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

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO
SECTIONS 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

(Mark One)

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

or

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _________ TO __________

Commission file number 000-24389

VASCO DATA SECURITY INTERNATIONAL, INC.
(Exact Name of Registrant as Specified in Its Charter)

DELAWARE	36-4169320
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)

1901 SOUTH MEYERS ROAD, SUITE 210
OAKBROOK TERRACE, ILLINOIS 60181
(Address of Principal Executive Offices)(Zip Code)

Registrant's telephone number, including area code:
(630) 932-8844

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

Title of each class	Name of exchange on which registered
COMMON STOCK, PAR VALUE $.001 PER SHARE	NASDAQ CAPITAL MARKET

Securities registered pursuant to Section 12(g) of the Act:
NONE

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

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

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

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

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

Large accelerated filer [ ] Accelerated filer [X] Non-accelerated filer [ ]

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

As of June 30, 2006, the aggregate market value of voting and non-voting common equity (based upon the last sale price of the common stock as reported on Nasdaq on June 30, 2006) held by non-affiliates of the registrant was $219,815,000 at $8.35 per share.

As of February 28, 2007, there were 36,801,890 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE None.

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This report contains the following trademarks of the Company, some of which are registered: VASCO, VACMAN, Digipass, and Digipass Pack.

PART I

CAUTIONARY STATEMENT FOR PURPOSES OF THE "SAFE HARBOR" PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This Annual Report on Form 10-K, including "Management's Discussion and Analysis of Financial Condition and Results of Operations," contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 concerning, among other things, the prospects, developments and business strategies for the Company (as defined) and its operations, including the development and marketing of certain new products and the anticipated future growth in certain markets in which we currently market and sell our products or anticipate selling and marketing our products in the future. These forward-looking statements (i) are identified by their use of such terms and phrases as "expected," "expects," "believe," "believes," "will," "anticipated," "emerging," "intends," "plans," "could," "may," "estimates," "should," "objective" and "goals" and (ii) are subject to risks and uncertainties and represent our present expectations or beliefs concerning future events. We caution that the forward-looking statements are qualified by important factors that could cause actual results to differ materially from those in the forward-looking statements, including (a) risks of general market conditions, including demand for our products and services, competition and price levels and our historical dependence on relatively few products, certain suppliers and certain key customers, and (b) risks inherent to the computer and network security industry, including rapidly changing technology, evolving industry standards, increasing numbers of patent infringement claims, changes in customer requirements, price competitive bidding, changing government regulations and potential competition from more established firms and others. Therefore, results actually achieved may differ materially from expected results included in, or implied by, these statements.

ITEM 1 - BUSINESS

VASCO Data Security International, Inc. was incorporated in the State of Delaware in 1997 and is the successor to VASCO Corp., a Delaware corporation. Our principal executive offices are located at 1901 South Meyers Road, Suite 210, Oakbrook Terrace, Illinois 60181 and the telephone number at that address is (630) 932-8844. Our principal operations offices in Europe are located at Koningin Astridlaan 164, B-1780 Wemmel (Belgium) and the telephone number at that address is 32(0)2/609.97.00. We announced on February 27, 2007 that we would establish our European headquarters office in Zurich, Switzerland. Unless otherwise noted, references in this Annual Report on Form 10-K to "VASCO," "Company," "company," "we," "our," and "us" refer to VASCO Data Security International, Inc. and its subsidiaries.

Additional information on the Company, its products and its results, including the Company's annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed with the Securities and Exchange Commission, or "SEC" may be found on the Company's web site at www.vasco.com, free of charge.

GENERAL

We, through our operating subsidiaries, design, develop, market and support open standards-based hardware and software security systems that manage and secure access to information assets. We design, develop, market and support patented "Strong User Authentication" products for e-business and e-commerce. Our products enable secure financial transactions to be made over private enterprise networks and public networks, such as the Internet. Our Strong User Authentication is delivered via our hardware and software Digipass security products, (collectively "Digipasses") most of which incorporate an electronic signature capability, which guarantees the integrity of electronic transactions and data transmissions. Some of our Digipasses are compliant with the Europay MasterCard Visa ("EMV") standard and are compatible with MasterCard's and VISA's Chip Authentication Program (CAP). Some of our Digipass units are OATH compliant.

The backbone of our product range is VACMAN Controller. VACMAN Controller has been extended to support all VASCO authentication technologies, including passwords, dynamic password technology (Digipass), certificates and biometrics, on one unique platform. Our strategy is to become the full option, all-terrain authentication company.

For user access control, our VACMAN Middleware products limit application access to designated Digipass users. Digipass and VACMAN combine to provide greater flexibility and a more affordable means than competing products of authenticating to any network, including the Internet.

VASCO's product lines include:

- (VACMAN LOGO) VACMAN: Core authentication platform, combining all technologies on one unique platform;

- (IDENTIKEY LOGO) IdentiKey: VASCO's authentication server, combining the VACMAN core authentication platform with full server functionality;

- (AXS GUARD LOGO) aXs GUARD: Leading authentication appliance services, combining Identikey with a wide variety of Internet communication solutions;

- (DIGIPASS LOGO) Digipass: A suite of over 50 multi-application client e-signature software products, based on the world's most widely spread electronic client platforms;

- (DIGIPASSPLUS LOGO) DigipassPlus: Authentication Services. Combines all VASCO products and solutions in an outsourced service offering. VASCO also offers related services under the DigipassPlus label, such as Fraud Detection and Analysis and the brand new VASCO Video Training.

Our target markets are the applications and their several hundred million users that utilize fixed passwords as security. Our event and time-based system generates a "one-time" password that changes with every use. As a result, when compared to fixed passwords, it substantially reduces the risk of unauthorized access to the application.

As of December 31, 2006, we had shipped approximately 32 million Digipass units since our inception. Our security solutions are sold worldwide through our direct sales force, as well as through distributors, resellers and systems integrators. We currently have more than 4,250 customers in more than 100 countries. Representative customers of our products include HSBC, Rabobank Nederland, ING Bank, Fortis Bank, Wachovia, Daimler Chrysler, Volvo and CoStar Group. In 2006, we sold to 1,553 new accounts of which 233 were banks and 1,320 were Enterprise Security customers. For full year 2005, we sold 821 new accounts including 89 new banks and 732 new Corporate Network Access accounts.

OUR BACKGROUND

Our predecessor company, VASCO Corp., entered the data security business in 1991 through the acquisition of a controlling interest in ThumbScan, Inc., which we renamed VASCO Data Security, Inc. in 1993. In 1996, we began an expansion of our computer security business by acquiring Lintel Security NV/SA, a Belgian corporation, which included assets associated with the development of security tokens and security technologies for personal computers and computer networks. In addition, in 1996, we acquired Digipass NV/SA, a Belgian corporation, which was also a developer of security tokens and security technologies and whose name we changed to VASCO Data Security NV/SA in 1997.

On March 11, 1998, we completed a registered exchange offer with the holders of the outstanding securities of VASCO Corp. Since the exchange offer, we have engaged in seven acquisitions and one disposition. Two of the acquisitions were in 2006.

On May 11, 2006, we acquired all of the shares of Logico Smart Card Solutions GmbH and its subsidiary, Logico Vertriebs GmbH, an authentication specialist located in Austria, with extensive experience in smart card operating systems. The aggregate cash purchase price was $2.2 million.

On October 25, 2006, we acquired the stock of Able NV, (Able), a Unified Threat Management (UTM) specialist located in Mechelen, Belgium. Able's key product is the aXs GUARD appliance, which combines 21 different applications for Internet security, including Digipass strong user authentication, VPN, firewall, anti-virus, hacker detection, statistics reporting, content scanning and more. The cost of the Able acquisition was $6.3 million in cash.

INDUSTRY BACKGROUND

The growth in electronic banking and electronic commerce, and the increasing use and reliance upon proprietary or confidential information by businesses, government and educational institutions that is remotely accessible by many users, has made information security a paramount concern. We believe that enterprises are seeking solutions that will continue to allow them to expand access to data and financial assets while maintaining network security.

Internet and Enterprise Security. With the advent of personal computers and distributed information systems in the form of wide area networks, intranets, local area networks and the Internet, as well as other direct electronic links, many organizations have implemented applications to enable their work force and third parties, including vendors, suppliers and customers, to access and exchange data and perform electronic transactions. As a result of the increased number of users having direct and remote access to such enterprise applications, data and financial assets have become increasingly vulnerable to unauthorized access and misuse.

Individual User Security. In addition to the need for enterprise-wide security, the proliferation of personal computers, personal digital assistants and mobile telephones in both the home and office settings, combined with widespread access to the Internet, have created significant opportunities for electronic commerce by individual users such as electronic bill payment, home banking and home shopping.

Fueled by well-publicized incidents, including misappropriation of credit card information and denial of service attacks, there is a growing perception among many consumers that there is a risk involved in transmitting information via the Internet. These incidents and this perception may hamper the development of consumer-based electronic commerce. Accordingly, we believe that electronic commerce will benefit from the implementation of improved security measures that accurately identify users and reliably encrypt data transmissions over the Internet. Many banks in European countries began to issue smart cards (credit cards with a micro-chip) that are compliant with the EMV standard in 2005.

Worldwide, more governments are issuing guidance for online banking security. For example, the Hong Kong Monetary Authority (HKMA), the Hong Kong Association of Banks (HKAB) and the Hong Kong Police Force (HKPF) jointly issued the following statement regarding the use of two-factor authentication for Internet banking:

"In view of the increasing acceptance of Internet banking services and the growing sophistication of Internet banking frauds, the banking industry in Hong Kong reached a general consensus in June 2004 to implement two-factor authentication for high-risk retail Internet banking transactions. Banks offering high-risk retail Internet banking transactions will have two-factor authentication ready for their customers by June 2005. Customers will need to adopt two-factor authentication if they wish to conduct those transactions."

In October 2005, in the U. S., the Federal Financial Institutions Examination Council (FFIEC) issued guidance for Strong Authentication/Two Factor Authentication in the Internet banking environment. Financial institutions were expected to achieve compliance by year-end 2006.

Components of Security. Data and financial asset security, and secured access to and participation in online commerce, generally consist of the following components:

- Encryption: Maintains data privacy by converting information into an unreadable pattern and allowing only authorized parties to decrypt the data. Encryption can also maintain data integrity by creating digital signatures for transmitted data, enabling the recipient to check whether the data has been changed since or during transmission.

- Identification and Authentication: Serves as the foundation for other security mechanisms by verifying that a user is who he or she claims to be. Identification and authentication mechanisms are often employed with encryption tools to authenticate users, to determine the proper encryption key for encrypting/decrypting data, or to enable users to digitally "sign" or verify the integrity of transmitted data.

- Access Control: Software that provides authentication, authorization, and accounting functions, controlling a user's access to only that data or the financial assets which he or she is authorized to access, and that keeps track of a user's activities after access has been granted.

- Administration and Management Tools: Software that sets, implements, and monitors security policies, the access to which is typically regulated by access control systems. These tools are extremely important to the overall effectiveness of a security system.

The most effective security policies employ most, if not all, of the above components. Many companies, however, only implement a patchwork of these components, which could result in their security systems being compromised.

OUR SOLUTION

We have found that, to date, most approaches to network security, including Internet security, have been limited in scope and have failed to address all of the critical aspects of data security. We believe that an effective enterprise-wide solution must address and assimilate issues relating to the following:

- Speed and ease of implementation, use and administration;

- Reliability;

- Interoperability with diverse enterprise environments, existing customer applications and the security infrastructure;

- Scalability; and

- Overall cost of ownership.

Accordingly, we have adopted the following approach to data security:

- In designing our products, we have sought to incorporate industry-accepted, open and non-proprietary protocols. This permits interoperability between our products and the multiple platforms, products and applications widely in use.

- We have designed our products and services to minimize their integration effort with, and disruption of, existing legacy applications and the security infrastructure. We provide customers with easier implementations and a more rapid means of implementing security across the enterprise, including the Internet. With security being a critical enabling technology for on-line business initiatives, speed and ease of security implementation has become crucial to an organization's success.

- We design our products and services to have a more attractive total cost of ownership than competing products and services. We have found that product improvements and tools that lower a customer's total cost of ownership create differentiating sales and marketing tools and also help in the development of a highly loyal customer base that is open to new solutions that we offer.

As a result of this approach, we believe that we are positioned to be the leading provider of strong software and hardware authentication security solutions for all types of on-line, risk-based transactions.

OUR STRATEGY

We believe we have one of the most complete lines of security products and services for Strong User Authentication available in the market today and we also believe that we are the leading worldwide provider of these products and services. A key element of our growth strategy is to demonstrate to an increasing number of distributors, resellers and systems integrators that, by incorporating our security products into their own products, they can more effectively differentiate themselves in their marketplaces and increase the value of their products. In addition, we will demonstrate to our corporate users that our products provide mission critical security to their internal and external security infrastructures. Following this active marketing and promotion effort, we will work with these resellers and integrators to support their sales of solutions that include our products. Also, we plan to expand our direct sales marketing program to new and existing blue chip customers. Further, we intend to:

Increase Sales and Marketing Efforts Worldwide. We intend to increase sales of our security products and services in our established European markets and to actively increase our sales and support presence and marketing efforts in North America, South America, Asia/Pacific, Australia and the Middle East. We plan to:

- Be the full option, all-terrain authentication company by offering our customers a solution with VACMAN Controller as the core and the backbone, encompassing all four authentication technologies (passwords, dynamic password technologies, certificates and biometrics);

- Market new services and products to our existing customers by providing testimonial evidence of user experiences from other customers;

- Maintain a marketing campaign in Europe, the Middle East, North America and Asia to raise awareness of our solutions among the distributors and resellers of popular third party software products and to establish relationships with them whereby they become resellers of our products and solutions;

- Form additional strategic relationships with resellers and vendors of complementary, innovative security products and systems; and

- Develop a marketing and sales infrastructure, largely in the form of new resellers, distributors, and solution providers, in new markets.

Continue Innovation. We intend to continue to enhance and broaden our line of security products to meet the changing needs of our existing and potential customers by:

- Building on our core software and hardware security expertise, such as expanding our technology and services for use on different platforms (like mobile phones and personal digital assistants);

- Acquiring complementary technologies or businesses; and

- Developing additional applications for our products in areas that may include securing the exchange of data in the business-to-business field and providing security for Internet gambling and lottery transactions, among others.

OUR PRODUCTS

VACMAN Product Line

The VACMAN Product line incorporates a range of strong authentication utilities and solutions designed to allow organizations to add Digipass strong authentication into their existing networks and applications.

In order to provide the greatest flexibility, while not compromising on functionality or security, VACMAN solutions are designed to integrate with most popular hardware and software. Once integrated, the VACMAN components become largely transparent to the users, minimizing rollout and support issues.

VACMAN Controller

VACMAN Controller is the backbone of VASCO's product strategy towards the banking and e-commerce markets. VACMAN Controller is natively embedded in or compatible with the solutions of over 100 VASCO solution partners.

Designed by specialists in "system entry" security, VACMAN Controller makes it easy to administer a high level of access control. The user simply adds a field to his or her existing user database, describing the unique Digipass token assigned to the user. VACMAN Controller takes it from there, automatically authenticating the logon request using the security sequence the user specifies, whether it's a one-time password using either response-only or a challenge/response authentication scheme or an electronic signature.

VACMAN Controller allows the user the freedom to provide secure remote access to virtually any type of application. VACMAN Controller is a library requiring only a few days to implement in most systems and supports all Digipass functionality. Once linked to an application, VACMAN Controller automatically handles login requests from any users authorized to have a Digipass.

VACMAN Middleware

For organizations of all sizes that need to authenticate remote users for access to enterprise networks and its applications, VACMAN Middleware is a software suite, used to verify authentication requests and to centrally administer user authentication policies. Unlike other authentication solutions, VACMAN Middleware -together with VASCO's DIGIPASS family- provides affordable strong authentication and secure access to web applications, business applications and VPN (virtual private networks).

VACMAN Middleware in combination with DIGIPASS authenticators eliminates the weakest link in any security structure, the use of static passwords. It's a turnkey solution that can be up and running in minutes, not hours or weeks.

The main authentication tool in a VACMAN Middleware enabled infrastructure remains the Active Directory service. The storage of the DIGIPASS related data is linked with the users in the Active Directory. As a result, a scalable approach is achieved and an optimal support is provided for multiple domains and delegated administration. VACMAN Middleware supports ODBC compliant databases, such as Oracle 9i, Microsoft SQL server 2000 and 2005, IBM DB2 8.1, Sybase Adaptive Server Anywhere 9.0 and PostgreSQL 8.0 and 8.1. VACMAN Middleware is standard delivered with PostgreSQL.

The audit console monitors incoming and outgoing radius and web traffic (or any other events) on the VACMAN Middleware server. The audit console presents all the statistical information you need to manage your remote access environment - providing details on events that have occurred since VACMAN Middleware started running, including:

- connection period
- number of information messages
- warnings
- errors and fatal errors

There are no hardware or software conflicts to worry about because VACMAN Middleware uses a non intrusive method of enabling DIGIPASS authentication. Simply place VACMAN Middleware between the Network Access Server and your existing radius server - without affecting the performance of either.

Digipass Product Line

Our Digipass product line, which exists as a family of authentication devices as well as extensive software libraries, provides a flexible and affordable means of authenticating users to any network, including the Internet.

Security can be broken into three factors:

- What the user has (the Digipass itself, in either hardware or software version);
- What the user knows (the PIN code to activate the Digipass); and
- Who the user is (biometrics).

The Digipass family is currently based on the first two factors. Using the Digipass system, in order to enter a remote system or to digitally sign data, the user needs the:

- Software and Hardware client authentication device (Digipass) itself so that if he or she does not physically have the device, he or she will not be able to log on to the system; and
- PIN code for the Digipass so if the user does not know the appropriate code, he or she will not be able to use the applications stored inside.

Both of these factors help to make sure that a natural person is authenticating (or signing), instead of a computer or another device. These factors also enable very high portability for security anytime, anywhere and anyhow.

Digipasses calculate dynamic signatures and passwords, also known as one-time passwords, to authenticate users on a computer network and for a variety of other applications. There are over 50 models of the Digipass, each of which has its own distinct characteristics depending on the platform that it uses and the functions it performs. However, the Digipass family is designed to work together and customers can switch their users' devices without requiring any changes to the customers' existing infrastructure. In addition, these devices can be used to calculate digital signatures, also known as electronic signatures or message authentication codes, to protect electronic transactions and the integrity of the contents of such transactions.

In addition, Digipass technology is designed to operate on non-VASCO platforms such as a desktop PC or laptop. Digipass technology is also available for personal digital assistants (PDA), mobile phones and smart cards.

For users of mobile phones, the virtual Digipass generates one-time passwords that are sent to the mobile telephone user by SMS (Short Messaging System).

Other technologies such as paper based authentication (TAN lists) are successfully created in the Digipass family, always based on the same back-end VACMAN core technology.

Digipass technology also combines the benefits of traditional password authenticators (authentication and digital signatures) with smart card readers. Together, they bring portability to smart cards and allow secure time-based algorithms.

Finally, the Digipass technology is also available in a Web browser based version. The Digipass for Web is the ideal product to replace a password-based security or paper based authentication system with a security system leveraging strong authentication, to achieve a higher security level. Digipass for Web supports user authentication, transaction signing and document signing. No software installation is required on the end-user's PC.

A VASCO-secured system has the features needed to secure both today's and tomorrow's IT resources.

DIGIPASS AT WORK

(GRAPHIC)

The above illustration shows the various steps in the Digipass authentication process. In the first step, the devices are initialized with their unique set of secrets and keys per device. These secrets are stored in an encrypted way on a compact disk or diskette that is sent to the application owner (for example, the information technology manager in an organization or the security department of a bank). These compact disks or diskettes are one way of safely transporting the Digipass secrets to the host computer.

The files on CD, Memory Stick or diskettes will be used to read all the necessary secrets and other data from the delivered Digipasses into a database. Then the application owner will assign the Digipass units to the end-users. This assignment is based on the serial number of the Digipass and the identity of the end-user. The Digipass is then shipped to the end-user along with a user manual. The protected PIN-code is sent to the end user in a separate shipment on a secure PIN-mailer.

Using a Digipass requires a connection to the host (server) computer that knows the parameters of the end-user's Digipass. Every time the user sends a dynamic password or digital signature to the host computer, the computer will retrieve all the necessary information from the database and will check the validity of the password or signature. After the host has checked the validity of the dynamic password or signature, it will notify the end-user of the correctness or incorrectness of the validity check.

Digipass security devices are not terminal dependent and do not require any specific software platform since they only interact with a person.

Currently, the Digipass is used in a wide variety of applications, the largest of which is banking. Banking applications include:

- Corporate banking through direct dial-up, as well as over the Internet, and

- Retail banking to secure transactions made through the use of a dial-up connection with a personal computer, the traditional phone system, the Internet, wireless phones and other communication devices such as personal digital assistants.

Another significant application for the Digipass is to secure access to corporate networks for home-based, traveling and other remote users. Finally, Digipasses are increasingly being used in a variety of e-commerce applications where the user is part of a pre-defined user group. We intend to expand the use of the Digipass to other groups of users and applications, including electronic commerce transactions directed at the general public.

Digipass Pack

Two Digipass Packs are available in two basic packs and one advanced pack. The advanced pack is combination of both basic packs.

DIGIPASS basic pack OTP

DIGIPASS basic pack OTP is a security software solution that provides two factor authentication based on One-Time-Passwords. DIGIPASS basic pack replaces the single-factor login sequence of typing username and password with a proven security technology: strong two-factor authentication. The DIGIPASS solution requires authorized users to demonstrate that they possess both the DIGIPASS Go3 device (by typing the One-Time-Password generated by the Go3) and that they know a secret - a unique PIN-code. This two-factor authentication technology works perfectly with RADIUS based remote VPN.

