the laws of Canada. Includes 400,000 shares of common stock issuable to Capital House Corporation upon exercise of the warrants owned by it. Bruce Benn and Ron Benn each has a beneficial interest in the shares of Capital House Corporation, and in 100,000 warrants owned of record by Capital House Corporation. Accordingly 100,000 warrants owned of record by Capital House Corporation have been included as beneficially owned by each of them. Bruce Benn and Ron Benn are brothers.

- (7) Includes (a) 30,000 shares held directly by Bruce Benn; (b) 2,650,000 shares owned of record by Valdosta Corporation; (c) 100,000 shares of common stock issuable pursuant to warrants held of record by Capital House Corporation; and (d) 300,000 shares issuable upon exercise of warrants held directly by Bruce Benn; and (e) 500,000 shares issuable upon exercise of options held directly by Bruce Benn. See footnotes (2) and (11).
- (8) Includes (a) 25,500 shares held directly by Ronald Benn, (b) 250,000 shares owned of record by Valdosta Corporation; (c) 100,000 shares of common stock issuable pursuant to warrants held of record by Capital House Corporation; and (d) 600,000 shares issuable upon exercise of options held directly by Ronald Benn. See footnotes (2) and (11).

The following table sets forth details regarding our common stock authorized for issuance under equity compensation plans as at March 30, 2007:

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 (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	7,000,000	\$ 0.50	1,697,698
Equity compensation plans not approved by security holders	--	--	--
Total	7,000,000	\$ 0.50	1,697,698

We have issued options pursuant to our Amended and Restated Incentive Equity Plan, which was adopted by our board of directors and became effective on May 30, 2003. The plan, as amended and restated, was approved by our stockholders on February 25, 2005. The amended and restated plan is administered by the board of directors, who has the authority to grant stock options and stock appreciation rights to our officers, employees and consultants. A total of 3,912,302 shares of common stock were reserved for issuance under the terms of the Amended and Restated Incentive Equity Plan. In the event of certain mergers, sales of assets, reorganizations, consolidations, recapitalizations, stock dividends or other changes in corporate structure affecting our common stock, the committee administering the plan must make an equitable substitution or adjustment in the aggregate number of shares reserved for issuance under the plan and in the number of shares exercisable under, and the exercise price of, outstanding options under the plan.

In respect of our Amended and Restated Incentive Equity Plan, we have granted options to purchase an aggregate of 3,912,302 shares of our common stock to non-employees in consideration for consulting services rendered. These options entitle the holders to purchase shares of common stock at an exercise price of \$0.33 per share. The options vested immediately upon their issuance, and are exercisable until May 7, 2008, provided the holder remains engaged by us as of that date, with provision for early forfeiture in the event the holder ceases to be engaged by us prior to the stated expiry date. Of the 3,912,302 options originally granted under this plan, none were exercised as of March 30, 2007, and 2,315,000 expired during the year ended December 31, 2005 on termination of the related consulting agreement, leaving 1,597,302 currently outstanding.

On December 15, 2004, the board of directors adopted the 2004 Incentive Equity Plan, which was approved by our stockholders on February 25, 2005. The 2004 Incentive Equity Plan is administered by the board of directors, who has the authority to grant stock options and stock appreciation rights to our officers, employees and consultants, and to establish the option vesting schedule. A total of 3,087,698 shares of common stock are reserved for issuance under the terms of the 2004 Incentive Equity Plan. In the event of certain mergers, sales of assets, reorganizations, consolidations, recapitalizations, stock dividends or other changes in corporate structure affecting our common stock, the committee administering the plan must make an equitable substitution or adjustment in the aggregate number of shares reserved for issuance under the plan and in the number of shares exercisable under, and the exercise price of, outstanding options under the plan.