DIGIPASS basic pack OTP is delivered in a box comprising 5 units of DP Go3 and 5 end user licenses for DIGIPASS for RADIUS.

DIGIPASS basic pack SPS

DIGIPASS basic pack SPS is a security software solution that provides two factor authentication based on strong passwords stored securely on smart cards. DIGIPASS basic pack replaces the single-factor login sequence of typing username and password with a proven security technology: strong two-factor authentication. The DIGIPASS solution requires authorized users to demonstrate that they possess both the DIGIPASS smart cards (by inserting the smart card into the smart card reader) and that they know a secret - a unique PIN-code. This two-factor authentication technology works perfectly with e.g. Windows(R) operating systems.

DIGIPASS basic pack SPS is delivered in a box comprising 5 units of DP 860 (smart card reader), 5 DIGIPASS smart cards and 5 end user licenses for DP Windows Logon.

DIGIPASS advanced pack

DIGIPASS advanced pack is a security software solution that provides two factor authentication based on One-Time-Passwords and strong static passwords stored securely on smart cards depending what technology is more appropriate. DIGIPASS advanced pack replaces the single-factor login sequence of typing username and password with a proven security technology: strong two-factor authentication. The DIGIPASS solution requires authorized users to demonstrate that they possess both a DIGIPASS identity device (either by typing the One-Time-Password generated by the Go3 or by inserting the smart card into the smart card reader) and that they know a secret - a unique PIN-code. This two-factor authentication technology works perfectly with e.g. Windows(R) operating systems or any RADIUS compliant VPN client.

DIGIPASS advanced pack is delivered in a box comprising 5 units of DP 860, 5 end user licenses for DP Windows Logon and 5 end user licenses for DIGIPASS software for RADIUS.

INTELLECTUAL PROPERTY AND PROPRIETARY RIGHTS AND LICENSES

We rely on a combination of patent, copyright, trademark and trade secret laws, as well as employee and third-party non-disclosure agreements to protect our proprietary rights. In particular, we hold several patents in the U. S. and in certain European countries, which cover multiple aspects of our technology. These patents expire between 2007 and 2022. In addition to the issued patents, we also have several patents pending in the U. S. and other countries. The majority of our issued and pending patents cover our Digipass family. We believe these patents to be valuable property rights and we rely on the strength of our patents and on trade secret law to protect our intellectual property rights. To the extent that we believe our patents are being infringed upon, we intend to assert vigorously our patent protection rights, including but not limited to, pursuing all available legal remedies.

RESEARCH AND DEVELOPMENT

Our research and development efforts historically have been, and will continue to be, concentrated on product enhancement, new technology development and related new product introductions. We employ a team of full-time engineers and, from time to time, also engage independent engineering firms to conduct non-strategic research and development efforts on our behalf. We recorded $5.5 million, $3.6 million and $2.4 million for fiscal years ended December 31, 2006, 2005 and 2004, respectively, on company-sponsored research and development.

PRODUCTION

Our security hardware Digipasses are manufactured by third parties pursuant to purchase orders that we issue. Our hardware Digipasses are made primarily from commercially available electronic components that are purchased globally. Our software products, including software versions of our Digipasses are produced either in-house or by several outside sources primarily in Australia and Europe.

Hardware Digipasses utilize commercially available programmable microprocessors, or chips. We use a limited number of microprocessors, made by Samsung, for the various hardware products we produce. The Samsung microprocessors are purchased from Samsung Semiconductor in France. The microprocessors are the only components of our security tokens that are not commodity items readily available on the open market.

Orders of microprocessors generally require a lead-time of 12-16 weeks. We attempt to maintain a sufficient inventory of all parts to handle short-term increases in orders. Large orders that would significantly deplete our inventory are typically required to be placed with more than 12 weeks of lead-time, allowing us to attempt to make appropriate arrangements with our suppliers.

We purchase the microprocessors and arrange for shipment to third parties for assembly and testing in accordance with our design specifications. Our Digipass products are assembled by one of three independent companies with headquarters in Hong Kong and production facilities in China. Purchases from these companies are made on a volume purchase order basis. These companies commit to very high production standards, and as a result, they also have major production contracts with companies such as Sony and Samsung. Equipment designed to test product at the point of assembly is supplied by us and periodic visits are made by our personnel for purposes of quality assurance, assembly process review and supplier relations.

COMPETITION

The market for computer and network security solutions is very competitive and, like most technology-driven markets, is subject to rapid change and constantly evolving products and services. Our main competitor is RSA Security, a subsidiary of EMC Corporation. Additional competitors are ActivIdentity, Xiring, Todos Data Systems and Kobil Systems. There are many other companies such as Secure Computing, SafeNet, Entrust, and Aladdin Knowledge Systems that offer authentication hardware, software and services that range from simple locking mechanisms to sophisticated encryption technologies. We believe that competition in this market is likely to intensify as a result of increasing demand for security products.

We believe that the principal competitive factors affecting the market for computer and network security products include the strength and effectiveness of the solution, technical features, ease of use, quality/reliability, customer service and support, name recognition, customer base, distribution channels and the total cost of ownership of the authentication solution. Although we believe that our products currently compete favorably with respect to such factors, other than name recognition in certain markets, there can be no assurance that we can maintain our competitive position against current and potential competitors, especially those with significantly greater financial, marketing, service, support, technical and other competitive resources.

Some of our present and potential competitors have significantly greater financial, technical, marketing, purchasing and other resources than we do, and as a result, may be able to respond more quickly to new or emerging technologies and changes in customer requirements, or to devote greater resources to the development, promotion and sale of products, or to deliver competitive products at a lower end-user price. Current and potential competitors have established or may establish cooperative relationships among themselves or with third parties to increase the ability of their products to address the needs of our prospective customers. It is possible that new competitors or alliances may emerge and rapidly acquire significant market share. Accordingly, VASCO has, and will continue to forge its own partnerships to offer a broader range of products and capabilities to the market.

Our products are designed to allow authorized users access to a computing environment, in some cases using patented technology as a replacement for the static password. Although certain of our security token technologies are patented, there are other organizations that offer token-type password generators incorporating challenge-response or response-only approaches that employ different technological solutions and compete with us for market share.

SALES AND MARKETING

Our security solutions are sold through our direct sales force, as well as through 52 distributors, their reseller networks and systems integrators. A sales staff of 49 coordinates our sales activity through both our sales channels and our strategic partners' sales channels and makes direct sales calls either alone or with sales personnel of vendors of computer systems. Our sales staff also provides product education seminars to sales and technical personnel of vendors and distributors with whom we have working relationships and to potential end-users of our products.

Part of our expanded selling effort includes approaching our existing strategic partners to find additional applications for our security products. In addition, our marketing plan calls for the identification of new business opportunities that may require enhanced security over the transmission of electronic data or transactions where we do not currently market our products. Our efforts also include the preparation and dissemination of white papers prepared by our support engineers that explain how we believe our security products can add value or otherwise be beneficial.

CUSTOMERS AND MARKETS

Customers for our products include some of the world's most recognized names: HSBC, Rabobank, ING Bank, Fortis Bank, Wachovia, Daimler Chrysler, Volvo and CoStar Group. In 2006, we announced numerous new customers around the world including, but not limited to Dexia (Belgium),Citibank (U.S.), Banco Bradesco (Brazil), Garanti Bank (Turkey) and Postfinance (Switzerland).

For the years 2006, 2005, and 2004, our top 10 customers contributed 49%, 64% and 60%, respectively, of total worldwide revenues. Sales to HSBC exceeded 10% of our total sales in 2006. Sales to Rabobank Nederland and HSBC each exceeded 10% of our revenue in 2005. Rabobank Nederland, Ementor and Fortis Bank each exceeded 10% of our revenue in 2004. The loss of any of these customers could result in a significant loss in revenues and could have a material adverse effect on our results of operations and financial condition.

A significant portion of our sales is denominated in foreign currencies and changes in exchange rates could impact results of operations. To minimize exposure to risks associated with fluctuations in currency exchange rates, we attempt to denominate an amount of billings in a currency such that it would provide a hedge against operating expenses being incurred in that currency. For additional information regarding how currency fluctuations can affect our business, please refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Quantitative and Qualitative Disclosures about Market Risk".

We also experience seasonality in our business. These seasonal trends are most notable in the summer months, particularly in Europe, when many businesses defer purchase decisions.

VASCO is active in four vertical markets:

- Banking and Finance: Our traditional stronghold where we are still growing rapidly.

- Enterprise Security: Our second market that has grown into a robust source of revenue.

- E-commerce: Both business-to-business and business-to-consumer e-commerce are becoming ever more important for VASCO.

- E-government: Our revenue in this market is still small, but we are ready to take advantage of the market's evolution.

Our channel partners are critical to our success in the Enterprise Security markets. VASCO serves this market exclusively via its two-tier indirect sales channel. VASCO trains employee of its resellers and distributors on-site and in the VASCO offices. In addition, VASCO has developed online video training software, allowing us to train people worldwide, resulting in cost and time benefits.

VASCO invests in and supports its channel with marketing and public relations actions. Distributors and resellers get the tools they need to be successful, such as campaigns, case studies, marketing funds and more. We expect our Enterprise Security market to become even more successful in the future.

FINANCIAL INFORMATION RELATING TO FOREIGN AND DOMESTIC OPERATIONS

See Note 13 to VASCO Notes to Consolidated Financial Statements for a breakdown of revenues and long-lived assets between U.S. and foreign operations.

EMPLOYEES

As of December 31, 2006, we had 184 full time employees. Of these, 22 were located in North America, 137 were located in Europe, 17 were located in Australia and 8 located in Asia. Of the total, 98 were involved in sales, marketing and customer support, 63 in research and development and 23 in general and administration.

ITEM 1A - RISK FACTORS

RISK FACTORS

You should carefully consider the following risk factors, which we consider the most significant, as well as other information contained in this Annual Report on Form 10-K. In addition, there are a number of less significant and other general risk factors that could affect our future results. If any of the events described in the risk factors were to occur, our business, financial condition or operating results could be materially and adversely affected.

RISKS RELATED TO OUR BUSINESS

WE HAD A HISTORY OF OPERATING LOSSES AND HAVE A LARGE ACCUMULATED DEFICIT.

Although we have reported net income of $12,587,000, $7,701,000 and $3,253,000 for the years ended December 31, 2006, 2005 and 2004, respectively, our accumulated deficit was $20,398,000 at December 31, 2006.

OUR REVENUE AND CASH RECEIPTS MAY NOT BE SUFFICIENT TO MEET THE OPERATING NEEDS OF OUR BUSINESS.

Our revenue and cash receipts may not be sufficient to meet the operating needs of the business. If this is the case, we may need to significantly reduce our workforce, sell certain of our assets, enter into strategic relationships or business combinations, discontinue some or all of our operations, or take other similar restructuring actions. While we expect that these actions would result in a reduction of recurring costs, they may also result in a reduction of recurring revenues and cash receipts. It is also likely that we would incur substantial non-recurring costs to implement one or more of these restructuring actions.

THE SALES CYCLE FOR OUR PRODUCTS AND TECHNOLOGY IS LONG, AND WE MAY INCUR SUBSTANTIAL EXPENSES FOR SALES THAT DO NOT OCCUR WHEN ANTICIPATED.

The sales cycle for our products, which is the period of time between the identification of a potential customer and completion of the sale, is typically lengthy and subject to a number of significant risks over which we have little control. If revenue falls significantly below anticipated levels, our business would be seriously harmed.

A typical sales cycle in the Banking market is often three to six months and with larger Banking transactions can be eighteen months or more. Purchasing decisions for our products and systems may be subject to delay due to many factors that are not within our control, such as:

- The time required for a prospective customer to recognize the need for our products;

- The significant expense of many data security products and network systems;

- Customers' internal budgeting processes; and

- Internal procedures customers may require for the approval of large purchases.

WE HAVE A GREAT DEPENDENCE ON A LIMITED NUMBER OF SUPPLIERS AND THE LOSS OF THEIR MANUFACTURING CAPABILITY COULD MATERIALLY IMPACT OUR OPERATIONS.

In the event that the supply of components or finished products is interrupted or relations with any of our principal vendors is terminated, there could be a considerable delay in finding suitable replacement sources to manufacture our products at the same cost or at all. The majority of our products are manufactured by four independent vendors, one headquartered in Europe and the other three in Hong Kong. Our hardware Digipasses are assembled at facilities in mainland China. The importation of these products from China exposes us to the possibility of product supply disruption and increased costs in the event of changes in the policies of the Chinese government, political unrest or unstable economic conditions in China or developments in the United States that are adverse to trade, including enactment of protectionist legislation.

WE HAVE A SIGNIFICANT DEPENDENCE ON MAJOR CUSTOMERS AND LOSING ANY OF THESE CUSTOMERS COULD RESULT IN A SIGNIFICANT LOSS IN REVENUES.

If we don't find other customers who generate significant future revenues, the unforeseen loss of one or more of our major customers, or the inability to maintain reasonable profit margins on sales to any of these customers, would have a material adverse effect on our results of operations and financial condition.

OUR SUCCESS DEPENDS ON ESTABLISHING AND MAINTAINING STRATEGIC RELATIONSHIPS WITH OTHER COMPANIES TO DEVELOP, MARKET AND DISTRIBUTE OUR TECHNOLOGY AND PRODUCTS AND, IN SOME CASES, TO INCORPORATE OUR TECHNOLOGY INTO THEIR PRODUCTS.

Part of our business strategy is to enter into strategic alliances and other cooperative arrangements with other companies in our industry. We currently are involved in cooperative efforts with respect to the incorporation of our products into products of others, research and development efforts, marketing efforts and reseller arrangements. None of these relationships are exclusive, and some of our strategic partners also have cooperative relationships with certain of our competitors. If we are unable to enter cooperative arrangements in the future or if we lose any of our current strategic or cooperative relationships, our business could be harmed. We do not control the time and resources devoted to such activities by parties with whom we have relationships. In addition, we may not have the resources available to satisfy our commitments, which may adversely affect these relationships. These relationships may not continue, may not be commercially successful, or may require our expenditure of significant financial, personnel and administrative resources from time to time. Further, certain of our products and services compete with the products and services of our strategic partners.

ANY ACQUISITIONS WE MAKE COULD DISRUPT OUR BUSINESS AND HARM OUR FINANCIAL CONDITION.

We may make investments in complementary companies, products or technologies. Should we do so, our failure to successfully manage future acquisitions could seriously harm our operating results. In the event of any future purchases, we will face additional financial and operational risks, including:

- Difficulty in assimilating the operations, technology and personnel of acquired companies;

- Disruption in our business because of the allocation of resources to consummate these transactions and the diversion of management's attention from our existing business;

- Difficulty in retaining key technical and managerial personnel from acquired companies;

- Dilution of our stockholders, if we issue equity to fund these transactions;

- Assumption of operating losses, increased expenses and liabilities; and

- Our relationships with existing employees, customers and business partners may be weakened or terminated as a result of these transactions.

RISKS RELATED TO THE MARKET

WE FACE SIGNIFICANT COMPETITION AND IF WE LOSE OR FAIL TO GAIN MARKET SHARE OUR FINANCIAL RESULTS WILL SUFFER.

The market for computer and network security products is highly competitive. Our competitors include organizations that provide computer and network security products based upon approaches similar to and different from those that we employ such as RSA Security (recently acquired by EMC Corporation), ActivIdentity, Xiring, Todos Data Systems and Kobil Systems. Many of our competitors have significantly greater financial, marketing, technical and other competitive resources than we do. As a result, our competitors 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.

WE MAY NEED ADDITIONAL CAPITAL IN THE FUTURE AND OUR FAILURE TO OBTAIN CAPITAL WOULD INTERFERE WITH OUR GROWTH STRATEGY.

Our ability to obtain financing will depend on a number of factors, including market conditions, our operating performance and investor interest. These factors may make the timing, amount, terms and conditions of any financing unattractive. They may also result in our incurring additional indebtedness or accepting stockholder dilution. If adequate funds are not available or are not available on acceptable terms, we may have to forego strategic acquisitions or investments, defer our product development activities, or delay the introduction of new products.

WE EXPERIENCE VARIATIONS IN QUARTERLY OPERATING RESULTS AND ARE SUBJECT TO SEASONALITY, BOTH OF WHICH MAY RESULT IN A VOLATILE STOCK PRICE.

In the future, as in the past, our quarterly operating results may vary significantly resulting in a volatile stock price. Factors affecting our operating results include:

- The level of competition;

- The size, timing, cancellation or rescheduling of significant orders;

- New product announcements or introductions by competitors;

- Technological changes in the market for data security products including the adoption of new technologies and standards;

- Changes in pricing by competitors;

- Our ability to develop, introduce and market new products and product enhancements on a timely basis, if at all;

- Component costs and availability;

- Our success in expanding our sales and marketing programs;

- Market acceptance of new products and product enhancements;

- Changes in foreign currency exchange rates; and

- General economic trends.

We also experience seasonality in all markets. These seasonal trends are most notable in the summer months, particularly in Europe, when many businesses defer purchase decisions.

A SMALL GROUP OF PERSONS CONTROL A SUBSTANTIAL AMOUNT OF OUR COMMON STOCK AND COULD DELAY OR PREVENT A CHANGE OF CONTROL.

Our Board of Directors, our officers and their immediate families and related entities beneficially own approximately 28.6%, with Mr. T. Kendall Hunt controlling approximately 26.7%, of the outstanding shares of our common stock. As the Chairman of the Board of Directors and our largest stockholder, Mr. Hunt may exercise substantial control over our future direction and operation and such concentration of control may have the effect of discouraging, delaying or preventing a change in control and may also have an adverse effect on the market price of our common stock.

OUR STOCK PRICE MAY BE VOLATILE AND YOU MAY NOT BE ABLE TO RESELL YOUR SHARES AT OR ABOVE ACCEPTABLE PRICES.

The market price of our common stock may fluctuate significantly in response to factors, some of which are beyond our control, including the following:

- Actual or anticipated fluctuations in our operating results;
- Changes in market valuations of other technology companies;
- Announcements by us or our competitors of significant technical innovations, contracts, acquisitions, strategic partnerships, joint ventures or capital commitments;
- Additions or departures of key personnel;
- Future sales of common stock;
- Any deviations in net revenues or in losses from levels expected by the investment community; and
- Trading volume fluctuations.

CERTAIN PROVISIONS OF OUR CHARTER AND OF DELAWARE LAW MAKE A TAKEOVER OF OUR COMPANY MORE DIFFICULT.

Our corporate charter and Delaware law contain provisions, such as a class of authorized but unissued preferred stock which may be issued by our board without stockholder approval that might enable our management to resist a takeover of our company. Delaware law also limits business combinations with interested stockholders. These provisions might discourage, delay or prevent a change in control or a change in our management. These provisions could also discourage proxy contests, and make it more difficult for you and other stockholders to elect directors and take other corporate actions. The existence of these provisions could limit the price that investors might be willing to pay in the future for shares of our common stock.

FUTURE ISSUANCES OF BLANK CHECK PREFERRED STOCK MAY REDUCE VOTING POWER OF COMMON STOCK AND MAY HAVE ANTI-TAKEOVER EFFECTS THAT COULD PREVENT A CHANGE IN CONTROL.

Our corporate charter authorizes the issuance of up to 500,000 shares of preferred stock with such designations, rights, powers and preferences as may be determined from time to time by our Board of Directors, including such dividend, liquidation, conversion, voting or other rights, powers and preferences as may be determined from time to time by the Board of Directors without further stockholder approval. The issuance of preferred stock could adversely affect the voting power or other rights of the holders of common stock. In addition, the authorized shares of preferred stock and common stock could be utilized, under certain circumstances, as a method of discouraging, delaying or preventing a change in control.

RISKS RELATED TO TECHNOLOGY AND INTELLECTUAL PROPERTY

TECHNOLOGICAL CHANGES OCCUR RAPIDLY IN OUR INDUSTRY AND OUR DEVELOPMENT OF NEW PRODUCTS IS CRITICAL TO MAINTAIN OUR REVENUES.

The introduction by our competitors of products embodying new technologies and the emergence of new industry standards could render our existing products obsolete and unmarketable. Our future revenue growth and operating profit will depend in part upon our ability to enhance our current products and develop innovative products to distinguish ourselves from the competition and to meet customers' changing needs in the data security industry. We cannot assure you that security-related product developments and technology innovations by others will not adversely affect our competitive position or that we will be able to successfully anticipate or adapt to changing technology, industry standards or customer requirements on a timely basis.

WE MUST CONTINUE TO ATTRACT AND RETAIN HIGHLY SKILLED TECHNICAL PERSONNEL FOR OUR RESEARCH AND DEVELOPMENT DEPARTMENT.

The market for highly skilled technicians in Europe, Asia, Australia and the United States is highly competitive. If we fail to attract, train, assimilate and retain qualified technical personnel for our research and development department, we will experience delays in introductions of new or modified products, loss of clients and market share and a reduction in revenues.

WE CANNOT BE CERTAIN THAT OUR RESEARCH AND DEVELOPMENT ACTIVITIES WILL BE SUCCESSFUL.

While management is committed to enhancing our current product offerings and introducing new products, we cannot be certain that our research and development activities will be successful. Furthermore, we may not have sufficient financial resources to identify and develop new technologies and bring new products to market in a timely and cost effective manner, and we cannot ensure that any such products will be commercially successful if and when they are introduced.