In respect of our 2004 Incentive Equity Plan, we have granted options to purchase 2,850,000 shares of our common stock to employees and non-employees in consideration for services rendered and as incentives, entitling the holders to purchase shares of our common stock at exercise prices as follows: 75,000 at \$0.95; 325,000 at \$0.90; 400,000 at \$0.50; 1,950,000 at \$0.67; and 100,000 at \$0.225. 2,483,000 of these options vested on various dates between October 1, 2004 and January 1, 2006, and are exercisable until various dates between March 31, 2009 and December 31, 2010. Of the remaining 367,000 options granted to employees under this plan, 317,000 were forfeited due to the termination of the related employment agreement; and 50,000 have not yet vested, and will vest on dates between November 14, 2007 and November 14, 2008. All options granted under our 2004 Incentive Equity Plan include provision for early forfeiture in the event the holder ceases to be engaged by us prior to the stated expiry date. Of the 2,850,000 options originally granted under this plan, none were exercised as of March 30, 2007, and 1,442,000 had expired or had been forfeited as of that date on termination of the related employment or consulting agreement, leaving 1,408,000 currently outstanding.

**Item 12. Certain Relationships and Related Transactions.**

Included in accrued liabilities at December 31, 2006 is \$128,715 in accrued salaries payable to the directors and former director of the Corporation. Included in 12% promissory notes payable is \$7,902 payable to a company controlled by a director of the Corporation, and 18,438 payable to a director. Included in interest and finance charges for the year ended December 31, 2006 is \$221 in accrued interest charges relating to these notes.

Effective July 1, 2004, our company entered into an agreement to sublease excess office space to a related company. This other company is related to our company due to Ronald Benn being an officer and director of both companies. Included in accounts receivable at December 31, 2006 and 2005, is \$nil and \$5,508, respectively, in rent receivable pursuant to this sublease agreement. Sublease income for the years ended December 31, 2006 and 2005, respectively, of \$31,808 and \$29,709, has been recorded as a reduction of rental expense in the accounts of our company.

### Item 13. Exhibits

Exhibit No.	Document Description
3.1	Restated Articles of Incorporation (1)
3.2	Amendment to Articles of Incorporation (5)
3.3	By-Laws (2)
3.4	Amendment to By-Laws (1)
4.1	Form of Class B Warrants (2)
4.2	Form of Class E Warrants (1)
4.3	Form of Class F Warrants (1)
4.4	Form of Class G Warrants (1)
4.5	Form of Class H Warrants (1)
4.6	Form of Class I Warrants (3)
4.7	Form of Class J Warrants
4.8	Form of 12% Promissory Note (1)
4.9	Form of 4% Convertible Debenture (1)
4.10	Form of 10% senior secured convertible note and security agreement
10.1	Registration Rights Agreement, dated as of March 8, 2004 by and among the Company and each entity named on the signature page thereto (3)
10.2	Securities Purchase Agreement, dated as of March 8, 2004 by and among the Company and each entity named on the signature page thereto (3)
10.3	Securities Purchase Agreement in respect of the 4% Convertible Debenture, dated as of December 30, 2003 by and between Validian Corporation and each individual or entity named on a signature page thereto (1)
10.4	Registration Rights Agreement, dated as of December 30, 2004 by and between the Company and each entity named on the signature page thereto (1)
10.5	Amended and Restated Incentive Equity Plan (4)
10.6	Validian Corporation 2004 Incentive Equity Plan (4)
10.7	Commercial Lease dated April 15, 2004 between Validian Corporation and National Capital Commission (5)
10.8	Commercial Renewal Lease dated March 20, 2007
10.9	Employment Agreement with Andre Maisonneuve * (5)
10.10	Employment Agreement with Bruce Benn * (5)
10.10	Employment Agreement with Ronald Benn * (5)
21.1	List of Subsidiaries (5)
31.1	Certification of Chief Executive Officer Pursuant to Section 302
31.2	Certification of Chief Financial Officer Pursuant to Section 302
32.1	Certification of Chief Executive Officer Pursuant to Section 906
32.2	Certification of Chief Financial Officer Pursuant to Section 906

\* Denotes management contract

(1) Previously filed as an exhibit to our Annual Report on Form 10-KSB, SEC File No. 0-28423, filed with the Commission on March 30, 2004 and incorporated herein by reference.

(2) Previously filed as an Exhibit to our Registration Statement on Form 10-SB, SEC File No. 0-28423, filed with the Commission on December 9, 1999 and incorporated herein by reference.

(3) Previously filed as an Exhibit to our Current Report on Form 8-K, SEC File No. 0-28423, filed with the Commission on March 8, 2004 and incorporated herein by reference.