WE DEPEND SIGNIFICANTLY UPON OUR PROPRIETARY TECHNOLOGY AND INTELLECTUAL PROPERTY AND THE FAILURE TO PROTECT OUR PROPRIETARY RIGHTS COULD REQUIRE US TO REDESIGN OUR PRODUCTS OR REQUIRE US TO ENTER INTO ROYALTY OR LICENSING AGREEMENTS, ANY OF WHICH COULD REDUCE REVENUE AND INCREASE OUR OPERATING COSTS.

We currently rely on a combination of patent, copyright and trademark laws, trade secrets, confidentiality agreements and contractual provisions to protect our proprietary rights. We seek to protect our software, documentation and other written materials under trade secret and copyright laws, which afford only limited protection, and generally enter into confidentiality and nondisclosure agreements with our employees and with key vendors and suppliers.

There has been substantial litigation in the technology industry regarding intellectual property rights, and we may have to litigate to protect our proprietary technology. We expect that companies in the computer and information security market will increasingly be subject to infringement claims as the number of products and competitors increases. Any such claims or litigation may be time-consuming and costly, cause product shipment delays, require us to redesign our products or require us to enter into royalty or licensing agreements, any of which could reduce revenue and increase our operating costs.

OUR PATENTS MAY NOT PROVIDE US WITH COMPETITIVE ADVANTAGES.

We hold several patents in the United States and in some European countries, which cover multiple aspects of our technology. The majority of our patents cover the Digipass product line. These patents expire between 2007 and 2022. Only one minor patent expired in 2006. In addition to the issued patents, we also have several patents pending in the United States and other countries. There can be no assurance that we will continue to develop proprietary products or technologies that are patentable, that any issued patent will provide us with any competitive advantages or will not be challenged by third parties, or that patents of others will not hinder our competitive advantage. Although certain of our security token technologies are patented, there are other organizations that offer token-type password generators incorporating challenge-response or response-only approaches that employ different technological solutions and compete with us for market share.

WE ARE SUBJECT TO PRODUCT LIABILITY RISKS.

A malfunction of or design defect in our products which results in a breach of a customer's data security could result in tort or warranty claims against us. We do not presently maintain product liability insurance for these types of claims.

THERE IS SIGNIFICANT GOVERNMENT REGULATION OF TECHNOLOGY EXPORTS AND TO THE EXTENT WE CANNOT MEET THE REQUIREMENTS OF THE REGULATIONS WE MAY BE PROHIBITED FROM EXPORTING SOME OF OUR PRODUCTS, WHICH COULD NEGATIVELY IMPACT OUR REVENUES.

Our international sales and operations are subject to risks such as the imposition of government controls, new or changed export license requirements, restrictions on the export of critical technology, trade restrictions and changes in tariffs. If we become unable to obtain foreign regulatory approvals on a timely basis our business in those countries would no longer exist and our revenues would decrease dramatically. Certain of our products are subject to export controls under U.S. law. The list of products and countries for which export approval is required, and the regulatory policies with respect thereto may be revised from time to time and our inability to obtain required approvals under these regulations could materially adversely affect our ability to make international sales.

WE EMPLOY CRYPTOGRAPHIC TECHNOLOGY IN OUR AUTHENTICATION PRODUCTS THAT USES COMPLEX MATHEMATICAL FORMULATIONS TO ESTABLISH NETWORK SECURITY SYSTEMS.

Many of our products are based on cryptographic technology. With cryptographic technology, a user is given a key that is required to encrypt and decode messages. The security afforded by this technology depends on the integrity of a user's key and in part on the application of algorithms, which are advanced mathematical factoring equations. These codes may eventually be broken or become subject to government regulation regarding their use, which would render our technology and products less effective. The occurrence of any one of the following could result in a decline in demand for our technology and products:

- Any significant advance in techniques for attacking cryptographic systems, including the development of an easy factoring method or faster, more powerful computers;

- Publicity of the successful decoding of cryptographic messages or the misappropriation of keys; and

- Increased government regulation limiting the use, scope or strength of cryptography.

RISKS RELATED TO INTERNATIONAL OPERATIONS

WE FACE A NUMBER OF RISKS ASSOCIATED WITH OUR INTERNATIONAL OPERATIONS, ANY OR ALL OF WHICH COULD RESULT IN A DISRUPTION IN OUR BUSINESS AND A DECREASE IN OUR REVENUES.

Our business internationally is subject to a number of risks any or all of which could result in a disruption in our business and a decrease in our revenues. These include:

- Inconsistent regulations and unexpected changes in regulatory requirements;

- Difficulties and costs of staffing and managing international operations;

- Potentially adverse tax consequences;

- Wage and price controls;

- Uncertain protection for intellectual property rights;

- Imposition of trade barriers;

- Differing technology standards;

- Uncertain demand for electronic commerce;

- Linguistic and cultural differences;

- Political instability; and

- Social unrest.

WE ARE SUBJECT TO FOREIGN EXCHANGE RISKS, AND IMPROPER MANAGEMENT OF THAT RISK COULD RESULT IN LARGE CASH LOSSES.

Because a significant number of our principal customers are located outside the United States, we expect that international sales will continue to generate a significant portion of our total revenue. We are subject to foreign exchange risks because the majority of our costs are denominated in U.S. dollars, whereas a significant portion of the sales and expenses of our European operating subsidiaries are denominated in various foreign currencies. A decrease in the value of any of these foreign currencies relative to the U.S. dollar could affect the profitability in U.S. dollars of our products sold in these markets. We do not currently hold forward exchange contracts to exchange foreign currencies for U.S. dollars to offset currency rate fluctuations.

U.S. INVESTORS MAY HAVE DIFFICULTIES IN MAKING CLAIMS FOR ANY BREACH OF THEIR RIGHTS AS HOLDERS OF SHARES BECAUSE SOME OF OUR ASSETS AND EXECUTIVES ARE NOT LOCATED IN THE UNITED STATES.

Several of our executives are residents of Belgium, and a substantial portion of our assets and those of some of our executives are located in Belgium. As a result, it may not be possible for investors to affect service of process on those persons located in Belgium, or to enforce judgments against some of our executives based upon the securities or other laws of jurisdictions other than Belgium. Moreover, we believe that under Belgian law there exists certain restrictions on the enforceability in Belgium in original actions, or in actions of enforcement of judgments rendered against us in courts of outside jurisdictions that are a party to the Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters (as amended). Actions for enforcement of such judgments may be successful only if the Belgian court confirms the substantive correctness of the judgment of such court, and is satisfied:

- That the judgment is not contrary to the principles of public policy in Belgium or rules of Belgian public law;

- That the judgment did not violate the rights of the defendant;

- That the judgment is final under applicable law;

- That the court did not accept its jurisdiction solely on the basis of the nationality of the plaintiff; and

- As to the authenticity of the text of the judgment submitted to it.

Judgments rendered in the courts of parties to the Brussels Convention will be enforceable by the courts of Belgium without reexamination of the merits of the case provided such judgment is final and otherwise satisfies all of the conditions provided for in this Convention. If proceedings have been brought in one country, however, new proceedings in another country may be barred.

ITEM 1B - UNRESOLVED STAFF COMMENTS

None.

ITEM 2 - PROPERTIES

Our corporate office is located in the U. S. in an office complex in Oakbrook Terrace, Illinois, a suburb of Chicago. This facility is leased through May 31, 2010, and consists of approximately 5,100 square feet.

Our sales office in the U. S. in located in Westborough, Massachusetts, a suburb of Boston. This facility is leased through February 28, 2009, and consists of approximately 3,900 square feet.

Our European administrative, sales and marketing, research and development and support facilities are located in a suburb of Brussels, Belgium. These facilities consist of approximately 29,600 square feet of office space that are occupied under a lease expiring on September 30, 2011. Our Netherlands sales and R&D facility, approximately 6,100 square feet, is occupied under a lease expiring on December 31, 2010.

Our operations for Able are located in Mechelen Belgium. These facilities consist of approximately 1,500 square feet of office space that are occupied under a lease expiring on December 14, 2013.

The operation of the business formerly known as Logico is located in Vienna Austria. These facilities consist of approximately 700 square feet of office space that are occupied under a lease expiring on May 31, 2008.

We have two offices located in Australia. One office is located in a suburb of Brisbane, consisting of approximately 3,600 square feet under a lease expiring on January 3, 2010. The second office, which is a sales office, is located in Sydney, consisting of approximately 700 square feet under a lease expiring on October 3, 2007.

We have two sales offices in the Asia/Pacific region. One sales office is located in an office complex in Singapore, consisting of approximately 3,300 square feet under a lease expiring on October 14, 2007. The second sales office is located in Shanghai, China consisting of approximately 1,200 square feet under a lease expiring on May 31, 2008.

We have signed a one-year lease for up to approximately 1,500 square feet in a business center in Zurich, Switzerland for our European headquarters.

We believe that these facilities are adequate for our present growth plans.

ITEM 3 - LEGAL PROCEEDINGS

We are from time to time involved in litigation incidental to the conduct of our business. We are not currently a party to any lawsuit or proceeding which, in the opinion of management, is likely to have a material adverse effect on our business, financial condition or results of operations.

ITEM 4 - SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matter was submitted to a vote of security holders during the fourth quarter of 2006, through solicitation of proxies or otherwise.

PART II

ITEM 5 - MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information (in thousands, except per share data)

On March 20, 1998, the Company's common stock was approved for trading on the NASD Electronic Bulletin Board system under the symbol "VDSI." On April 7, 2000, the common stock was listed on the Nasdaq National Market in the U. S. under the trading symbol "VDSI." In February 2003, the common stock was moved from the Nasdaq National Market to the Nasdaq SmallCap Market, now the Nasdaq Capital Market, and continued trading under the symbol "VDSI."

On July 15, 2003, the Company issued 2 million shares of its common stock to Ubizen N.V. as part of the consideration given in exchange for all of the Company's Series C Convertible Preferred Stock and Purchase Warrants owned by Ubizen.

On September 11, 2003, the Company sold 0.8 shares, with a stated value of $10,000 per share, of its Series D 5% Cumulative Convertible Voting Preferred Stock and 600 warrants to purchase common stock to various accredited investors. The Series D Preferred was convertible into 4,000 shares of common stock. The warrants have an exercise price of $3.47 per share. The proceeds from the sale, $8,000 gross and approximately $7,260 net, were used for general corporate purposes. The Series D Stock was convertible into common stock at any time and the warrants can be exercised at any time from the date of issue until September 10, 2008, at which time the warrants expire. As of February 28, 2005, all of the Series D Preferred stock had been converted to common stock. There were 114 warrants outstanding at February 28, 2007.

The following table sets forth the high and low closing bid quotations for the common stock for the periods indicated.

	High	Low
2007		
First Quarter, through February 28	$19.50	$11.71
2006		
Fourth Quarter	$12.49	$ 9.80
Third Quarter	10.63	7.22
Second Quarter	9.94	6.88
First Quarter	11.44	7.88
2005		
Fourth Quarter	$12.48	$ 7.72
Third Quarter	12.05	8.59
Second Quarter	11.45	6.00
First Quarter	9.14	5.50

Holders and Dividends

On February 28, 2007, the closing sale price for the common stock on the Nasdaq was $17.59 per share. Such market quotations reflect inter-dealer prices, without retail mark-up, markdown or commission and may not necessarily represent an actual transaction. On February 28, 2007, there were approximately 8,200 holders, including holders through banks, brokers and nominees, of the Company's common stock.

The Company has not paid any dividends on its common stock since incorporation. Restrictions or limitations on the payment of dividends may be imposed under the terms of credit agreements or other contractual obligations of the Company. In the absence of such restrictions or limitations, the declaration and payment of dividends will be at the sole discretion of the Board of Directors and subject to certain limitations under the General Corporation Law of the State of Delaware. The timing, amount and form of dividends, if any, will depend, among other things, on the Company's results of operations, financial condition, cash requirements, plans for expansion and other factors deemed relevant by the Board of Directors. The Company intends to retain any future earnings for use in its business and therefore does not anticipate paying any cash dividends in the foreseeable future.

See Item 12 for a description of securities authorized for issuance under our equity compensation plan.

Recent Sales of Unregistered Securities

None

Issuer Purchases of Equity Securities

None.

ITEM 6 - SELECTED FINANCIAL DATA

(IN THOUSANDS, EXCEPT PER SHARE DATA)

	YEAR ENDED DECEMBER 31,				
	2006 (8)	2005 (7)	2004	2003	2002 (1)
Statements of Operations Data:					
Net revenues	$76,062	$54,579	$29,893	$22,866	$17,370
Operating income (loss) from continuing operations	18,942	10,953(2)	5,552(2)	1,123	(4,898)(2)
Net income (loss) from continuing operations	12,587	7,701	3,253	761	(5,293)
Net income (loss) from discontinued operations	--	--	--	1,995(6)	754
Net income (loss)	12,587	7,701	3,253	2,756	(4,539)
Net income (loss) available to common stockholders	12,587	7,687(3)	3,021(3)	(1,715)(4)	(5,703)(5)
Diluted income (loss) per common share from continuing operations	$ 0.33	$ 0.21(3)	$ 0.09(3)	$ (0.13)(4)	$ (0.22)(5)
Shares used in computing per share amounts	37,765	37,244	33,128	29,270	28,348
Balance Sheet Data:					
Cash and equivalents	$14,768	$16,962	$ 8,138	$ 4,817	$ 2,616
Working capital (deficiency)	22,058	16,325	9,995	5,218	(587)
Total assets	62,646	41,505	20,250	13,383	11,133
Stockholders' equity	42,206	25,395	13,031	8,943	2,811

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(1) Years prior to 2003 have been restated to reclassify the results of the VACMAN Enterprise business unit, which was sold in the third quarter of 2003, and reflected as a discontinued operation.

(2) Includes restructuring expenses (recovery) of $(172) in 2005, $(32) in 2004 and $320 in 2002.

(3) Includes the impact of preferred stock dividends of $14 in 2005 and $232 in 2004.

(4) Includes the impact of a beneficial conversion feature of $3,720 related to the issuance of Series D Convertible Preferred Stock in the third quarter of 2003, preferred stock accretion of $630 and preferred stock dividends of $121.

(5) Includes the impact of preferred stock accretion of $1,164 in 2002.

(6) Includes $638 from discontinued operations and $1,357 from gain on sale of discontinued operations.

(7) Includes the results of AOS-Hagenuk B.V., acquired on February 4, 2005.

(8) Includes the results of Logico Smartcard Solutions GmbH, acquired May 11, 2006 and Able NV, acquired October 25, 2006.

ITEM 7 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(IN THOUSANDS, EXCEPT HEAD COUNT AND UNIT PRICE DATA)

OVERVIEW

The following discussion is based upon our consolidated results of operations for the years ended December 31, 2006, 2005 and 2004 (percentages in the discussion are rounded to the closest full percentage point) and should be read in conjunction with our consolidated financial statements included elsewhere in this Annual Report on Form 10-K.

We design, develop, market and support identity authentication products that reduce the risk of loss from unauthorized transactions by validating a person's identity using a one-time password and obtaining a legally-enforceable digital signature, if needed, for financial transactions. Our products are used currently in a wide variety of applications including, but not limited to, Internet banking, Internet brokerage, e-commerce applications dealing with web or mobile access and various enterprise security applications. As evidenced by our current customer base, our products are purchased by companies and, depending on the business application, are distributed to either their employees or their customers. Those customers may be other businesses or, as an example in the case of Internet banking, the banks' corporate and retail customers.

Our target market is any business process that uses some form of electronic interface where the owner of that process is at risk if unauthorized users can gain access to its process and either obtain proprietary information or execute transactions that are not authorized. Our products can not only increase the security associated with accessing the business process, thereby reducing the losses from unauthorized access, but also, in many cases, can reduce the cost of the process itself by automating activities that were previously performed manually.

Industry Growth: We believe that, while there are no accurate measurements of the total industry's size, the industry growth rate is increasing and will continue to grow at a significant rate into the foreseeable future. Growth is being driven by new government regulations, growing awareness of the impact of identity theft, and the growth in commerce that is transacted electronically. The issues driving the growth are global issues and the rate of adoption in each country is a function of that country's culture, the competitive position of businesses operating in those countries, the country's overall economic conditions and the degree to which businesses and consumers within the country use technology.

Economic Conditions: Our revenues may vary significantly with changes in the economic conditions in the countries in which we sell products currently. With our current concentration of revenues in Europe and specifically in the banking/finance vertical market, significant changes in the economic outlook for the European banking market may have a significant effect on our revenues. During difficult economic periods, our customers often delay the rollout of existing applications and defer purchase decisions related to the implementation of our product in new applications.

Currency Fluctuations. In 2006, approximately 90% of our revenue and approximately 76% of our operating expenses were generated/incurred outside of the U. S. In 2005, approximately 93% of our revenue and approximately 74% of our operating expenses were generated/incurred outside of the U. S. As a result, changes in currency, especially the Euro to U.S. Dollar, can have a significant impact on revenue and expenses. To minimize the net impact of currency on operating earnings, we attempt to denominate an amount of billings in a currency such that it would provide a hedge against the operating expenses being incurred in that currency. In addition, we also attempt to minimize transaction gains and losses by hedging our net U.S. dollar asset exposure by borrowing U.S. dollars in foreign countries such that assets denominated in U.S. dollars are approximately equal to liabilities denominated in U.S. dollars.

In 2006, the annual average exchange rate for the Euro was approximately the same as in 2005 and the Australian Dollar weakened approximately 2% against the U.S. Dollar. The Euro strengthened approximately 1% and the Australian Dollar strengthened approximately 4% against the U.S. Dollar in 2005. We estimate that the strengthening of the two currencies in 2006 compared to 2005 resulted in an increase in revenues of approximately $246 and an increase in operating expenses of approximately $267. We estimate that the strengthening of the two currencies in 2005 compared to 2004 resulted in a decrease in revenues of approximately $301 and an increase in operating expenses of approximately $112. While we expected that a strengthening of the Euro compared to the U.S. dollar would result in an increase in revenue; that was not the case in 2005. The decline in revenue in 2005, due to currency, reflects the timing of when revenue was realized and the corresponding changes in currency rates in those periods. In the fourth quarter of 2005, we realized a significant portion of our revenues when the Euro was weaker than the same period in 2004.

Gains and losses resulting from foreign currency transactions are included in the consolidated statements of operations. Foreign exchange transaction losses aggregating $65 are included in other non-operating income (expense) for 2006. Foreign exchange transaction gains aggregating $330 are included in other non-operating income (expense) for 2005 and losses aggregating $538 are included in other non-operating income (expense) for 2004.

The financial position and the results of operations of our foreign subsidiaries are measured using the local currency as the functional currency. Accordingly, assets and liabilities are translated into U.S. dollars using current exchange rates as of the balance sheet date. Revenues and expenses are translated at average exchange rates prevailing during the year. Translation adjustments arising from differences in exchange rates generated a surplus of $2,194 in 2006 and a deficit of $1,218 in 2005 and are included as a separate component of stockholders' equity.

REVENUE

REVENUES BY GEOGRAPHIC REGIONS: We sell the majority of our products in European countries with significant sales in the U. S. and other countries, primarily Australia and Asia/Pacific. The breakdown of revenue in each of our major geographic areas was as follows:

YEAR	EUROPE	UNITED STATES	OTHER COUNTRIES	TOTAL
Total Revenue:				
2006	$47,449	$7,397	$21,216	$76,062
2005	39,219	3,687	11,673	54,579
2004	24,245	3,105	2,543	29,893
Percent of Total:				
2006	62%	10%	28%	100%
2005	72%	7%	21%	100%
2004	81%	10%	9%	100%

2006 Compared to 2005 - Overview and Geographic Breakdown

Total revenues in 2006 increased $21,483 or 39% over 2005. The increase was primarily attributable to an increase in the number of Digipass units sold and the acquisitions of Logico Smart Card Solutions, GmbH ("Logico") and Able N.V. ("Able"), partially offset by a decline in the average sales price per unit. Revenues from Logico and Able combined were $724 in 2006.

In 2006, we sold approximately 11,189 Digipass products, an increase of approximately 3,849 units, or 52%, over the 7,340 Digipass products sold in 2005. We believe that the increase in Digipass volume is attributable to the strength and flexibility of our VACMAN Controller software platform, growth in our distribution channel, increased investment in sales staff and marketing programs, increased awareness of the need for strong authentication to combat identity theft and our ability to deploy large volumes of high-quality products at an affordable price. The strategy introduced in the beginning of 2006 of being the Full-Option, All-Terrain Company allowed us to compete effectively in both the banking/finance ("Banking") market and enterprise security ("Enterprise Security") markets. With the introduction of our DigipassPlus strategy in January 2007, we expect to see continued worldwide expansion in authentication for consumer-related applications and believe that we are well positioned to compete for that business as the market expands.

The average price per unit in 2006 was $6.80 and was 9% lower than the $7.44 average price per unit in 2005. The decline in average price per unit reflects our strategy of providing volume-purchase discounts to customers that place firm purchase orders for large-volume deployments. We believe that the lower average prices are a critical element in our customers' decision to deploy our technology to their consumer-level customers.

As noted in the table above, revenues from each of our geographic regions increased. Both the absolute amount of revenue from each region and the growth over the prior year reflect, in general, the regulatory environment of the region and the customers' attitudes towards and acceptance of two-factor authentication. The growth in Europe, $8,230 or 21% over 2005, was attributable to several factors including, but not limited to, the acquisition of Logico and Able and increased investment in sales staff and marketing programs. The growth in the United States, $3,710 or 101% over 2005, was a result of the strong banking industry directive issued on October 12, 2005 by the FFIEC, an umbrella group of regulators that includes the FDIC, increased investment in our sales staff and increased investment in marketing programs. The growth in other countries, $9,543 or 82% over 2005, reflects the growth in the Asian and Central/South American markets. The growth in other countries was primarily attributable to increased investment in our sales staff and marketing programs.