(4) Previously filed as an Exhibit to our Amended Proxy Statement, filed with the Commission on January 12, 2005 and incorporated herein by reference.

(5) Previously filed as an Exhibit to our Annual Report on Form 10-KSB for the year ended December 31, 2004, filed with the Commission on April 14, 2005 and incorporated herein by reference.



Statements contained in this Form 10-KSB as to the contents of any agreement or other document referred to are not complete, and where such agreement or other document is an exhibit to this Report or is included in any forms indicated above, each such statement is deemed to be qualified and amplified in all respects by such provisions.

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

The following table sets out fees billed by the Company's principal accountant for audit and related services for each of the previous two fiscal years:

<b>Description of services</b>	<b>Fees billed for 2006 fiscal year</b>	<b>Fees billed for 2005 fiscal year</b>
Audit fees	\$ 37,416	\$ 35,216
Audit-related fees	\$ 66,879	\$ 69,441

We do not currently have an audit committee, however it is our policy to have all audit and audit-related fees pre-approved by the board of directors. All of the above fees were pre-approved by the board of directors.

Audit-related fees were incurred in relation to our quarterly reports on Form 10-QSB and our Forms SB2, which were filed in connection with the registration of the common stock underlying our 4% senior subordinated convertible debentures and our private placement of common stock and warrants.

There were no tax-related fees incurred during the year.

## **SIGNATURES**

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, the small business issuer has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

### **VALIDIAN CORPORATION**

(Registrant)

By: /s/ Bruce Benn

Bruce Benn

President, Chief Executive Officer and director  
(principal executive officer)

Dated: May 29, 2007

By: /s/ Ronald Benn

Ronald Benn

Chief Financial Officer, Treasurer and director  
(principal financial and accounting officer)

Dated: May 29, 2007

## Exhibits.

Exhibit No.	Document Description
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3.3	By-Laws (2)
3.4	Amendment to By-Laws (1)
4.1	Form of Class B Warrants (2)
4.2	Form of Class E Warrants (1)
4.3	Form of Class F Warrants (1)
4.4	Form of Class G Warrants (1)
4.5	Form of Class H Warrants (1)
4.6	Form of Class I Warrants (3)
4.7	Form of Class J Warrants
4.8	Form of 12% Promissory Note (1)
4.9	Form of 4% Convertible Debenture (1)
4.10	Form of 10% Senior secured convertible note and security agreement
10.1	Registration Rights Agreement, dated as of March 8, 2004 by and among the Company and each entity named on the signature page thereto (3)
10.2	Securities Purchase Agreement, dated as of March 8, 2004 by and among the Company and each entity named on the signature page thereto (3)
10.3	Securities Purchase Agreement in respect of the 4% Convertible Debenture, dated as of December 30, 2003 by and between Validian Corporation and each individual or entity named on a signature page thereto (1)
10.4	Registration Rights Agreement, dated as of December 30, 2004 by and between the Company and each entity named on the signature page thereto (1)
10.5	Amended and Restated Incentive Equity Plan (4)
10.6	Validian Corporation 2004 Incentive Equity Plan (4)
10.7	Commercial Lease dated April 15, 2004 between Validian Corporation and National Capital Commission (5)
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10.10	Employment Agreement with Bruce Benn * (5)
10.11	Employment Agreement with Ronald Benn * (5)
21.1	List of Subsidiaries (5)
31.1	Certification of Chief Executive Officer Pursuant to Section 302
31.2	Certification of Chief Financial Officer Pursuant to Section 302
32.1	Certification of Chief Executive Officer Pursuant to Section 906
32.2	Certification of Chief Financial Officer Pursuant to Section 906

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\* Denotes management contract

(1) Previously filed as an exhibit to our Annual Report on Form 10-KSB, SEC File No. 0-28423, filed with the Commission on March 30, 2004 and incorporated herein by reference.

(2) Previously filed as an Exhibit to our Registration Statement on Form 10-SB, SEC File No. 0-28423, filed with the Commission on December 9, 1999 and incorporated herein by reference.

(3) Previously filed as an Exhibit to our Current Report on Form 8-K, SEC File No. 0-28423, filed with the Commission on March 8, 2004 and incorporated herein by reference.