2005 Compared to 2004 - Overview and Geographic Breakdown

Total revenues in 2005 increased $24,686 or 83% over 2004. The increase was primarily attributable to an increase in the number of Digipass units sold and the acquisition of AOS-Hagenuk ("AOS"), partially offset by a decline in the average sales price per unit. Revenues from AOS were $4,542 in 2005, net of purchase price amortization costs of $421. Excluding revenue from AOS, consolidated revenue increased $20,144 or 67% from 2004.

In 2005, we sold approximately 7,340 Digipass products, an increase of approximately 4,505 units, or 159%, over the 2,835 Digipass products sold in 2004. We believe that the increase in Digipass volume is attributable to the growth in our distribution channel, increased investment in sales staff and marketing programs, increased awareness of the need for strong authentication to combat identity theft and our ability to deploy large volumes of high-quality products at an affordable price.

The average price per unit in 2005 was $7.44 and was 29% lower than the $10.54 average price per unit in 2004. The decline in average price per unit reflects our strategy of providing volume-purchase discounts to customers that place firm purchase orders for large-volume deployments and a change in mix of our business. We believe that the lower average prices are a critical element in our customers' decision to deploy our technology to their consumer-level customers. In 2005, while each of our markets grew, the growth in large-volume deployments exceeded our growth in our lower-volume, higher priced markets, such as Corporate Banking and Enterprise Security.

As noted in the table above, revenues from each of our geographic regions increased. Both the absolute amount of revenue from each region and the growth over the prior year reflect, in general, the regulatory environment of the region and the customers' attitudes towards and acceptance of two-factor authentication. The growth in Europe, $14,974 or 62% over 2004, was attributable to several factors including, but not limited to, the acquisition of AOS, the maturity of our sales and distribution channels, increased investment in sales staff and marketing programs and the rollout of the new smart card standard by Europay, Mastercard, Visa ("EMV"). The growth in the United States, $582 or 19%, was a result of increased investment in our sales staff and marketing programs. The growth in other countries, $9,130 or 359%, reflects the growth in the Asia and Central/South American markets. The growth in other countries was not only attributable to increased investment in our sales staff and marketing programs, but also to changes in regulations. In 2005, new regulations were enacted in Hong Kong. Under the new regulations, each bank that offered internet banking services was required to provide some form of two-factor authentication to its customers.

REVENUES BY TARGET MARKET: Revenues are generated currently from two primary markets, Banking and Enterprise Security through the use of both direct and indirect sales channels. The breakdown of revenue between the two primary markets is as follows:

YEAR	BANKING	ENTERPRISE SECURITY	TOTAL
Total Revenue:			
2006	$64,987	$11,075	$76,062
2005	46,784	7,795	54,579
2004	23,977	5,916	29,893
Percent of Total:			
2006	85%	15%	100%
2005	86%	14%	100%
2004	80%	20%	100%

Revenues from the Banking market increased $18,203 or 39% in 2006 over 2005 and revenues from the Enterprise Security market increased $3,280 or 42% in the same period. The increase in revenues in both markets is attributable, in part, to the continued development of the indirect sales channel, which includes distributors, resellers, and solution partners. The number of distributors increased to 52 at the end of 2006 from 45 at the end of 2005. The indirect sales channel supplements the Company's direct sales force in the Banking market and is the primary source of revenues in the Enterprise Security market. Revenues generated by Logico and Able in 2006 are included in the Enterprise Security market.

Revenues from the Banking market increased $22,807 or 95% in 2005 over 2004 and revenues from the Enterprise Security market increased $1,879 or 32% in the same period. The increase in revenues in both markets is attributable, in part, to the continued development of the indirect sales channel. The number of distributors increased to 45 at the end of 2005 from 39 at the end of 2004. Revenues generated by AOS in 2006 are included in the Banking market.

The amounts shown above for Enterprise Security currently include revenues generated in the e-commerce and e-government markets. We expect that the e-commerce and e-government markets will be an important source of future revenue for the Company as our products will not only provide a higher level of security for purchases made over the Internet, they can also help protect our customers' revenue stream by making it more difficult for subscribers to our customers' Internet services to share passwords.

GROSS PROFIT AND OPERATING EXPENSES

The following table sets forth, for the periods indicated, certain consolidated financial data as a percentage of revenues for the years ended December 31, 2006, 2005 and 2004.

	PERCENTAGE OF REVENUE YEAR ENDED DECEMBER 31,		
	2006	2005	2004
Revenues	100.0%	100.0%	100.0%
Cost of goods sold	32.0	36.9	30.7
Gross profit	68.0	63.1	69.3
Operating costs:			
Sales and marketing	25.6	27.1	30.6
Research and development	7.3	6.6	8.2
General and administrative	9.4	8.3	10.7
Restructuring expenses (recoveries)	--	(0.3)	(0.1)
Amortization of purchased intangible assets	0.8	1.3	1.3
	43.1	43.0	50.7
Operating income	24.9	20.1	18.6
Impairment of investment	(0.8)	--	--
Interest income (expense)	0.2	0.1	0.4
Other income (expense), net	0.2	0.9	(1.8)
Income before income taxes	24.5	21.1	17.2
Provision for income taxes	8.0	7.0	6.3
Net income	16.5	14.1	10.9

GROSS PROFIT

2006 Compared to 2005

Consolidated gross profit for 2006 was $51,703, an increase of $17,265, or 50%, from the $34,438 reported for 2005. Gross profit as a percentage of revenue was 68% in 2006, as compared to 63% in 2005. The increase in the gross profit as a percentage of revenue primarily reflects:

- An increase in our software product revenues as a percentage of our total revenue;

- A decline in manufacturing cost of our product; and

- An increase in revenues from consumer-related products percentage of total product revenues.

Software product revenues include revenues from VACMAN Controller, software versions of our Digipasses and other non-manufactured products. Software product revenue increased to approximately 12% of revenue in 2006 from 7% in 2005. The gross profit on software products is substantially higher than on manufactured products.

The impact of the decline in the manufacturing costs and change in mix of products sold are reflected in the change in average selling price and average cost. The average selling price, hardware and software combined, per Digipass product declined approximately 9% to $6.80 per unit in 2006 from $7.44 in 2005. The average cost, hardware and software combined, per Digipass unit sold declined approximately 20% to $2.18 per unit in 2006 from $2.74 in 2005. The decline in the average cost per unit reflected the increased software content, a reduction in the manufacturing cost of most units sold and a change in mix of products sold towards product targeted for use by the consumer. While the average gross profit per unit declined on an absolute dollar basis, gross profit as a percentage of revenue improved.

Our purchases of inventory are denominated in U.S. dollars. Also, as previously noted, the Company denominates a portion of its sales in Euros in an effort to offset the effects of currency fluctuations on operating expenses. The increase in revenue and gross margins resulting from changes in currency rates in 2006 was $246, as noted above. The changes in currency did not, however, have a significant impact on gross margins as a percentage of revenue.

2005 Compared to 2004

Consolidated gross profit for 2005 was $34,438, an increase of $13,729, or 66%, from the $20,709 reported for 2004. Gross profit as a percentage of revenue was 63% in 2005, as compared to 69% in 2004. The decrease in the gross profit as a percentage of revenue reflected a decline in average sales price per unit partially offset by a decline in the average manufacturing cost per unit.

The significant increase in the Digipass products sold in 2005 over 2004 reflected larger customer deployments in the Banking market, the results of which were reflected in an increase in the total quantity ordered and a decrease in the average sales price per unit. The average selling price, hardware and software combined, per Digipass unit sold declined approximately 29% to $7.44 per unit in 2005 from $10.54 in 2004.

The average cost, hardware and software combined, per Digipass unit sold declined from approximately $3.24 to $2.74, or 15%, in 2005 as compared to 2004. The decline in the average cost per unit reflected a reduction in the manufacturing cost of most units as well as a change in mix of specific products sold.

Changes in currency rates reduced revenue and gross margin by $301 in 2005, as noted above. The changes in currency did not, however, have a significant impact on gross margins as a percentage of revenue.

SALES AND MARKETING EXPENSES

2006 Compared to 2005

Consolidated sales and marketing expenses for the year ended December 31, 2006 were $19,482, an increase of $4,698, or 32%, from the $14,784 reported for 2005.

The increase was primarily due to an increase in average headcount and related compensation expenses, an increase in marketing programs and materials, an increase in travel and an increase in commissions paid to third-party agents. The average full-time sales, marketing and operations employee headcount increased 23% to 87 in 2006 from 71 in 2005. At year-end 2006, the Company employed 98 full-time sales, marketing and operations employees, reflecting its increased investment in an effort to accelerate its sales growth.

2005 Compared to 2004

Consolidated sales and marketing expenses for the year ended December 31, 2005 were $14,784, an increase of $5,624, or 61%, from the $9,160 reported for 2004. Expenses in 2005 included approximately $841 of expense related to AOS. Excluding AOS, sales and marketing expenses increased approximately $4,783 or 52% from 2004.

The increase was primarily due to an increase in average headcount and related compensation expenses, an increase in marketing programs and materials, an increase in travel, an increase in commissions paid to third-party agents and redundancy costs associated with the termination of a small group of employees. The average full-time sales, marketing and operations employee headcount increased 42% to 71 in 2005 from 50 in 2004. At year-end 2005, the Company employed 80 full-time sales, marketing and operations employees.

RESEARCH AND DEVELOPMENT EXPENSES

2006 Compared to 2005

Consolidated research and development costs for the year ended December 31, 2006 were $5,529, an increase of $1,950, or 54%, from the $3,579 reported for 2005. Expenses in 2006 included approximately $1,090 of expense related to Logico and Able combined. Excluding Logico and Able, research and development expenses increased approximately $860 or 24% from 2005.

The increase primarily reflects higher compensation-related expense. Average full-time research and development employee headcount in 2006 was 44 compared to 27 in 2005.

2005 Compared to 2004

Consolidated research and development costs for the year ended December 31, 2005 were $3,579, an increase of $1,138, or 47%, from the $2,441 reported for 2004. Expenses in 2006 included approximately $802 of expense related to AOS. Excluding AOS, research and development expenses increased approximately $336 or 14% from 2005.

The increase primarily reflects higher compensation-related expense. Average full-time research and development employee headcount in 2005 was 27 compared to 18 in 2004.

GENERAL AND ADMINISTRATIVE EXPENSES

2006 Compared to 2005

Consolidated general and administrative expenses for the year ended December 31, 2006 were $7,157, an increase of $2,601 or 57%, from the $4,556 reported for 2005.

The increase was primarily due to an increase in average headcount and related compensation expenses, an increase in non-cash compensation expenses, increased cost of insurance, increased cost of professional services and an increase in the provision for uncollectible accounts. The average full-time general and administrative employee headcount increased 36% to 19 in 2006 from 14 in 2005.

2005 Compared to 2004

Consolidated general and administrative expenses for the year ended December 31, 2005 were $4,556, an increase of $1,365 or 43%, from the $3,191 reported for 2004. Expenses in 2005 included approximately $269 of expense related to AOS. Excluding AOS, general and administrative expenses increased approximately $1,096 or 34% from 2004.

The increase was primarily due to increased cost of professional services, an increase in average headcount and related compensation expenses and an increase in the provision for uncollectible accounts. The increase in professional services was primarily related to the cost of performing management's assessment of internal controls over financial reporting, the increased cost of the integrated audit and legal services related to tax planning initiatives. The average full-time general and administrative employee headcount increased 27% to 14 in 2005 from 11 in 2004.

RESTRUCTURING EXPENSES

2006 Compared to 2005

There were no adjustments to the restructuring reserves in 2006.

2005 Compared to 2004

During the fourth quarter of 2002, we recorded restructuring charges of $319 related to operations in France and excess space in our U.S. headquarters. In 2005, we resolved all issues associated with the closure of the French operation and reversed reserves that were no longer needed, some of which had been recorded prior to the decision to close the operation, resulting in a gain of $172.

AMORTIZATION EXPENSE

2006 Compared to 2005

Amortization expense for 2006 was $593, a decrease of $145 or 20% from 2005 amount. The decrease was due to an intangible asset for purchase orders obtained as part of the AOS-Hagenuk acquisition, which was fully amortized in 2006, partially offset by increased amortization related to the purchase of Logico and Able in 2006.

2005 Compared to 2004

Amortization expense for 2005 was $738, an increase of $341 or 86% over the 2004 amount. The increase was due to the amortization of a $367 intangible asset for purchase orders obtained as part of the AOS-Hagenuk acquisition in February, 2005.

IMPAIRMENT OF INVESTMENT IN SECURED SERVICES, INC.

2006 Compared to 2005

We received preferred stock and a note receivable from Secured Services, Inc. ("SSI") in 2003 as consideration for assets of the VACMAN Enterprise business unit. Based on a detailed valuation, we established the initial value of the consideration received from SSI, using a discounted value of the payment streams expected from the note and the preferred stock. Interest income on the note was recorded over time at the discount rate. In 2006, SSI discontinued its monthly note payments to the Company due to its continuing operating losses and an inability to secure new financing. We concluded that a decline in fair value had occurred, which was other than temporary in nature as defined in EITF Issue 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments. We eventually collected the entire note receivable and interest, but did record an asset impairment charge of $600 in 2006 to fully write down the value of the investment in the preferred stock of SSI.

INTEREST INCOME, NET

2006 Compared to 2005

Consolidated net interest income was income of $121 in 2006 compared to income of $69 in 2005. The increase in income reflected an increase in our average net cash balances partially offset by the cost of increased borrowing related to our foreign currency hedging program. Average net cash balances were $14,888 in 2006, an increase of $5,688 or 62% from $9,200 in 2005. Our bank borrowings are solely related to our foreign currency hedging program. We invested our cash balances in short-term money market instruments at nominal rates of interest.

2005 Compared to 2004

Consolidated net interest income was income of $69 in 2005 compared to income of $120 in 2004. The reduction in income reflected the cost of borrowings related to our foreign currency hedging program, lower interest earned on the installment note we received as a result of our sale of the VACMAN Enterprise business in 2003, partially offset by interest earned on an increase in average net cash balances that resulted from our strong operating cash flow throughout 2005. Average net cash balances were $9,200 in 2005, an increase of $2,700 or 42% from $6,500 in 2004.

OTHER INCOME (EXPENSE)

2006 Compared to 2005

Other income (expense) in 2006 primarily included exchange gains (losses) on transactions that are denominated in currencies other than the subsidiaries' functional currency and subsidies received from foreign governments related to increasing trade in other countries. Other income was $178 in 2006, a decline of $328 from 2005, which primarily reflects changes in exchange gains and losses. We realized exchange losses of $65 in 2006 compared to exchange gains of $330 in 2005.

2005 Compared to 2004

Other income was $506 in 2005, an increase of $1,045 over 2004, which primarily reflects changes in exchange gains and losses. We reported exchange gains of $330 in 2005 compared to exchange losses of $538 in 2004. We implemented a hedging program in the second quarter of 2005 to minimize the impact of changes in currency rates.

INCOME TAXES

2006 Compared to 2005

Income tax expense for 2006 was $6,054, compared to expense of $3,827 in 2005. The expense related primarily to our subsidiaries in Belgium, the Netherlands and Singapore. The effective tax rate in 2006 was 32.5%, a decrease of 0.7 percentage point from 33.2% in 2005. The expense reported for 2006 reflected a benefit of $226 from the use of net operating loss carryforwards ("NOL") in Australia and an additional benefit of $120 from elimination of the valuation reserve for the remaining unused NOLs in Australia. In the United States, the NOL utilization benefit of $953 was partially offset by foreign income taxed in the U.S. of $854.

2005 Compared to 2004

Income tax expense for 2005 was $3,827, compared to expense of $1,880 in 2004. The expense related primarily to our subsidiaries in Belgium, the Netherlands and Singapore, whose tax loss carryforward was fully utilized in 2005. The effective tax rate in 2005 was 33.2%, a decrease of 3.4 percentage points from 36.6% in 2004. The tax loss carryforward in Singapore utilized in 2005 reduced 2006 tax expense by approximately $180. The tax rate also reflected an improvement in earnings in countries in which we continue to have a tax loss carryforward.

Loss Carryforwards Available

At December 31, 2006, we had U. S. net operating loss carryforwards of $23,086 and foreign net operating loss carryforwards of $7,829. Such losses are available to offset future taxable income in the respective jurisdictions. The U. S. loss carryforwards expire in varying amounts beginning in 2018 and continuing through 2023. The foreign loss carryforwards have no expiration dates. The foreign loss carryforward includes $3,042 which was obtained in the Logico acquisition and, if utilized, would not reduce income tax expense, but would reduce deferred tax assets or goodwill instead. In addition, if certain substantial changes in the Company's ownership are deemed to have occurred, there would be an annual limitation on the amount of the U.S. carryforwards that could be utilized.

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2006, we had net cash balances (total cash, cash equivalents and restricted cash less bank borrowings), totaling $12,615 and no outstanding term debt. Cash generated from operating activities was $7,819 during the year ended December 31, 2006. During 2006, we used $9,883 for investing activities, primarily related to the acquisitions of Logico and Able, and used $247 in financing activities, primarily consisting of a reduction in bank borrowing offset by proceeds from the exercise of stock options. Capital expenditures were $459 for the year ended December 31, 2006.

Cash generated from operating activities was $7,542 during the year ended December 31, 2005. During 2005, we used $4,456 in investing activities, primarily related to the acquisition of AOS-Hagenuk and generated $6,614 in financing activities primarily consisting of an increase in bank borrowing and proceeds from the exercise of stock options. Capital expenditures were $507 for the year ended December 31, 2005.

On September 11, 2003, we sold 0.8 shares, with a stated valued of $10,000 per share, of its Series D 5% Cumulative Convertible Voting Preferred Stock (the "Series D Preferred Stock") and 600 warrants to purchase common stock. The Series D Preferred Stock carried a 5% dividend and was convertible into 4,000 shares of common stock at a fixed price of $2.00 per share. The net proceeds from the sale totaled $7,260 of which $5,786 was allocated to the Series D Preferred Stock and $1,474 was allocated to the warrants based upon their relative fair values. In addition, a beneficial conversion value was calculated for the Series D Preferred Stock as the difference between the price of the common stock at the transaction date and the conversion price of the Series D Preferred Stock. The amount of the beneficial conversion, $3,720, is analogous to a dividend and was recorded to accumulated deficit.

On February 4, 2005, we acquired all of the share capital of A.O.S. Hagenuk B.V. ("AOS") a private limited liability company organized and existing under the laws of the Netherlands. The base purchase price was E5,000 of which E3,750 was paid in cash and the remainder was paid in our common stock. The common stock was held in escrow for the benefit of the seller for a period of twelve (12) months. In addition to the base purchase price, a variable amount related to the gross profits collected on the sales of certain equipment will be paid to the seller over a period of two (2) years following the closing. We do not expect that additional payments will be made to seller with regards to the sales of such certain equipment.

On February 17, 2005, we, in accordance with the Designation of Rights and Preferences of the Series D 5% Cumulative Convertible Voting Preferred Stock (the "Series D Preferred Stock"), issued a call for the mandatory conversion of all outstanding shares of the Series D Preferred Stock. All accrued dividends through the conversion date have been paid.

On May 11, 2006, we acquired all of the issued and outstanding shares of Logico Smart Card Solutions GmbH and Logico Smartcard Solutions Vertriebs, GmbH. (the combined group was previously defined as Logico.) Logico is an authentication storage specialist with extensive experience in smart card based authentication, located in Vienna, Austria. We believe that significant synergies will be created by combining Logico's technology with our technology, customer base and marketing channels. The shares of Logico were acquired for a cash payment of E1236 (equivalent to $1,578). An additional payment of up to E150 (or $198 at the December 31, 2006 exchange rate) may be due on March 31, 2007 if certain performance conditions are met.

On October 25, 2006, we acquired Unified Threat Management (UTM) specialist Able N.V. of Mechelen, Belgium. Able's key product is the aXs GUARD appliance. This appliance contains 21 different modules, including Digipass strong user authentication, VPN, firewall, anti-virus, hacker detection, statistics & reporting, content scanning and more. VASCO acquired all of the stock of Able N.V., in exchange for cash consideration of E5 million ($6.3 million). The purchase price included E1.25 million ($1.65 million) which is subject to a bank guarantee and may be returned to the company in whole or in part if the seller terminates his employment with the Company before four years from the acquisition date. As required by EITF 95-8, Accounting for Contingent Consideration Paid to the Shareholders of an Acquired Enterprise in a Purchase Business Combination, the Company has recorded this portion of the purchase price as deemed compensation, to be amortized over the required employment period.

We maintain an overdraft agreement with Fortis Banque/Bank of Belgium. Under terms of the agreement, we can borrow an amount equal to 80% of our Belgium subsidiary's defined accounts receivable up to a maximum of either 3,500 Euros or U.S. dollars. Borrowings under the overdraft agreement accrue interest at an annual rate of 5.7% and we are obligated to pay a quarterly commitment fee of 0.125%. As of December 31, 2006, 1,346 Euros or U.S. dollars were available under the overdraft agreement as there were borrowings or $2,154 outstanding under the agreement as part of our currency hedging program. The assets, excluding inventory, of the Belgian subsidiary secure the agreement and while it has no specific termination date, it can be terminated with thirty (30) days notice. The agreement is governed by the General Lending Conditions for Corporate Customers, registered in Brussels, Belgium on December 20, 2001.

The net effect of 2006 activity resulted in a decrease in net cash of $1,355 and a net cash balance of $12,614 at December 31, 2006, compared to $13,970 at the end of 2005. Our working capital at December 31, 2006 was $22,058, an increase of $5,733 from $16,325 at December 31, 2005. The change is primarily attributable to the generation of positive cash flow from operations in 2006. Our current ratio was 2.15 to 1.0 at December 31, 2006. We believe that our current cash balances, credit available under our existing overdraft agreement and the anticipated cash generated from operations, including deposits received on orders of Digipass to be delivered in 2007, will be sufficient to meet our anticipated cash needs for the next twelve months.

The net effect of 2005 activity resulted in an increase in net cash of $5,750 and a net cash balance of $13,970 at December 31, 2005, compared to $8,220, at the end of 2004. Our working capital balance at December 31, 2005 was $16,325, an increase of $6,330 from $9,995 at December 31, 2004. The change is primarily attributable to the generation of positive cash flow from operations in 2005. Our current ratio was 2.03 to 1.0 at December 31, 2005.

We believe that our financial resources and current borrowing arrangements are adequate to meet our operating needs. There is risk, however, that our revenue and cash receipts will not be sufficient to meet the operating needs of the business. If this is the case, we will need to significantly reduce our workforce, sell certain of our assets, enter into strategic relationships or business combinations, discontinue some or all of our operations, or take other similar restructuring actions. While we expect that these actions would result in a reduction of recurring costs, they also may result in a reduction of recurring revenues and cash receipts. It is also likely that we would incur substantial non-recurring costs to implement one or more of these restructuring actions.

OFF-BALANCE SHEET ARRANGEMENTS

The Company has no off-balance sheet arrangements.

CONTRACTUAL OBLIGATIONS

The Company has the following contractual obligations:

	Payments Due by Period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Operating lease obligations	$6,340	$1,654	$2,726	$1,622	$338
Purchase obligations	605	605	--	--	--
Deferred warranty	451	149	258	44	--
Total contractual obligations	$7,396	$2,408	$2,984	$1,666	$338

"Management's Discussion and Analysis of Financial Condition and Results of Operations" discusses our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the U. S. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period.

On an on-going basis, management evaluates its estimates and judgments, including those related to bad debts, net realizable value of inventory and intangible assets. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Management believes the following critical accounting policies, among others, affect its more significant judgments and estimates used in the preparation of its consolidated financial statements.

Revenue Recognition

We recognize revenue in accordance with AICPA Statement of Position ("SOP") 97-2 and SEC Staff Accounting Bulletin ("SAB") 104. Revenue is recognized when there is persuasive evidence that an arrangement exists, delivery has occurred, the fee is fixed or determinable and collection of the revenue is probable.

Hardware Revenue and License Fees: Revenues from the sale of computer security hardware or the license of software are recorded upon shipment or, if an acceptance period is allowed, at the later of shipment or customer acceptance. No significant obligations or contingencies exist with regard to delivery, customer acceptance or rights of return at the time revenue is recognized.

Support Agreements: Support agreements generally call for us to provide technical support and software updates to customers. Revenue on technical support and software update rights is deferred and recognized ratably over the term of the support agreement.

Consulting and Education Services: We provide consulting and education services to our customers. Revenue from such services is recognized during the period in which the services are performed.

Multiple-Element Arrangements: We allocate revenues to the various elements of the arrangements based on the estimated fair value of each deliverable as required by SOP 97-2 and Emerging Issues Task Force ("EITF") Issue No. 00-21. The fair value for each element is based on the price charged when that element is sold separately, price lists, renewal rates and other methods. When discounts are given in a multiple-element arrangement, a proportionate amount of the discount is applied to each element based on each element's fair value without regard to the discount. The estimated fair value of undelivered elements is deferred and recorded as revenue when services are performed or products are delivered.

Sales to distributors and resellers are recognized on the same basis as sales made directly to customers. Revenue is recognized when there is persuasive evidence that an arrangement exists, delivery has occurred, the fee is fixed or determinable and collection of the revenue is probable.

For large-volume transactions, we may negotiate a specific price that is based on the number of users of the software license or quantities of hardware supplied. The per unit prices for large-volume transactions are generally lower than transactions for smaller quantities and the price differences are commonly referred to as volume-purchase discounts.

Allowance for Doubtful Accounts:

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make payments for goods and services. We analyze accounts receivable, customer credit-worthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. The allowance is based on a specific review of all significant past-due accounts. If the financial condition of our customers deteriorates, resulting in an impairment of their ability to make payments, additional allowances may be required.

Net Realizable Value of Inventory:

We write down inventory where it appears that the carrying cost of the inventory may not be recovered through subsequent sale of the inventory. We analyze the quantity of inventory on hand, the quantity sold in the past year, the anticipated sales volume in the form of sales to new customers as well as sales to previous customers, the expected sales price and the cost of making the sale when evaluating the valuation of our inventory. If the sales volume or sales price of a specific model declines significantly, additional writedowns may be required.

Valuation of Goodwill and Other Intangible Assets and Software Development Costs:

We assess the impairment of goodwill and intangible assets with indefinite lives annually and whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important which could trigger an impairment review include significant underperformance relative to expected historical or projected future operating results, significant changes in the manner of our use of the acquired assets or the strategy for our overall business, and significant negative industry or economic trends. We assess the recoverability of its purchased software against estimated future revenue for the individual products over the estimated remaining economic life of the software.

When we determine that the carrying value of intangibles and goodwill may not be recoverable based upon the existence of one or more of the above indicators of impairment, we measure any impairment based on a projected discounted cash flow method using a discount rate determined by our management to be commensurate with the risk inherent in our current business model. Given the highly competitive environment and frequency of technological changes in our industry, it is reasonably possible that estimates of anticipated future revenue, the remaining economic life of our software products, or both may be reduced significantly.

The total amount of goodwill and other intangible assets as of December 31, 2006 was $15,698 and the full amount is at risk of impairment. See footnotes 1and 4 to the consolidated financial statements for more detailed information.

Research and Development:

We are devoting substantial capital and other resources to enhance our existing security products and develop new products to provide identity authentication security solutions on different platforms and for different applications. Costs of research and development, principally the design and development of hardware and software prior to the determination of technological feasibility, are expensed as incurred on a project-by-project basis. Our software capitalization policy currently defines technological feasibility as a functioning beta test prototype with confirmed manufacturability (a working model), within a reasonably predictable range of costs. Additional criteria include receptive customers, or potential customers, as evidenced by interest expressed in a beta test prototype, at some suggested selling price.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June, 2006, the Financial Accounting Standards Board (FASB) issued Financial Accounting Interpretation (FIN) 48, "Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109", which changes the threshold for recognizing the benefit of an uncertain tax position, prescribes a method for measuring the tax benefit to be recorded and requires incremental disclosures about uncertain tax positions. This interpretation is effective for years beginning after December 15, 2006. The interpretation is expected to have no material effect on the Company's financial condition or results of operations.

In June, 2006, the FASB ratified the Emerging Issues Task Force consensus on Issue 06-3, "How Sales Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross Versus Net Presentation)" This pronouncement will not affect the Company's income statement presentation.

ITEM 7A - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

(IN THOUSANDS)

Foreign Currency Exchange Risk - In 2006, approximately 90% of our business was conducted outside the United States, primarily in Europe and Asia/Pacific. A significant portion of our business operations is transacted in foreign currencies. As a result, we have exposure to foreign exchange fluctuations. We are affected by both foreign currency translation and transaction adjustments. Translation adjustments result from the conversion of the foreign subsidiaries' balance sheets and income statements to U.S. dollars at year-end exchange rates and weighted average exchange rates, respectively. Translation adjustments resulting from this process are recorded directly into stockholders' equity. Transaction adjustments result from currency exchange movements when a foreign subsidiary transacts business in a currency that differs from its local currency. These adjustments are recorded as gains or losses in our statements of operations. Our foreign subsidiaries' business transactions are spread across numerous countries and currencies. This geographic diversity reduces the risk to our operating results.

As noted in Management's Discussion and Analysis above, we attempt to minimize the net impact of currency on operating earnings by denominating an amount of billings in a currency such that it would provide a hedge against the operating expenses being incurred in that currency. In addition, we also attempt to minimize transaction gains and losses by hedging our net U.S. dollar asset exposure by borrowing U.S. dollars in foreign countries such that assets denominated in U.S. dollars are approximately equal to liabilities denominated in U.S. dollars.

Interest Rate Risk - We have minimal interest rate risk. Our outstanding debt at December 31, 2006 was $2,154 and was at fixed interest rates and our cash is invested in short-term instruments at current market rates. If rates were to increase or decrease by one percentage point, the Company's interest income would increase or decrease approximately $82 annually.

Impairment Risk - At December 31, 2006, we had goodwill of $12,685 and other intangible assets of $3,013 related mostly to the acquisition of Logico and Able in 2006, the acquisition of AOS-Hagenuk in 2005 and to technology purchased in 2001 as part of our acquisition of Identikey. We will assess the net realizable value of the goodwill and other intangible assets on a regular basis, but at least annually, to determine if we have incurred any declines in the value of our capital investment. While we did not experience impairment during the year ended December 31, 2006, we may incur impairment charges in future periods.

ITEM 8 - FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The information in response to this item is included in our consolidated financial statements, together with the report thereon of KPMG LLP, appearing on pages F-1 through F-22 of this Form 10-K, and in Item 7 under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations."

ITEM 9 - CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A - CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

The Company maintains a system of disclosure controls and procedures that is designed to ensure that information required to be disclosed by the Company in this Annual Report on Form 10-K, and in other reports required to be filed or submitted under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission for such filings. As required by Rule 13a-15(b) under the Exchange Act, management of the Company, under the direction of the Company's Chief Executive Officer and Chief Financial Officer, reviewed and performed an evaluation of the effectiveness of the Company's disclosure controls and procedures as of December 31, 2006. Based on that review and evaluation, the Chief Executive Officer and Chief Financial Officer, along with the management of the Company, have determined that as of December 31, 2006, the disclosure controls and procedures were and are effective as designed to ensure that information relating to the Company and its consolidated subsidiaries would be accumulated and communicated to them, as appropriate, to allow timely disclosures regarding required disclosures.

CHANGES IN INTERNAL CONTROLS

There were no significant changes in the Company's internal controls over financial reporting during the quarter ended December 31, 2006.

MANAGEMENT ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of VASCO Data Security International, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control system was designed to provide reasonable assurance to the company's management and board of directors regarding the preparation and fair presentation of published financial statements. Internal control over financial reporting is defined in Rule 13a-15(f) or 15d-15(f) promulgated under the Securities Exchange Act of 1934 as a process designed by, or under the supervision of, the company's principal executive and principal financial officers and effected by the company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

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

- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and

- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Our management, including our Chief Executive Officer and Chief Financial Officer, do not expect that our disclosure controls and procedures or internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well designed and implemented, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues within a company are detected. The inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the controls. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and may not be detected.

Our management assessed the effectiveness of its internal control over financial reporting as of December 31, 2006. In making this assessment, it used the criteria based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission in "Internal Controls - Integrated Framework" (COSO). Based on our assessments we believe that, as of December 31, 2006, our internal control over financial reporting is effective based on those criteria.

Our independent registered public accounting firm, KPMG LLP, has issued an audit report on our assessment of our internal control over financial reporting. Their report on management's assessment and their opinion on the effectiveness of our internal control over financial reporting appear below.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders

VASCO Data Security International, Inc.:

We have audited management's assessment, presented in Management's Annual Report on Internal Control over Financial Reporting, that VASCO Data Security International, Inc. maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control--Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). VASCO Data Security International, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that VASCO Data Security International, Inc. maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, VASCO Data Security International, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

VASCO Data Security International, Inc. acquired Logico Smart Card Solutions (Logico) and Able N.V. (Able) during 2006, and management excluded from its assessment of the effectiveness of VASCO Data Security International, Inc.'s internal control over financial reporting as of December 31, 2006, Logico and Able's internal control over financial reporting associated with total assets of $4.8 million and $8.2 million, respectively, and total revenues of $191,000 and $533,000, respectively, included in the consolidated financial statements of VASCO Data Security International, Inc. and subsidiaries as of and for the year ended December 31, 2006. Our audit of internal control over financial reporting of VASCO Data Security International, Inc. also excluded an evaluation of the internal control over financial reporting of Logico and Able.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of VASCO Data Security International, Inc. and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2006, and our report dated March 15, 2007 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Chicago, Illinois

March 15, 2007

ITEM 9B - OTHER INFORMATION

None.

PART III

ITEM 10 - DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

DIRECTORS AND EXECUTIVE OFFICERS

T. KENDALL "KEN" HUNT -- Mr. Hunt is Chairman of the Board and Chief Executive Officer. He served as our Chief Executive Officer through June 1999. He returned as CEO in November 2002. He has been a director since July 1997 and currently serves a one-year term. He served since 1990 as Chairman and President of our predecessor, VASCO Corp. He is also affiliated with several high-tech early-stage companies, serving as a member of their Board of Directors. He is a co-founder and on the board of Secured Services, Inc., a publicly-held company, listed on the Nasdaq (Symbol: ssvc). Mr. Hunt is President of the Belgian Business Club of Chicago. Additionally, he is on the Advisory Board for the Posse Foundation, an organization dedicated to providing full college scholarships to urban minority youth leaders through its partnerships with elite universities across the U.S. He holds an MBA from Pepperdine University, Malibu, California, 1979, and a BBA from the University of Miami, Florida, 1965. Mr. Hunt is 63 years old.

MICHAEL P. CULLINANE -- Mr. Cullinane has been a director since April 10, 1998 and currently serves a one-year term. He is the Chairman of our Audit Committee and a member of our Compensation Committee and our Governance and Nominating Committee. Mr. Cullinane currently serves as the Executive Vice President and Chief Financial Officer of Lakeview Technology. Mr. Cullinane served as the Executive Vice President and Chief Financial Officer and a director of Divine, Inc. from July 1999 to May 2003. He served as Executive Vice President, Chief Financial Officer and a director of PLATINUM Technology International, Inc. from 1988 to June 1999. On February 25, 2003, Divine, Inc. filed for protection under the federal bankruptcy laws. Mr. Cullinane received a B.B.A. from the University of Notre Dame, South Bend, Indiana. Mr. Cullinane is 57 years old.

JOHN N. FOX, JR. -- Mr. Fox has been a director since April 2005 and currently serves a one-year term. He is Chairman of our Compensation Committee and is a member of our Audit Committee and our Governance and Nominating Committee. From 1998 to 2003, Mr. Fox served as a Vice Chairman of Deloitte & Touche and the Global Director, Strategic Clients for Deloitte Consulting. He held various other positions with Deloitte Consulting from 1968 to 2003, and served on the board of Deloitte Touche Tohmatsu from 1998 to 2003. Mr. Fox currently serves on a variety of non-profit boards of directors. Mr. Fox received his B.A. degree from Wabash College and his MBA from the University of Michigan. Mr. Fox is 64 years old.

JEAN K. HOLLEY-- Ms. Holley was elected to the Board of Directors of VASCO effective August 1, 2006, and was named to the Audit Committee, the Compensation Committee and the Governance and Nominating committee of the Board. Ms. Holley is the Executive Vice President and Chief Information Officer for Tellabs. Ms Holley served as VP and CIO for USG Corporation as well at the Sr. IT Director for Waste Management. Ms. Holley holds a BS in Computer Science/Electrical Engineering from the University of Missouri-Rolla, and a MS in Computer Science/Engineering from Illinois Institute of Technology in Chicago. She has served on a variety of boards including Blue Wolff, Illinois Institute of Technology, Northern Illinois University's College of Engineering & Engineering Technology, University of Missouri - Rolla's College of Mines & Metallurgy, and the School of Management Information Systems. She served as President of the Academy for Computer Science at UMR and is a current Board member for Junior Achievement. Finally, she serves as a Board member for Giant Steps of Illinois, an autistic school for children with autistic spectrum disorders. Ms. Holley is 47 years old.

JOHN R. WALTER -- Mr. Walter has been a director since April 2003 and currently serves a one-year term. He is Chairman of our Governance and Nominating Committee and is a member of our Audit Committee and our Compensation Committee. Mr. Walter is Chairman and CEO of Ashlin Management Co., a private investment and management services firm. Mr. Walter also serves as a director for Deere & Company, Manpower, Inc., Inner Workings and SNP Corporation of Singapore. Mr. Walter served as President and Chief Operating Officer of AT&T Corporation from 1996 to 1997. He served as Chairman and CEO of R.R. Donnelley & Sons Company, a print and digital information management company, from 1989 through 1996. Mr. Walter received a B.S. degree in management from Miami University, Oxford, Ohio. Mr. Walter is 60 years old.

EXECUTIVE OFFICERS

JAN VALCKE -- Mr. Valcke is President & Chief Operating Officer. Mr. Valcke has been an officer of the Company since 1996. From 1992 to 1996, he was Vice-President of Sales and Marketing of Digipass NV/SA, a member of the Digiline group. He co-founded Digiline in 1988 and was a member of the Board of Directors of Digiline. Mr.Valcke received a degree in Science from St. Amands College in Kortrijk, Belgium. Mr. Valcke is 52 years old.

CLIFFORD K. BOWN -- Mr. Bown is Executive Vice President & Chief Financial Officer. Mr. Bown started his career with KPMG LLP where he directed the audits for several publicly held companies, including a global leader that provides integrated and embedded communications solutions. From 1991 to 1993, he was CFO for publicly held XL/DATACOMP, a $300 million provider of midrange computer systems and support services in the U. S. and U. K. Mr. Bown also held CFO positions in two other companies focused on insurance and healthcare from 1995 through 2001. Mr. Bown received a B.S. in Accountancy from the University of Illinois, Urbana, Illinois, his MBA from the University of Chicago, and he has a CPA certificate. Mr. Bown is 55 years old.

AUDIT COMMITTEE FINANCIAL EXPERT

The Board of Directors has designated an Audit Committee, which consists of Mr. Cullinane, Mr. Fox, Ms. Holley and Mr. Walter. The Board has determined that Mr. Cullinane, Chairman of the Audit Committee and Mr. Walter each qualify as a financial expert and has designated each person as a financial expert. Each member of the Audit Committee has been determined to be independent as defined by The Nasdaq Stock Market, Inc. and the Securities and Exchange Commission.

SECTION 16(A) BENEFICIAL OWNERSHIP COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934 requires directors and executive officers, and persons who beneficially own more than 10% of a registered class of our equity securities, to file reports of ownership and changes in ownership with the Securities and Exchange Commission and The Nasdaq Stock Market, Inc. Directors, executive officers and beneficial owners of more than 10% of the outstanding shares of common stock are required by Securities and Exchange Commission regulations to furnish us with copies of all Section 16(a) forms that they file. Based solely on review of the copies of such forms or written representations that no reports under Section 16(a) were required, we believe that for the year period ended December 31, 2006, all of the Company's directors, executive officers and greater than 10% beneficial owners complied with Section 16(a) filing requirements applicable to them.

CODE OF ETHICS

The Company has adopted a Code of Ethics that applies to all of its employees, including its principal executive officer and principal financial officer. The Code of Ethics was filed in the prior year and is noted as Exhibit 14.1 herein. A copy of the Code of Ethics can also be found on our website, www.vasco.com in the investor, corporate governance section.

ITEM 11 - EXECUTIVE COMPENSATION

COMPENSATION DISCUSSION AND ANALYSIS

Overview

The Compensation Committee (the "Committee") of the Board of Directors is responsible for the compensation of the Chief Executive Officer, T. Kendall Hunt; President and Chief Operating Officer, Jan Valcke; and our Executive Vice President and Chief Financial Officer, Clifford K. Bown, who are collectively referred to as our "named executive officers". They are the only executive officers of the Company and our subsidiaries. It is the Committee's responsibility to assure that the named executive officers are compensated in a manner consistent with our compensation philosophy, internal equity considerations, competitive practice, and the requirements of the appropriate regulatory bodies.

Compensation Philosophy

We operate in the competitive technology industry and view our ability to attract and retain highly qualified and dedicated executives and key employees as a critical component of our future success. We strive to maintain an entrepreneurial atmosphere and to maintain a low cost operating structure. Our targeted growth strategies require an executive compensation program that reinforces the importance of performance and accountability. Accordingly the programs designed to provide executives with meaningful rewards for achievement of results above established goals, while maintaining alignment with shareholder interests, corporate values and important strategic initiatives. Consequently, we employ a combination of salary, annual and long-term incentive-based cash and non-cash based compensation to retain, reward and provide incentives to our executives and key employees.

The company has not established any guidelines regarding stock ownership as the named executive officers already hold substantial equity interests which we believe directly align their interests with those of our shareholders.

Responsibility and Process

The Compensation Committee's primary responsibility is to assure that the Company's compensation programs and plans for executive officers are consistent with the Company's compensation philosophy, internal equity considerations, competitive practice, and the requirements of the appropriate regulatory bodies.

More specifically, with respect to the compensation of the named executive officers, the Committee has the responsibility to:

- Review, from time to time, the Company's compensation strategy to ensure that the Company's compensation programs and plans allow the Committee to structure the compensation of the chief executive officer and the other executive officers in a manner that is consistent with the Company's goals and objectives and shareholders' interests.

- Review and approve annually the Company's goals and objectives relevant to the compensation of the chief executive officer and other executive officers, including both quantitative and qualitative goals and objectives, evaluate the chief executive officer's and other executive officers' performance against those goals and objectives and set the chief executive officer's and other executive officers' compensation based on this evaluation

- Review and periodically make recommendations, if needed, to our board of directors with respect to all compensation plans maintained by the Company or proposed to be adopted by the Company.

- Exercise all rights, authority and functions of the Board under the Company's compensation plans including, but not limited to, establishing policies and procedures with respect to grants of stock options and/or other equity awards, and reviewing and approving all grants of stock options and/or other equity awards.

- Establish and periodically review policies with respect to executive officer perquisites.

- Review and recommend to the Board the terms of any employment agreement or any amendment to an employment agreement proposed between the Company and any executive officer.