(4) Previously filed as an Exhibit to our Amended Proxy Statement, filed with the Commission on January 12, 2005 and incorporated herein by reference.

(5) Previously filed as an Exhibit to our Annual Report on Form 10-KSB for the year ended December 31, 2004, filed with the Commission on April 14, 2005 and incorporated herein by reference.

**Exhibit 31.1**

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER,  
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Bruce Benn, of Validian Corporation, certify that:

- (1) I have reviewed this report on Form 10-KSB, as amended by this Amendment No. 1, on Form 10\_KSB/A, of Validian Corporation;
- (2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operation and cash flows of the small business issuer as of, and for, the periods presented in this report;
- (4) The small business issuer's other certifying officer(s) 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)) for the small business issuer and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the small business issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the small business issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report any change in the small business issuer's internal control over financial reporting that occurred during the small business issuer's most recent fiscal quarter (the small business issuer's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the small business issuer's internal control over financial reporting; and
- (5) The small business issuer's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer's auditors and the audit committee of the small business issuer's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the small business issuer'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 small business issuer's internal controls over financial reporting.

Date: May 29, 2007

**By: /s/ Bruce Benn**  
Bruce Benn  
Chief Executive Officer

**Exhibit 31.2**

**CERTIFICATION OF CHIEF FINANCIAL OFFICER,  
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Ronald Benn, of Validian Corporation, certify that:

- (1) I have reviewed this report on Form 10-KSB, as amended by this Amendment No. 1, on Form 10-KSB/A, of Validian Corporation;
- (2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operation and cash flows of the small business issuer as of, and for, the periods presented in this report;
- (4) The small business issuer's other certifying officer(s) 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)) for the small business issuer and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the small business issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the small business issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report any change in the small business issuer's internal control over financial reporting that occurred during the small business issuer's most recent fiscal quarter (the small business issuer's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the small business issuer's internal control over financial reporting; and
- (5) The small business issuer's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer's auditors and the audit committee of the small business issuer's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the small business issuer'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 small business issuer's internal controls over financial reporting.

Date: May 29, 2007

**By: /s/ Ronald Benn**  
Ronald Benn  
Chief Financial Officer

## **Exhibit 32.1**

### **CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to 18 U.S.C. Section 1350 (as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002), I, the undersigned Chief Executive Officer of Validian Corporation (the "Corporation"), hereby certify that, to the best of my knowledge, the Annual Report on Form 10-KSB of the Corporation, as amended by this Amendment No. 1 on Form 10-KSB/A, for the year ended December 31, 2006 (the "Report") fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in the Report fairly presents, in all material respects, the financial condition and results of the operation of the Corporation as of, and for, the periods presented in the Report. A signed original of this written statement required by Section 906 has been provided to the registrant and will be retained by it and furnished to the Securities and Exchange Commission or its staff upon request.

The foregoing certification is being furnished as an exhibit to the Form 10-KSB pursuant to Item 601(b)(32) of Regulation S-B and Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code) and, accordingly, is not being filed as part of the Form 10-KSB for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not incorporated by reference into any filing of the Company, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

Date: May 29, 2007

**By: /s/ Bruce Benn**

Bruce Benn

Chief Executive Officer

## **Exhibit 32.2**

### **CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to 18 U.S.C. Section 1350 (as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002), I, the undersigned Chief Financial Officer of Validian Corporation (the "Corporation"), hereby certify that, to the best of my knowledge, the Annual Report on Form 10-KSB of the Corporation, as amended by this Amendment No. 1 on Form 10-KSB/A, for the year ended December 31, 2006 (the "Report") fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in the Report fairly presents, in all material respects, the financial condition and results of the operation of the Corporation as of, and for, the periods presented in the Report. A signed original of this written statement required by Section 906 has been provided to the registrant and will be retained by it and furnished to the Securities and Exchange Commission or its staff upon request.

The foregoing certification is being furnished as an exhibit to the Form 10-KSB pursuant to Item 601(b)(32) of Regulation S-B and Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code) and, accordingly, is not being filed as part of the Form 10-KSB for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not incorporated by reference into any filing of the Company, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

Date: May 29, 2007

**By: /s/ Ronald Benn**  
Ronald Benn  
Chief Financial Officer