The Committee makes all compensation decisions regarding the named executive officers. The Committee may solicit input from our named executive officers regarding goal setting and their performance if the Committee deems such input to be appropriate and helpful to these decisions. The Committee also approves the long term incentive awards for certain other key employees recommended by the named executive officers.

The Committee considers a number of factors in establishing the compensation program for our named executive officers, including compensation paid to executives of companies with which we compete, the relative size and stage of our development compared to others with which we compete, our performance compared to those competitive companies, the performance of our named executive officers, and input from third party consultants.

Although we strive to maintain a low cost operating structure, the Committee aims to set our compensation programs at competitive levels. Our compensation program consists primarily of base salary, annual cash incentive compensation and long-term equity awards.

We have a compensation program that is designed to reward company performance by giving greater weight, relative to base salary, to the annual cash incentive compensation and long-term incentive components of total compensation. In addition, we have endeavored to make our compensation program simple, transparent and directly aligned with performance and long-term growth in earnings per share.

Generally, we review the compensation of our named executive officers on an annual basis. In connection with our review of 2006 results and setting compensation for 2007, we increased our compensation targets to the 75th percentile of benchmarking data, compared to prior years when compensation was closer to the 50th percentile of that data. This increase was the result of a number of factors, most importantly, to recognize and reward our named executive officers for the performance of the Company, including substantial growth in revenues, net income and earnings per share, which has been, in large part, attributable to their superior performance. In addition, due to our thin executive officer structure, our named executive officers have a broader range of duties than those of similar officers of other companies. Finally, we recognized that technology companies, generally, and the ten identified competitors, in particular, pay above the more broadly defined market benchmarks. These objectives also recognize the Committee's expectation that, over the long term, VASCO will continue to generate returns greater than the average of its peer group.

Consultants

During 2006, the Committee engaged Hewitt Associates LLC, an independent global human resources consulting firm, to assist the Committee with structuring the compensation of our named executive officers. Hewitt provided benchmarking information, including its Total Compensation MeasurementTM (TCM) data. Because of the large variance in size of the companies comprising the TCM data, regression analysis was used to adjust the compensation data for differences in revenue to a value approximating the Company's revenues. Hewitt also advised the Committee with respect to types of compensation, including the accounting and tax treatment of various types of compensation, and provided recommendations with respect to our compensation structure.

Also the Committee worked with Hewitt to analyze the executive compensation of ten competitor companies: Activcard Corp., Entrust Inc., Internet Security Systems Inc., RSA Security Inc., Safenet Inc., Saflink Corp., Secure Computing Corp., Sonicwall Inc., Verisign Inc. and Watchguard Technologies. We utilized this analysis, as well as the TCM data, to assist us in setting compensation levels and in determining the appropriate mix of compensation elements.

We targeted the 75th percentile of the TCM data to establish compensation for 2007. We used data provided by Hewitt to establish a target value of total compensation for our named executive officers. Considering that target, our compensation philosophy and the referenced benchmarks, we determined how to divide total compensation among base salary, annual cash incentive compensation and long-term equity compensation. With additional input from Hewitt on valuing long-term incentive compensation, the Committee was able to set long-term incentive compensation consistent with the objective of providing a specific economic value to the named executive officers as opposed to targeting the number of shares.

Base Salary

Each of our named executive officers is party to an employment agreement with the Company and base salary and other elements of compensation are determined pursuant to those employment agreements. In establishing base salary, we reviewed the performance of each of our named executive officers, their duties and responsibilities relative to their counterparts at our benchmark group of competitors, as well as Company objectives with respect to retention and succession. The base salary for each executive officer is set on the basis of personal performance and the salary level in effect for comparable positions at companies that compete for executive talent.

Mr. Hunt's annual base salary during 2006 was $270,000. Based primarily on the Committee's decision to increase our target level of compensation from the 50th percentile to the 75th percentile of the TCM data, and on Mr. Hunt's performance evaluation, his annual base salary was increased approximately 11.1% to $300,000 for 2007.

During 2006, Mr. Valcke's annual base salary was 270,000 Euros, or approximately $338,000. In setting base salary for 2007, the Committee determined that Mr. Valcke's blended executive duties, including sales, marketing and personnel matters, in a thin executive structure, warranted an increase in annual base salary. For this reason, as well as the decision to increase our target level of compensation generally, Mr. Valcke's annual base salary was increased 11.1% to 300,000 Euros, or approximately $390,000, for 2007.

Mr. Bown's annual base salary during 2006 was $220,000. In setting base salary for 2007, the Committee considered his added responsibilities, including oversight of human resources, and his planned relocation to Zurich, Switzerland to establish our European headquarters. For this reason, as well as the decision to increase our target level of compensation generally, Mr. Bown's annual base salary was increased 13.6% to $250,000, for 2007.

Actual base salaries for each of the named executive officers for the fiscal years 2006, 2005 and 2004 are disclosed in the tables below.

Annual Cash Incentive Compensation

In February this year the Committee made non-equity incentive plan awards to our named executive officers, payment of which is subject to the achievement of an earnings per share target during 2007. We believe annual cash incentive plans help communicate critical success factors to our named executive officers, promote pay for performance and motivate our named executives to achieve higher levels of success.

The Committee established minimum, target and maximum levels of payment to which each named executive officer will be entitled, based on the relationship of audited earnings per fully diluted share, or "EPS," to the target established by the Committee, subject to a threshold equal to eighty percent of the target. Provided the threshold is met, each named executive officer will receive 50-75% of the target payment if EPS is 80-90% of the performance target, 100% of the target payment if EPS is 100% of the performance target, and 110%-150% of the target payment if EPS is 110-140% of the performance target. The payouts for the achievement of certain performance levels will be interpolated for achievement of performance goals between the stated values.

As noted above, cash incentive plan compensation was established as part of total compensation and in consideration of benchmark data regarding cash incentive plan compensation as a percentage of base salary and other factors discussed below.

Mr. Hunt's target payment for 2007 was maintained at approximately sixty-five percent of base salary. As a result of the increase in his base salary, the target payment increased from the 2006 target of $175,000 to $195,000, which corresponds to a threshold payment of $97,500, based on achievement of 80% of the EPS target, and a maximum payment of $292,500, based on achievement of 140% of the EPS target.

For the reasons set forth above, namely the additional executive duties performed by Mr. Valcke, we increased his 2007 target payment to seventy-five percent of base salary from sixty-five percent of base salary for 2006. Mr. Valcke's target incentive payment for 2007 is 225,000 Euros (approximately $292,500), which corresponds to a threshold payment of 112,500 Euros (approximately $146,250) and a maximum payment of 337,500 Euros (approximately $438,750). Mr. Valcke's target payment for 2006 was 175,000 Euros (approximately $227,500).

Mr. Bown's target incentive payment for 2007 is sixty percent of base salary, or $150,000. For the reasons set forth above, namely the additional duties performed by Mr. Bown and his relocation to Europe, we increased his target bonus to sixty percent of base salary from fifty-five percent of base salary, or $120,000, for 2006. His target incentive payment for 2007 corresponds to a threshold payment of $75,000 and a maximum payment of $225,000.

For the fiscal year ended December 31, 2006, earnings per share exceeded 110% of the target. Accordingly the maximum payout of 120% of the targeted payout of cash bonus incentive, provided under the terms of the 2006 award, was earned. The following incentive bonus payments were made in February, 2007 for the fiscal 2006 performance: T. Kendall Hunt $210,000; Jan Valcke 210,000 Euros (approximately $277,547, based on the exchange rate on February 15, 2007); and Clifford K. Bown $144,000. For fiscal year ended 2007, the Committee expects that the earnings per share target will be met.

Actual bonuses paid for each of the named executive officers for the fiscal years 2006, 2005 and 2004 are disclosed in the tables below.

Long Term Incentives

Our 1997 Stock Compensation Plan, which was amended and restated with the approval of our shareholders in 1999, serves as our primary vehicle for long-term incentive awards. The plan was designed to serve as a performance incentive to encourage our executives, key employees and others to acquire or increase a proprietary interest in the success of the company. The Committee believes that, over a period of time, our share performance will, to a great extent, reflect executive and key employee performance.

The stock compensation plan provides that options or other forms of stock compensation, including restricted stock and participation awards, may be granted at the discretion of the Committee, in such amounts and subject to such conditions as the Committee may determine. All awards of stock based compensation under the aforementioned Plan are based on the closing price on the date of grant, which generally occurs in January or February of each year to ensure that such date is not tied to the release of any material nonpublic information.

Prior to 2006, awards under our stock compensation plan included option awards and awards of restricted stock. For 2006, the Committee decided to move from the award of stock options, which had been the primary form of long-term incentive award in prior years, entirely to restricted stock. The number of full value restricted shares to be awarded was determined based on approximating the equivalent number of options granted in 2005. We made restricted stock awards of 35,000 shares, 35,000 shares and 20,000 shares to Messrs. Hunt, Valcke and Bown, respectively. Such awards will vest ratably over a four-year period from the date of grant.

For 2007, we made a number of changes in the types of awards made. First, we looked to other types of awards to achieve our compensation goals. Second, we did not target awards based on number of shares, but on a measure of the economic value to the recipients.

With respect to determining awards, we reviewed long-term incentive compensation as part of total compensation as compared to benchmark data regarding long-term incentive compensation as a percentage of base salary. Targeting the 75th percentile for long-term incentive compensation, we determined the economic value to the executive of each long-term grant to be awarded and determined the actual awards based on VASCO's closing stock price on the date of grant and various discounting factors. Fifty percent of the targeted value was granted as restricted stock and fifty percent of the targeted value was granted as a performance award. The Committee believes this mix of long-term incentives enhances the linkage between the creation of share holder value and long-term executive compensation; provides increased equity ownership by the named executives; and enables competitive levels of total compensation with an emphasis on payment for results. The Committee believes the 50/50 mix of direct award and award only if target results are achieved best aligns the named executive officers interests to those of shareholders.

Each restricted stock award vests in equal annual installments over a four-year period, beginning on the first anniversary of the date of grant. Each performance award will vest upon the achievement of cumulative EPS target through 2009. Under the terms of the award, no shares will vest if the cumulative EPS target is not met and no additional shares will be earned if the cumulative EPS target is exceeded. However, the Committee has the discretion to adjust the awards should it deem appropriate to do so. The EPS target has been set in alignment with the Company's strategic plan and the Committee expects that the plan will be achieved.

The Committee targeted an economic value to:

Mr. Hunt of $360,000, or 120% of base salary. As a result, he received a restricted stock award of 13,400 shares and a performance award of 20,200 shares.

Mr. Valcke of 210,000 Euros (approximately $270,000), or 70% of base salary. As a result, he received a restricted stock award of 10,200 shares and a performance award of 15,300 shares.

Mr. Bown of $162,500, or 65% of base salary. Accordingly, he received a restricted stock award of 6,100 shares and a performance award of 9,100 shares.

The value of equity awards for each of the named executive officers for the fiscal years 2006, 2005 and 2004 are disclosed in the tables below.

Retirement Plans

The Company does not provide retirement plans for the named executives.

Perquisites and Other Personal Benefits

Mr. Valcke is provided use of a company automobile. Mr. Bown, upon his relocation to Zurich, Switzerland to establish the Company's European Headquarters, will be provided an allowance for housing, an automobile, certain other relocation expenses and tax equalization.

Deductibility of Executive Compensation

As part of its role, the Committee reviews and considers the deductibility of executive compensation under Section 162(m) of the Internal Revenue Code of 1986, as amended, which limits the annual amount of compensation that the Company may deduct to $1,000,000 for any named executive officer. An exception to this regulation is for performance-based compensation which meets certain requirements of the code. Awards made under the Incentive Compensation and Stock Plan may qualify as performance-based compensation under Section 162(m) of the Code. However, not all grants that may be made under the plan or that have been made under the plan meet all requirements for deductibility under Section 162(m) of the code. However, unless the amounts involved become material, the Committee believes that it is more important to preserve its flexibility under the plan to craft appropriate incentive awards than to meet every requirement for deductibility with respect to every grant. The Committee continues to believe that this is not currently a significant issue, but continues to monitor the issue.

Employment Agreements

As mentioned above, each of our named executive officers is party to an employment agreement with the Company. In addition to governing base salary, incentive compensation and other items, each agreement provides for severance compensation, including severance compensation following a change in control of the Company.

Mr. Hunt's employment agreement is dated November 20, 2002. Under the terms of his agreement, in the event he is terminated without cause or he quits for good reason, whether after a change in control of the Company or not, Mr. Hunt will continue to receive his base pay and any applicable incentive compensation over a 24-month period. In the event of a change in control, if any payment or benefit to be received by Mr. Hunt would be subject to an excise tax under the Internal Revenue Code, the Company will increase the payments and benefits to Mr. Hunt to reimburse him, on an after-tax basis, for the amount of such excise tax. If Mr. Hunt is terminated for cause or quits without good reason, he will not be entitled to any severance compensation. Mr. Hunt has agreed to abide by several non-compete restrictions following the termination of his employment. The restricted period will be either 12 or 24 months, depending on the nature of the termination.

Mr. Valcke's employment agreement is dated June 29, 2005. Under the terms of his agreement, in the event he is terminated without cause or quits for good reason, whether after a change in control of the Company or not, Mr. Valcke will continue to receive his base pay and any applicable incentive compensation over a 24-month period. In the event of a change in control, if any payment or benefit to be received by Mr. Valcke would be subject to an excise tax under the Internal Revenue Code, the Company will increase the payments and benefits to Mr. Valcke to reimburse him, on an after-tax basis, for the amount of such excise tax. If Mr. Valcke is terminated for cause or quits without good reason, he will not be entitled to any severance compensation. Mr. Valcke has agreed to abide by several non-compete restrictions following the termination of his employment. The restricted period will be either 12 or 24 months, depending on the nature of the termination.

Mr. Bown's employment is dated January 1, 2003. Under the terms of his agreement, in the event he is terminated without cause or quits for good reason, whether after a change in control of the Company or not, Mr. Bown will continue to receive his base pay and any applicable incentive compensation over a 12-month period. In the event of a change in control, if any payment or benefit to be received by Mr. Bown would be subject to an excise tax under the Internal Revenue Code, the Company will increase the payments and benefits to Mr. Bown to reimburse him, on an after-tax basis, for the amount of such excise tax. If Mr. Bown is terminated for cause or quits without good reason, he will not be entitled to any severance compensation. Mr. Bown has agreed to abide by several non-compete restrictions following the termination of his employment. The restricted period will be either 3 or 12 months, depending on the nature of the termination. On February 26, 2007 the Company entered into a supplemental employment agreement with Mr. Bown which describes the terms and conditions applicable to his assignment in Zurich, Switzerland to establish the Company' European Headquarters. The agreement provides for housing and certain relocation expenses and a tax equalization policy.

We believe the severance and change in control benefits which our named executive officers are entitled to receive are comparable with those benefits offered by our competitors and necessary to retain a talented executive team.

SUMMARY COMPENSATION TABLE

The following table sets forth all compensation awarded to, earned by, or paid for services rendered to VASCO and our subsidiaries in all capacities during the years ended December 31, 2006, 2004 and 2004 for our Chief Executive Officer, President and Chief Operating Officer and Executive Vice President, who are the only executive officers of VASCO and our subsidiaries whose salary and bonus for such year exceeded $100,000 (collectively, the "Named Executive Officers").

NAME AND PRINCIPAL POSITION	YEAR	SALARY ($)	STOCK AWARDS ($)(2)	OPTION AWARDS ($)(4)	NON-EQUITY PLAN COMPEN-SATION ($)	ALL OTHER ANNUAL COM-PENSATION ($)(1)	TOTAL ($)
T. KENDALL HUNT Chairman and Chief Executive Officer	2006	$270,000	$ 78,258	$ 90,934	$210,000	--	$649,192
JAN VALCKE (3) President and Chief Operating Officer	2006	338,600	101,186	182,012	263,356	13,062	898,216
CLIFFORD K. BOWN Executive Vice President, Chief Financial Officer and Secretary	2006	220,000	60,004	91,025	144,000	--	515,029

(1) All other annual compensation reflects the value of Mr. Valcke's car allowance.

(2) Reflects the value of restricted stock granted on January 24, 2006 and January 14, 2005. The restricted stock vests 25% per year on the award anniversary date over a four year period. The value of the award reflects the amortization of the grant date fair value of the award, which is based on the number of shares awarded and the closing price of the stock on the date of award, over the vesting period.

(3) Mr. Valcke's salary and non-equity plan compensation for 2006, 2005 and 2004 were denominated in Euros. The above information reflects the Euros paid translated into U.S. dollars at the average exchange rate for the year.

(4) Compensation amounts for Option Awards for 2006 was determined in accordance with Statement of Financial Accounting Standards ("SFAS") 123(R), Stock-Based Compensation, which the Company adopted in 2006. The fair value of stock options at the date of grant is estimated using the Black-Scholes option pricing model, with the expected life adjusted to reflect the effect of post-vesting restrictions. This compensation expense is recorded on a straight-line basis over the vesting period of the options. The assumptions used to determine the fair falue of the stock options at the date of grant are described in footnote 10 of the audited financial statements.

GRANTS OF PLAN-BASED AWARDS

The following table sets forth all plan-based awards granted to the named executive officers during 2006.

NAME	GRANT DATE	ESTIMATED FUTURE PAYOUTS UNDER NON-EQUITY INCENTIVE PLAN AWARDS (1) THRES-HOLD ($)	TARGET ($)	MAXIMUM ($)	STOCK AWARDS: NUMBER OF SHARES OF STOCK (#)	GRANT DATE FAIR VALUE OF STOCK AWARDS ($)
T. KENDALL HUNT Chairman and Chief Executive Officer	1/24/06	140,000	175,000	210,000	35,000	333,900
JAN VALCKE President and Chief Operating Officer	1/24/06	175,570	219,460	263,356	35,000	333,900
CLIFFORD K. BOWN Executive Vice President, Chief Financial Officer and Secretary	1/24/06	96,0000	120,000	144,000	20,000	190,800

(1) The non-equity incentive plan awards reflect performance bonus targets for 2006. As discussed in the Annual Cash Incentive Compensation section above, the amounts are earned if the actual audited fully diluted earnings per share equals at least 90% of the target amount established by the Compensation Committee of the Board of Directors. The amounts included above were established and earned in 2006 and were paid at the maximum in 2007.

OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END

The following table sets forth the aggregate number of outstanding equity awards held by the named executive officers as of December 31, 2006.

	OPTION AWARDS				STOCK AWARDS	
NAME	SECURITIES UNDERLYING UNEXERCISED OPTIONS (#) EXERCISABLE	SECURITIES UNDERLYING UNEXERCISED OPTIONS (#) UNEXERCISABLE	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 (#)
T. KENDALL HUNT						
AWARD DATED:						
6/16/1997 (1)	125,000	--	$4.000	6/16/07	--	--
1/11/1999 (2)	30,000	--	3.125	1/11/09	--	--
1/11/2000 (1)	30,000	--	8.875	1/11/10	--	--
11/30/2001 (3)	90,000	--	1.250	11/30/11	--	--
1/9/2002 (3)	120,000	--	2.270	1/9/12	--	--
1/9/2003 (3)	125,000	--	0.720	1/9/13	--	--
1/8/2004 (3)	121,527	3,473	2.530	1/8/14	--	--
1/24/2006 (1)	--	--	--	--	35,000	414,750
JAN VALCKE						
AWARD DATED:						
8/18/1999 (2)	5,000	--	2.938	8/18/09	--	--
11/30/2001 (3)	50,000	--	1.250	11/30/11	--	--
1/9/2002 (3)	50,000	--	2.270	1/9/12	--	--
1/9/2003 (3)	100,000	--	0.720	1/9/13	--	--
1/8/2004 (3)	97,222	2,778	2.530	1/8/14	--	--
1/14/2005 (4)	47,915	52,085	6.380	1/14/12	--	--
1/14/2005 (1)	--	--	--	--	11,250	133,313
1/24/2006 (1)	--	--	--	--	35,000	414,750
CLIFFORD K. BOWN						
AWARD DATED:						
8/19/2002 (3)	75,000	--	1.200	8/19/12	--	
1/9/2003 (3)	50,000	--	0.720	1/9/13	--	--
1/8/2004 (3)	48,611	1,389	2.530	1/8/14	--	--
1/14/2005 (4)	23,957	26,043	6.380	1/14/12	--	--
1/14/2005 (1)	--	--	--	--	7,500	88,875
1/24/2006 (1)	--	--	--	--	20,000	237,000

(1) Vests annually over a 4-year period

(2) Vests annually over a 5-year period

(3) Vests monthly over a 36-month period

(4) Vests monthly over a 48-month period

OPTION EXERCISES AND STOCK VESTED

The following table sets forth the stock options exercised and stock awards vested in the year ended December 31, 2006 held by the named executive officers.

NAME	OPTION AWARDS: NUMBER OF SHARES ACQUIRED ON EXERCISE (#)	OPTION AWARDS: VALUE REALIZED ON EXERCISE ($)	STOCK AWARDS: NUMBER OF SHARES ACQUIRED ON VESTING (#)	STOCK AWARDS: VALUE REALIZED ON VESTING ($)
T. KENDALL HUNT	--	--	--	--
JAN VALCKE	28,750	224,688	3,750	38,025
CLIFFORD K. BOWN	25,000	203,750	2,500	25,350

PAYMENTS UPON TERMINATION OR CHANGE-IN-CONTROL

As noted above under Employment Agreements and in accordance with the terms of the Agreements as described above, each of the named executives will each be entitled to receive their then existing rates of base pay and incentive compensation for a period of time, as defined in their Agreements, if their employment is terminated without cause or if they quit for good reason, whether after a change in control of the Company or not. In addition, if there is a change of control of the Company, all of the outstanding and unvested stock options and awards, including those of the named executives, would automatically vest. Assuming that a triggering event had occurred on December 31, 2006, the total amount of the benefits that would be received by the named executives would be as follows:

(1) Mr. Hunt would receive from the Company aggregate cash compensation of $890,000 over a period of 24 months. In addition, Mr. Hunt's unvested stock options of 3,473 shares and unvested stock awards totaling 35,000 shares would become fully vested and would have a value of approximately $ $32,000 and $415,000, respectively, using the closing price of the Company's stock on December 31, 2006 of $11.85 per share.

(2) Mr. Valcke would receive from the Company aggregate cash compensation of 890,000 Euros (approximately $1,174,000 using the exchange rate as of December 31, 2006) over a period of 24 months. In addition, Mr. Valcke's unvested stock options of 54,863 shares and unvested stock awards of 46,250 shares would become fully vested and would have a value of approximately $311,000 and $548,000, respectively, using the closing price of the Company's stock on December 31, 2006 of $11.85 per share.

(3) Mr. Bown would receive from the Company aggregate cash compensation of $400,000 using the exchange rate as of February 28, 2007) over a period of 12 months. In addition, Mr. Bown's unvested stock options of 27,432 shares and unvested stock awards of 27,500 shares would become fully vested and would have a value of approximately $155,000 and $326,000, respectively, using the closing price of the Company's stock on December 31, 2006 of $11.85 per share.

COMPENSATION OF DIRECTORS

The Committee reviews and sets the salaries and incentive compensation for our executive officers. The Committee reviews information relevant to Director compensation and presents its recommendation for such compensation to the full Board for its approval. The Committee also administers our 1997 Stock Compensation Plan, referred to as the "Stock Plan." In its capacity as administrator of the Stock Plan, the Committee has authority to grant options and other stock-based awards to all employees and determine the terms thereof. The Committee also makes recommendations to the Board for its approval relative to options and other stock-based awards to be granted to non-employee Board members. The members of the Committee for 2006 were: John Fox, Jr., Chairman, Michael P. Cullinane, Jean, K. Holley, John R. Walter and Michael A. Mulshine through the date of his retirement, June 14, 2006.

Each of our directors received a quarterly cash payment of $5,000 in connection with his or her service on the Board of Directors in 2006. The directors also receive cash compensation for participation on committees of the Board as follows: Audit Committee Chair $10,000 annually, paid quarterly; other committee chairs $5,000 annually, paid quarterly; Audit Committee members $5,000 annually, paid quarterly; and other committee members $2,500 annually, paid quarterly. Our directors are also reimbursed for expenses incurred in connection with their attendance at periodic Board meetings. In addition, non-employee directors are eligible to receive option grants or other stock-based awards from time to time. In January, 2006, each non-employee director was awarded 6,500 shares of restricted stock. Such shares vest fully in one year. Ms. Holley's, who was appointed to the Board on August 2, 2006, was awarded of 3,250 shares of restricted stock.

	FEES EARNED OR PAID IN CASH ($)	STOCK AWARDS ($) (1)	OPTION AWARDS ($) (2)	TOTAL ($)
MICHAEL CULLINANE	$35,000	$58,134	$44,683	$137,817
JOHN WALTER	32,500	58,134	44,683	135,317
MICHAEL MULSHINE	15,000	58,134	44,683	117,817
JOHN FOX	32,500	58,134	33,793	124,427
JEAN HOLLEY	15,000	24,615	--	39,615

(1) The value of the award reflects the amortization of the full value of the award, which is based on the number of shares awarded and the closing price of the stock on the date of award, over the vesting period.

(2) Compensation amounts for Option Awards for 2006 was determined in accordance with Statement of Financial Accounting Standards ("SFAS") 123(R), Stock-Based Compensation, which the Company adopted in 2006. The fair value of stock options at the date of grant is estimated using the Black-Scholes option pricing model, with the expected life adjusted to reflect the effect of post-vesting restrictions. This compensation expense is recorded on a straight-line basis over the vesting period of the options. The assumptions used to determine the fair falue of the stock options at the date of grant are described in footnote 10 of the audited financial statements.

The following table sets forth the aggregate number of outstanding equity awards held by the non-employee Board members as of December 31, 2006.

	AGGREGATE NUMBER OF STOCK AWARDS OUTSTANDING AT 12/31/06	AGGREGATE NUMBER OF OPTION AWARDS OUTSTANDING AT 12/31/06
MICHAEL CULLINANE	6,500	112,000
JOHN WALTER	6,500	60,000
JOHN FOX	6,500	15,000
JEAN HOLLEY	3,250	--

In January 2006, the Board of Directors approved the issuance of equity awards with an aggregate grant date fair value of $62,010 for each Mr. Cullinane, Mr. Fox, Mr. Walter and Mr. Mulshine. In August 2006, the Board of

Directors approved the issuance of an equity award with an aggregate grant date fair value of $28,308 for Ms. Holley.

For 2007, our directors will receive a quarterly cash payment of $8,750 in connection with his or her service on the Board of Directors. The directors will also receive cash compensation for participation on committees of the Board as follows: Audit Committee Chair $10,000 annually, paid quarterly; other Committee Chairs $5,000 annually, paid quarterly and other Committee members $3,000 annually, paid quarterly. For 2007, each non-employee director was granted a deferred share award of 3,800 shares (restricted stock units). Such shares vest fully in one year, but will be paid only upon the director's departure from the Board.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

The current members of our Compensation Committee are Mr.Cullinane, Mr. Fox, Ms. Holley and Mr. Walter. None of these individuals were at any time during fiscal year 2006 or were formerly an officer or employee of ours. In addition, none or our executive officers serve as a member of the board of directors or compensation committee of any entity that has one or more executive officers serving as a member of our Board or Compensation Committee.

COMPENSATION COMMITTEE REPORT

The Compensation Committee has reviewed and discussed the section of this Annual Report on Form 10-K titled, "Compensation Discussion and Analysis," with management and, based on such review and discussions, recommended to our Board of Directors that the "Compensation Discussion and Analysis" section be included in this Annual Report on Form 10-K.

Submitted by the Compensation Committee:

John N. Fox, Jr., Chairman
Michael P. Cullinane
John R. Walter
Jean K. Holley

March 9, 2007

ITEM 12 - SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table sets forth shares of our common stock that are authorized to be issued as of December 31, 2006 under the Company's 1997 Stock Compensation Plan, as amended and restated in 1999:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plan (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	2,054,938	$3.25	5,368,070
Equity compensation plans not approved by security holders	0	Not applicable	Not applicable
Total	2,054,938	$3..25	5,368,070

The following table sets forth certain information with respect to the beneficial ownership of our common stock as of February 28, 2007 for each person or entity who is known to us to beneficially own five percent or more of the common stock. For purposes of the table, a person or group of persons is deemed to have beneficial ownership of any shares as of a given date that such person has the right to acquire within 60 days after such date.

NAME AND ADDRESS OF BENEFICIAL OWNER	AMOUNT AND NATURE OF BENEFICIAL OWNERSHIP	PERCENT OF CLASS
T. Kendall Hunt 1901 S. Meyers Road Ste. 210 Oakbrook Terrace, IL 60181	9,880,052 (1)	26.66%
Oberweis Asset Management, Inc. 333 Warrenville Road, Suite 500 Lisle, IL 60532	2,210,159 (2)	6.05

(1) Includes 100,000 shares held in the T. Kendall Hunt Charitable Remainder Trust and 1,011,300 shares held by the estate of Barbara J. Hunt, with Mr. Hunt as executor of the estate, as to which shares Mr. Hunt disclaims beneficial ownership. The amount also includes 520,000 shares that may be acquired pursuant to options which are exercisable at February 28, 2007 or become exercisable within 60 days.

(2) Based on a Schedule 13G/A filed with the SEC on February 14, 2007.

The table below sets forth certain information with respect to the beneficial ownership of our common stock as of February 28, 2007 for (i) each of our directors, (ii) each of our named executive officers, and (iii) all directors and executive officers as a group. The persons named in the table have sole voting and investment power with respect to all shares of common stock shown as beneficially owned by them unless otherwise indicated. For purposes of the table, a person or group of persons is deemed to have beneficial ownership of any shares as of a given date that such person has the right to acquire within 60 days after such date.

NAME AND ADDRESS OF BENEFICIAL OWNER	AMOUNT AND NATURE OF BENEFICIAL OWNERSHIP (1)	PERCENT OF CLASS
T. Kendall Hunt 1901 S. Meyers Road Ste. 210 Oakbrook Terrace, IL 60181	9,880,052(2)	26,66%
Jan Valcke Koningin Astridlaan 164 B-1780 Wemmel, Belgium	419,200(3)	1.14%
Cliff Bown 1901 S. Meyers Road Ste. 210 Oakbrook Terrace, IL 60181	253,183(4)	0.69%
Michael P. Cullinane 1901 S. Meyers Road Ste. 210 Oakbrook Terrace, IL 60181	122,300(5)	0.33%
John N. Fox 1901 S. Meyers Road Ste. 210 Oakbrook Terrace, IL 60181	28,300(6)	0.08%
Jean K. Holley 1901 S. Meyers Road Ste. 210 Oakbrook Terrace, IL 60181	7,050	0.02%
John R. Walter 1901 S. Meyers Road Ste. 210 Oakbrook Terrace, IL 60181	90,300(7)	0.25%
All Executive Officers and Directors as a Group (7 persons)	10,800,385	28.57%

(1) The number of shares beneficially owned by each director and executive officer is determined under rules promulgated by the Securities and Exchange Commission, and the information is not necessarily indicative of beneficial ownership for any other purpose. Under such rules, beneficial ownership includes any shares as to which the individual has sole or shared voting power or investment power and also any shares that the individual has the right to acquire within 60 days after February 28, 2007 through the exercise of any stock option or other right. The inclusion herein of such shares, however, does not constitute an admission that the named stockholder is a direct or indirect beneficial owner of such shares. Unless otherwise indicated, each person or entity named in the table has sole voting power and investment power (or shares such power with his or her spouse) with respect to all shares of capital stock listed as owned by such person or entity.

(2) Includes 100,000 shares held in the T. Kendall Hunt Charitable Remainder Trust and 1,011,300 shares held by the estate of Barbara J. Hunt, with Mr. Hunt as executor of the estate, as to which shares Mr. Hunt disclaims beneficial ownership. The amount also includes 520,000 shares that may be acquired pursuant to

options which are exercisable at February 28, 2007 or become exercisable within 60 days.

(3) Includes 355,000 shares that may be acquired pursuant to options which are exercisable at February 28, 2007 or become exercisable within 60 days.

(4) Includes 202,083 shares that may be acquired pursuant to options which are exercisable at February 28, 2007 or become exercisable within 60 days.

(5) Includes 112,000 shares that may be acquired pursuant to options which are exercisable at February 28, 2007 or become exercisable within 60 days.

(6) Includes 15,000 shares that may be acquired pursuant to options which are exercisable at February 28, 2007 or become exercisable within 60 days.

(7) Includes 60,000 shares that may be acquired pursuant to options which are exercisable at February 28, 2007 or become exercisable within 60 days.

ITEM 13 - CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

TRANSACTIONS WITH RELATED PERSONS

In July 2003, the Company sold its VACMAN Enterprise business unit ("VACMAN") to SecureD Services, Inc. ("SSI"), a then newly organized company in which T. Kendall Hunt had a 19% equity ownership interest and was one of seven directors on its board. The transaction was approved by all of the independent directors of the Company. The Company received a $1.1 million senior secured promissory note and 2,000,000 shares of convertible preferred stock from SSI in exchange for the VACMAN assets. The note was payable in 36 monthly installments and bore an interest of 6% per annum. The preferred stock was to pay a 6% cumulative stock dividend quarterly, and was convertible into SSI common stock on a share-for-share basis in phases commencing July 1, 2005. We valued the transaction at approximately $1.6 million, using a discounted value of the payment streams expected from the note and preferred stock.

In 2006, SSI discontinued its monthly note payments to the Company due to its continuing operating losses and an inability to secure new financing. We concluded that a decline in fair value had occurred, which was other than temporary in nature as defined in EITF Issue 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments. We eventually collected the entire note receivable and interest, but did record an asset impairment charge of $600 in 2006 to fully write down the value of the investment in the preferred stock of SSI.

As we have not engaged in related person transactions, with the exception of the one transaction noted above, we have not adopted any formal policies or procedures for the review, approval or ratification of related person transactions. The disclosed transaction was approved by action of the entire Board of Directors, with the interested person abstaining.

DIRECTOR INDEPENDENCE

Our Board of Directors has determined that directors Michael P. Cullinane, John N. Fox, Jr., Jean K. Holley and John R. Walter are independent directors under Nasdaq independence standards. Accordingly, all members of our audit, nominating and compensation committees were determined to be independent. The only member of the Board of Directors who was determined to be not independent was T. Kendall Hunt.

ITEM 14 - PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following sets forth the amount of fees paid to our registered public accounting firm, KPMG LLP, for services rendered in 2006 and 2005 (in thousands):

AUDIT FEES: The aggregate fees billed by KPMG LLP for professional services rendered for the audit of the Company's annual financial statements, the reviews of the financial statements included in the Company's quarterly reports on Form 10-Q, and services normally provided by the independent auditor in connection with statutory and regulatory filings were $468 for the fiscal year ended 2006, and $367 for the fiscal year ended December 31, 2005.

AUDIT-RELATED FEES: There were no audit-related fees paid in 2006 or 2005.

TAX FEES: The aggregate fees billed by KPMG LLP for tax compliance and tax advice were $2 in 2006 and $2 in 2005. The fee for 2006 and 2005 related to the filing of a foreign subsidiary tax return.

ALL OTHER FEES: The aggregate fees billed by KPMG LLP for filing withholding returns on intercompany dividend payments were $4 in 2006. Fees for due diligence and reviews of registrations related to the acquisition of AOS Hagenuk aggregated $55 in 2005.

It is currently the policy of the Audit Committee of the Board of Directors to pre-approve all services rendered by KPMG LLP. The Audit Committee pre-approved all of the above fees for both 2006 and 2005.

PART IV

ITEM 15 - EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) (1) The following consolidated financial statements and notes thereto, and the related independent auditors' report, are included on pages F-1 through F-23 of this Form 10-K:

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of December 31, 2006 and 2005

Consolidated Statements of Operations for the Years Ended December 31, 2006, 2005 and 2004

Consolidated Statements of Comprehensive Income (Loss) for the Years Ended December 31, 2006, 2005 and 2004

Consolidated Statements of Stockholders' Equity for the Years Ended December 31, 2006, 2005 and 2004

Consolidated Statements of Cash Flows for the Years Ended December 31, 2006, 2005 and 2004

Notes to Consolidated Financial Statements

(2) The following consolidated financial statement schedule of the Company is included in this Form 10-K:

- Schedule II - Valuation and Qualifying Accounts

All other financial statement schedules are omitted because such schedules are not required or the information required has been presented in the aforementioned consolidated financial statements.

(3) The following exhibits are filed with this Form 10-K or incorporated by reference as set forth at the end of the list of exhibits:

EXHIBIT NUMBER	DESCRIPTION
+3.1	Certificate of Incorporation of Registrant, as amended.
++3.2	Bylaws of Registrant, as amended and restated.
4.1	Intentionally Omitted.
+4.2	Specimen of Registrant's Common Stock Certificate.
4.3	Intentionally Omitted.
+4.4	Form of Letter of Transmittal and Release.
+4.5	Form of Registrant's Warrant Agreement.
+4.6	Form of Registrant's Option Agreement.
+4.7	Form of Registrant's Convertible Note Agreement.
+10.1	Netscape Communications Corporation OEM Software Order Form dated March 18, 1997 between VASCO Data Security, Inc. and Netscape Communications Corporation.**
+10.2	License Agreement between VASCO Data Security, Inc. and SHIVA Corporation effective June 5, 1997.**
+10.3	Heads of Agreement between VASCO Data Security International, Inc., VASCO Data Security Europe S.A., Digiline International Luxembourg, Digiline S.A., Digipass S.A., Dominique Colard and Tops S.A. dated May 13, 1996.
+10.4	Agreement relating to additional terms and conditions to the Heads of Agreement dated July 9, 1996, among the parties listed in Exhibit 10.3.
+10.5	Agreement between VASCO Data Security International, Inc., VASCO Data Security Europe SA/NV, Mario Houthooft and Guy Denudt dated March 1, 1996.
+10.6	Asset Purchase Agreement dated as of March 1996 by and between Lintel Security SA/NV and Lintel SA/NV, Mario Houthooft and Guy Denudt.
+10.7	Management Agreement dated January 31, 1997 between LINK BVBA and VASCO Data Security NV/SA (concerning services of Mario Houthooft).
+10.8	Sublease Agreement by and between VASCO Data Security International, Inc. and APL Land Transport Services, Inc. dated as of August 29, 1997.
+10.10	Lease Agreement by and between TOPS S.A. and Digipass S.A. effective July 1, 1996.
+10.11	Lease Agreement by and between Perkins Commercial Management Company, Inc. and VASCO Data Security, Inc. dated November 21, 1995.
+10.12	Asset Purchase Agreement by and between VASCO Data Security International, Inc. and Wizdom Systems, Inc. dated August 20, 1996.
+10.13	1997 VASCO Data Security International, Inc. Stock Option Plan, as amended.
+10.14	Distributor Agreement between VASCO Data Security, Inc. and Hucom, Inc. dated June 3, 1997.**

EXHIBIT NUMBER	DESCRIPTION
+10.15	Non-Exclusive Distributor Agreement by and between VASCO Data Security, Inc. and Concord-Eracom Nederland BV dated May 1, 1994.**
+10.16	Banque Paribas Belgique S. A. Convertible Loan Agreement for $3.4 million.
+10.17	Pledge Agreement dated July 15, 1997 by and between T. Kendall Hunt and Banque Paribas Belgique S.A.
+10.18	Engagement Letter between Banque Paribas S.A. and VASCO Data Security International, Inc. dated June 20, 1997, as amended.
+10.19	Financing Agreement between Generale Bank and VASCO Data Security International, Inc. dated as of June 27, 1997.
+10.20	Letter Agreement between Generale Bank and VASCO Data Security International, Inc. dated June 26, 1997.
+10.21	Form of Warrant dated June 16, 1997 (with Schedule).
+10.22	Form of Warrant dated October 31, 1995 (with Schedule).
+10.23	Form of Warrant dated March 7, 1997 (with Schedule).
+10.24	Form of Warrant dated August 13, 1996 (with Schedule).
+10.25	Form of Warrant dated June 27, 1996 (with Schedule).
+10.26	Form of Warrant dated June 27, 1996 (with Schedule).
+10.27	Convertible Note in the principal amount of $500,000.00, payable to Generale de Banque dated July 1, 1997 (with Schedule).
+10.28	Agreement by and between VASCO Data Security NV/SA and S.I. Electronics Limited effective January 21, 1997.**
+10.29	Agreement effective May 1, 1993 by and between Digipass s.a. and Digiline s.a.r.l.
+10.30	VASCO Data Security, Inc. purchase order issued to National Electronic & Watch Co. LTD. **
+10.31	VASCO Data Security, Inc. purchase order issued to Micronix Integrated Systems.**
+10.32	Agreement between Registrant and VASCO Data Security International, Inc. dated as of August 25, 1997.
+10.33	Convertible Note dated June 1, 1996 made payable to Mario Houthooft in the principal amount of $373,750.00.
+10.34	Convertible Note dated June 1, 1996 made payable to Guy Denudt in the principal amount of $373,750.00.
+10.35	Osprey Partners Warrant (and Statement of Rights to Warrant and Form of Exercise) issued June 1, 1992.
+10.36	Registration Rights Agreement dated as of October 19, 1995 between certain purchasing shareholders and VASCO Data Security International, Inc.
+10.37	First Amendment to Registration Rights Agreement dated July 1, 1996.
+10.38	Second Amendment to Registration Rights Agreement dated March 7, 1997.

EXHIBIT NUMBER	DESCRIPTION
+10.39	Purchase Agreement by and between VASCO Data Security International, Inc. and Kyoto Securities Ltd.
+10.40	Convertible Note dated May 28, 1996 payable to Kyoto Securities, Ltd. in principal amount of $5 million.
+10.41	Amendment to Purchase Agreement and Convertible Note by and between VASCO Data Security International, Inc. and Kyoto Securities, Ltd.
+10.42	Executive Incentive Compensation Plan.
+10.43	Letter for Credit granted by Generale de Banque to Digipass SA dated January 27, 1997.
++10.44	License Agreement dated as of March 25, 1998 by and between VASCO Data Security International, Inc., for itself and its subsidiaries, and Lernout & Hauspie Speech Products N.V.
++10.45	Loan Agreement dated as of March 31, 1998 by and between Lernout & Hauspie Speech Products N.V. and VASCO Data Security International, Inc.
++10.46	Convertible Note dated April 1, 1998 payable to Lernout & Hauspie Speech Products N.V. in the principal amount of $3 million.
#10.47	Amendment I dated as of December 31, 1998 to the License Agreement dated as of March 25, 1998 by and between VASCO Data Security International, Inc., for itself and its subsidiaries, and Lernout & Hauspie Speech Products N.V.
10.48	Acquisition of Identikey, Ltd. (Incorporated by reference - Form 8-K filed March 29, 2001.)
10.49	Agreement with Artesia Bank to revise the terms of the $3.4 million convertible loan. (Incorporated by reference - Form 8-K filed August 9, 2001.)
## 10.50	Employment agreement with T. Kendall Hunt.
10.51	Not currently used
## 10.52	Employment agreement with Clifford Bown.
## 10.53	Indemnification Agreement with T. Kendall Hunt.
10.54	Not currently used
10.55	Share Sale and Purchase Agreement by and among VASCO Data Security International, Inc., A.O.S. Holding B.V., Filipan Beheer B.V., Mr. Mladen Filipan and Pijnenburg Beheer N.V., dated February 4, 2005 (Incorporated by reference - Form 8-K filed February 8, 2005.
10.56	Registration Rights Agreement by and among A.O.S. Holding B.V., Filipan Beheer B.V., Mr. Mladen Filipan, Pijnenburg Beheer N.V. and VASCO Data Security International, Inc., dated February 4, 2005 (Incorporated by reference - Form 8-K filed February 8, 2005.
10.57	Employment Agreement by and between VASCO Data Security International, Inc. and Jan Valcke effective as of January 1, 2005 (Incorporated by reference - Form 8-K filed July 1, 2005.Letter agreement dated February 26, 2007, supplementing the Employment Agreement dated January 1, 2003 between the Company and Clifford K. Bown.

EXHIBIT NUMBER	DESCRIPTION
*** 10.58	Letter agreement dated February 26, 2007, supplementing the Employment Agreement dated January 1, 2003 between the Company and Clifford K. Bown
* 14.1	Code of Ethics.
21	Subsidiaries of Registrant. (Incorporated by reference - Form S-1 filed February 27, 2006.)
23	Consent of KPMG LLP.
31.1	Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated March 15, 2007.
31.2	Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated March 15, 2007.
32.1	Section 1350 Certification of Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated March 15, 2007.
32.2	Section 1350 Certification of Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated March 15, 2007.

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+ Incorporated by reference to the Registrant's Registration Statement on Form S-4, as amended (Registration No. 333-35563), originally filed with the Securities and Exchange Commission on September 12, 1997.

++ Incorporated by reference to the Registrant's Annual Report on Form 10-K, originally filed with the Securities and Exchange Commission on May 5, 1998.

Incorporated by reference to the Registrant's Annual Report on Form 10-K, originally filed with the Securities and Exchange Commission on April 14, 1999.

Incorporated by reference to the Registrant's Annual Report on Form 10-K, originally filed with the Securities and Exchange Commission on March 31, 2003.

* Incorporated by reference to the Registrant's Annual Report on Form 10-K, originally filed with the Securities and Exchange Commission on March 30, 2004.

** Confidential treatment has been granted for the omitted portions of this document.

*** Incorporated by reference to the Registrant's Annual Report on Form 10-K, originally filed with the Securities and Exchange Commission on March 2, 2007.

(b) VASCO DATA SECURITY INTERNATIONAL, INC. WILL FURNISH ANY OF THE ABOVE EXHIBITS TO ITS STOCKHOLDERS UPON WRITTEN REQUEST ADDRESSED TO THE SECRETARY AT THE ADDRESS GIVEN ON THE COVER PAGE OF THIS FORM 10-K. THE CHARGE FOR FURNISHING COPIES OF THE EXHIBITS IS $.25 PER PAGE, PLUS POSTAGE.

VASCO DATA SECURITY INTERNATIONAL, INC.
INDEX TO FINANCIAL STATEMENTS AND SCHEDULE

All other financial statement schedules are omitted because they are not applicable or the required information is shown in the consolidated financial statements or notes thereto.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
VASCO Data Security International, Inc.:

We have audited the accompanying consolidated balance sheets of VASCO Data Security International, Inc. and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2006. In connection with our audits of the consolidated financial statements, we have also audited the accompanying consolidated financial statement Schedule II - Valuation and Qualifying Accounts. These consolidated financial statements and the consolidated financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and the consolidated financial statement schedule based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of VASCO Data Security International, Inc. and subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related consolidated financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As described in Note 1 to the consolidated financial statements, in 2006 the Company adopted the provisions of Statement of Financial Accounting Standards No. 123R, Share-Based Payment, modifying share-based compensation.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of VASCO Data Security International, Inc.'s internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control--Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 15, 2007 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

/s/ KPMG LLP
Chicago, Illinois
March 15, 2007

VASCO DATA SECURITY INTERNATIONAL, INC.
CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS EXCEPT SHARE DATA)

	DECEMBER 31, 2006	DECEMBER 31, 2005
ASSETS		
CURRENT ASSETS:		
Cash and equivalents	$ 14,768	$ 16,962
Restricted cash	0	181
Accounts receivable, net of allowance for doubtful accounts of $712 and $156 in 2006 and 2005, respectively	19,617	12,083
Inventories, net	4,275	1,570
Prepaid expenses	1,295	726
Deferred income taxes	375	117
Foreign sales tax receivable	967	89
Other current assets	23	451
Total current assets	41,320	32,179
Property and equipment:		
Furniture and fixtures	2,273	1,893
Office equipment	2,395	2,155
	4,668	4,048
Accumulated depreciation	(3,246)	(3,066)
Property and equipment, net	1,422	982
Goodwill, net of accummulated amortization	12,685	6,665
Intangible assets, net of accumulated amortization	3,013	1,054
Other assets, net of accumulated amortization	4,206	625
TOTAL ASSETS	$ 62,646	$ 41,505
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Bank borrowing	$ 2,154	$ 3,173
Accounts payable	7,579	4,753
Deferred revenue	2,081	1,765
Accrued wages and payroll taxes	3,176	2,329
Income taxes payable	1,396	1,547
Current deferred income taxes	125	--
Other accrued expenses	2,751	2,287
Total current liabilities	19,262	15,854
Deferred warranty revenues	302	256
Long-term compensation plan	356	--
Long-term deferred taxes	520	--
TOTAL LIABILITIES	20,440	16,110
STOCKHOLDERS' EQUITY :		
Common stock, $.001 par value - 75,000,000 shares authorized; 36,546,289 shares issued and outstanding in 2006, 36,180,425 shares issued and outstanding in 2005	37	36
Additional paid-in capital	61,251	59,625
Deferred compensation	--	(403)
Accumulated deficit	(20,398)	(32,985)
Accumulated other comprehensive income (loss) - Cumulative translation adjustment	-- 1,316	(878)
Total stockholders' equity	42,206	25,395
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 62,646	$ 41,505

See accompanying notes to consolidated financial statements.

VASCO DATA SECURITY INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE DATA)

	For the Years Ended December 31,		
	2006	2005	2004
Net revenues	$76,062	$54,579	$29,893
Cost of goods sold	24,359	20,141	9,184
Gross profit	51,703	34,438	20,709
Operating costs:			
Sales and marketing	19,482	14,784	9,160
Research and development	5,529	3,579	2,441
General and administrative	7,157	4,556	3,191
Restructuring recoveries	--	(172)	(32)
Amortization of purchased intangible assets	593	738	397
Total operating costs	32,761	23,485	15,157
Operating income	18,942	10,953	5,552
Interest income, net	121	69	120
Impairment of investment in Secured Services, Inc.	(600)	--	--
Other income (expense), net	178	506	(539)
Income before income taxes	18,641	11,528	5,133
Provision for income taxes	6,054	3,827	1,880
Net income	12,587	7,701	3,253
Preferred stock accretion and dividends	--	(14)	(232)
Net income available to common shareholders	$12,587	$ 7,687	$ 3,021
Net income per share:			
Basic	$ 0.35	$ 0.22	$ 0.09
Diluted	$ 0.33	$ 0.21	$ 0.09
Weighted average common shares outstanding:			
Basic	36,230	35,429	32,216
Dilutive	37,765	37,244	33,128

See accompanying notes to consolidated financial statements.

VASCO DATA SECURITY INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(IN THOUSANDS)

	For the Years Ended December 31,		
	2006	2005	2004
Net income	$12,587	$ 7,701	$3,253
Other comprehensive income (loss) -			
Cumulative translation adjustment	2,194	(1,218)	687
Comprehensive income	$14,781	$ 6,483	$3,940

See accompanying notes to consolidated financial statements.

VASCO DATA SECURITY INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004
(IN THOUSANDS EXCEPT SHARE DATA)

Description	Preferred Stock Shares	Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Deferred Compen-sation	Accumulated Deficit	Accumulated Other Com-prehensive Income (Loss)	Total Stock-holders' Equity
BALANCE AT DECEMBER 31, 2003	800	$ 5,786	30,425,284	$30	$47,167	$ --	$(43,693)	$ (347)	$ 8,943
Net income	--	--	--	--	--	--	3,253	--	3,253
Foreign currency translation adjustment	--	--	--	--	--	--	--	687	687
Exercise of stock options	--	--	118,062	1	188	--	--	--	189
Conversion of series D preferred stock	(592)	(4,282)	2,960,000	3	4,279	--	--	--	--
Cash dividend on series D preferred stock	--	--	--	--	--	--	(182)	--	(182)
Dividend paid in common stock on series D preferred stock	--	--	64,843	--	144	--	(23)	--	121
Dividend payable	--	--	--	--	--	--	(27)	--	(27)
Conversion of series D warrants	--	--	13,500	--	47	--	--	--	47
BALANCE AT DECEMBER 31, 2004	208	1,504	33,581,689	34	51,825	--	(40,672)	340	13,031
Net income	--	--	--	--	--	--	7,701	--	7,701
Foreign currency translation adjustment	--	--	--	--	--	--	--	(1,218)	(1,218)
Exercise of stock options	--	--	690,807	1	1,902	--	--	--	1,903
Common stock issued for acquisitions	--	--	331,104	--	2,278	--	--	--	2,278
Restricted stock awards	--	--	84,500	--	538	(403)	--	--	135
Conversion of series D preferred stock	(208)	(1,504)	1,040,000	1	1,503	--	--	--	--
Cash dividend on series D preferred stock	--	--	--	--	--	--	(14)	--	(14)
Conversion of warrants	--	--	447,250	--	1,552	--	--	--	1,552
Dividend paid in common stock on series D preferred stock	--	--	5,075	--	27	--	--	--	27
BALANCE AT DECEMBER 31, 2005	--	--	36,180,425	36	59,625	(403)	(32,985)	(878)	25,395
Net income	--	--	--	--	--	--	12,587	--	12,587
Reclassification for adoption of FAS 123(R)	--	--	--	--	(403)	403	--	--	--
Foreign currency translation adjustment	--	--	--	--	--	--	--	2,194	2,194
Exercise of stock options	--	--	228,614	1	683	--	--	--	684
Restricted stock awards	--	--	111,750	--	577	--	--	--	577
Conversion of warrants	--	--	25,500	--	88	--	--	--	88
Stock option compensation	--	--	--	--	681	--	--	--	681
BALANCE AT DECEMBER 31, 2006	--	$ --	36,546,289	$37	$61,251	$ --	$(20,398)	$ 1,316	$ 42,206

See accompanying notes to consolidated financial statements.

VASCO DATA SECURITY INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)

	For the Years ended December 31, 2006	2005	2004
Cash flows from operating activities:			
Net income from continuing operations	$ 12,587	$ 7,701	$3,253
Adjustments to reconcile net income from continuing operations to net cash provided by operating activities:			
Impairment of SSI Investment	600	--	--
Depreciation and amortization	1,242	1,076	734
Deferred tax expense (benefit)	(632)	(122)	46
Non-cash compensation and other expenses	1,259	146	16
Changes in assets and liabilities, net of effects of acquisitions:			
Accounts receivable, net	(5,348)	(7,114)	(3,002)
Inventories, net	(2,175)	(438)	(168)
Other current assets	(558)	73	(260)
Accounts payable	1,338	2,342	1,138
Income taxes payable	(296)	1,257	598
Accrued expenses	317	1,686	202
Other current liabilities	(515)	935	320
Net cash provided by operations	7,819	7,542	2,877
Cash flows from investing activities:			
Business acquisitions, net of cash acquired	(7,362)	(3,990)	--
Additions to property and equipment	(459)	(507)	(252)
Capitalized software	(2,448)	--	--
Other assets	(74)	(182)	(64)
Increase in restricted cash	181	(127)	(82)
Disposals of property, plant and equipment, net	59	7	--
Payments received on note receivable	220	343	304
Net cash used in investing activities	(9,883)	(4,456)	(94)
Cash flows from financing activities:			
(Repayment) proceeds from bank borrowing	(1,019)	3,173	--
Proceeds from exercise of stock options and warrants	772	3,455	236
Dividends paid on preferred stock	--	(14)	(182)
Net cash provided by (used in) financing activities	(247)	6,614	54
Effect of exchange rate changes on cash	117	(876)	484
Net increase in cash	(2,194)	8,824	3,321
Cash and equivalents, beginning of year	16,962	8,138	4,817
Cash and equivlents, end of year	$ 14,768	$16,962	$8,138

See accompanying notes to consolidated financial statements.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

VASCO Data Security International, Inc. and its wholly owned subsidiaries (the Company) design, develop, market and support security products and services which manage and protect against unauthorized access to computer systems of corporate and government customers. VASCO has operations in Austria, Australia, Belgium, China, The Netherlands, Singapore and the United States (U.S.).

Principles of Consolidation

The consolidated financial statements include the accounts of VASCO Data Security International, Inc. and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Foreign Currency Translation and Transactions

The financial position and results of operations of the Company's foreign subsidiaries are measured using the local currency as the functional currency. Accordingly, assets and liabilities are translated into U.S. dollars using current exchange rates as of the balance sheet date. Revenues and expenses are translated at average exchange rates prevailing during the year. Translation adjustments arising from differences in exchange rates are included as a separate component of stockholders' equity. Gains and losses resulting from foreign currency transactions are included in the consolidated statements of operations. Foreign exchange transaction gains (losses) aggregating $(65), $330 and $(538) are included in other income (expense) for 2006, 2005 and 2004, respectively. We implemented a hedging program in the second quarter of 2005 to minimize the impact of changes in currency rates.

Revenue Recognition

The Company recognizes revenue in accordance with AICPA Statement of Position ("SOP") 97-2 and SEC Staff Accounting Bulletin ("SAB") 104. Revenue is recognized when there is persuasive evidence that an arrangement exists, delivery has occurred, the fee is fixed or determinable and collection of the revenue is probable.

Hardware Revenue and License Fees: Revenues from the sale of computer security hardware or the license of software are recorded upon shipment or, if an acceptance period is allowed, at the later of shipment or customer acceptance. No significant obligations or contingencies exist with regard to delivery, customer acceptance or rights of return at the time revenue is recognized.

Support Agreements: Support agreements generally call for the Company to provide technical support and software updates to customers. Revenue on technical support and software update rights is deferred and recognized ratably over the term of the support agreement.

Consulting and Education Services: The Company provides consulting and education services to its customers. Revenue from such services is recognized during the period in which the services are performed.

Multiple-Element Arrangements: The Company allocates revenues to the various elements of the arrangements based on the estimated fair value of each deliverable as required by SOP 97-2 and Emerging Issues Task Force ("EITF") Issue No. 00-21. The fair value for each element is based on the price charged when that element is sold separately, price lists, renewal rates and other methods. When discounts are given in a multiple-element arrangement, a proportionate amount of the discount is applied to each element based on each element's fair value without regard to the discount. The estimated fair value of undelivered elements is deferred and recorded as revenue when services are performed or products are delivered.

Sales to distributors and resellers are recognized on the same basis as sales made directly to customers. Revenue is recognized when there is persuasive evidence that an arrangement exists, delivery has occurred, the fee is fixed or determinable and collection of the revenue is probable.

For large-volume transactions, the Company may negotiate a specific price that is based on the number of users of the software license or quantities of hardware supplied. The per unit prices for large-volume transactions are generally lower than transactions for smaller quantities and the price differences are commonly referred to as volume-purchase discounts.

Cash and Equivalents

The Company classifies as cash and equivalents amounts on deposit in banks and cash invested temporarily in various instruments with maturities of three months or less at time of purchase.

Restricted cash of $181 at December 31, 2005 supports a bank guarantee issued in favor of a customer relating to a contract prepayment. Under the terms of the contract, the Company obtained unrestricted use of this cash in 2006 when it fulfilled its commitment to deliver the products.

Accounts Receivable and Allowance for Doubtful Accounts

The Company records trade accounts receivable at invoice values, which are generally equal to fair value. The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make payments for goods and services. The Company analyzes accounts receivable, customer credit-worthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. The allowance is based on a specific review of all significant past-due accounts. If the financial condition of our customers deteriorates, resulting in an impairment of their ability to make payments, additional allowances may be required.

Inventories

Inventories, consisting principally of hardware and component parts, are stated at the lower of cost or market. Cost is determined using the first-in-first-out (FIFO) method. The Company writes down inventory where it appears that the carrying cost of the inventory may not be recovered through subsequent sale of the inventory. The Company analyzes the quantity of inventory on hand, the quantity sold in the past year, the anticipated sales volume in the form of sales to new customers as well as sales to previous customers, the expected sales price and the cost of making the sale when evaluating the valuation of our inventory. If the sales volume or sales price of a specific model declines significantly, additional write downs may be required.

Property and Equipment

Property and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets ranging from three to seven years. Additions and improvements are capitalized, while expenditures for maintenance and repairs are charged to operations as incurred. Gains or losses resulting from sales or retirements are recorded as incurred, at which time related costs and accumulated depreciation are removed from the accounts.

Research and Development Costs

Costs for research and development, principally the design and development of hardware and software prior to the determination of technological feasibility, are expensed as incurred on a project-by-project basis. The Company's research and development costs were $5,529, $3,579 and $2,441 for 2006, 2005 and 2004, respectively.

Software Development Costs

The Company capitalizes software development costs in accordance with Statement of Financial Accounting Standards (SFAS) No. 86, Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed. Research costs and software development costs, prior to the establishment of technological feasibility, determined based upon the creation of a working model, are expensed as incurred. Our software capitalization policy currently defines technological feasibility as a functioning beta test prototype with confirmed manufacturability (a working model), within a reasonably predictable range of costs. Additional criteria include receptive customers, or potential customers, as evidenced by interest expressed in a beta test prototype, at some suggested selling price. The Company's policy is to amortize capitalized costs by the greater of (a) the ratio that current gross revenues for a product bear to the total of current and anticipated future gross revenues for that product or (b) the straight-line method over the remaining estimated economic life of the product, generally two to five years, including the period being reported on. In 2006, the company capitalized $2,448 for instructional software (see footnote 5). The Company did not incur any capitalizable software costs during the years ended December 31, 2005 and 2004.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The Company has significant net operating loss carryforwards in the U. S. and other countries which are available to reduce the liability on future taxable income. A valuation reserve has been provided to offset most of these future benefits because we have not determined that their realization is more likely than not.

Fair Value of Financial Instruments

At December 31, 2006 and 2005 the Company's financial instruments were accounts receivable, notes receivable, accounts payable and accrued liabilities. The estimated fair value of the Company's financial instruments has been determined by using available market information and appropriate valuation methodologies. The fair values of the Company's financial instruments were not materially different from their carrying amounts at December 31, 2006 and 2005.

Accounting for Leases

All of the Company's leases are operating leases. Rent expense on facility leases is charged evenly over the life of the lease, regardless of the timing of actual payments.

Use of Estimates

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

Valuation of Investment in Secured Services, Inc.

The Company received preferred stock and a note receivable from Secured Services, Inc. ("SSI") in 2003 as consideration for assets of the VACMAN Enterprise business unit. Based on a detailed valuation, the Company established the initial value of the consideration received from SSI, using a discounted value of the payment streams expected from the note and the preferred stock. Interest income on the note was recorded over time at the discount rate. In the first quarter of 2006, SSI discontinued its monthly note payments to the Company, due to its continuing operating losses and an inability to secure new financing. The Company concluded that a decline in fair value had occurred, which was other than temporary in nature as defined in EITF Issue 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments. The Company therefore recorded an asset impairment charge of $789 in the first quarter of 2006 to fully write down the value of the note receivable and the investment in SSI.

In the second quarter of 2006, the Company did receive payment for the remaining note balance of $189, which was recorded in income as a partial recovery of the impaired value. On July 17, 2006, SSI filed a Form 8-K with the SEC, announcing that it had defaulted on its primary bank debt obligations and had agreed to surrender all of its secured assets under the loan agreements. No further recoveries are likely to occur. No tax benefit was recorded for the asset impairment because the Company has a net operating loss carryforward in the U.S., for which the tax benefit is fully reserved.

Goodwill and Other Intangibles

The Company accounts for goodwill and other indefinite-lived intangible assets in accordance with SFAS No. 142, Goodwill and Other Intangible Assets. This statement replaced the requirements to amortize intangible assets with indefinite lives and goodwill with a requirement for an impairment test. SFAS 142 also established accounting guidelines for identifiable intangible assets, which included customer lists, proprietary technology and other intangible assets. Intangible assets other than patents with definite lives are amortized over the useful life, generally three to seven years for proprietary technology. Patents are amortized over the life of the patent, generally 20 years in the U. S.

The Company assesses the impairment of goodwill and intangible assets with indefinite lives each year-end or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The Company completed its last review during December 2006. Factors considered important which could trigger an impairment review include significant underperformance relative to expected historical or projected future operating results, significant changes in the manner of our use of the acquired assets or the strategy for our overall business, and significant negative industry or economic trends.

(IN THOUSANDS EXCEPT PER SHARE DATA)

When the Company determines that the carrying value of intangibles and goodwill may not be recoverable based upon the existence of one or more of the above indicators of impairment, any impairment is measured by the excess of the carrying amount of the asset over its fair value as determined by an estimate of discounted future cash flows.

Stock-Based Compensation

The Company has a stock-based employee compensation plan, which is described more fully in Note 10. As of January 1, 2006, the Company adopted Statement of Financial Accounting Standards ("SFAS") 123(R), Stock-Based Compensation. This statement requires the Company to estimate the fair value of stock options granted to employees, directors and others and to record compensation expense equal to the estimated fair value. The fair value of stock options at the date of grant is estimated using the Black-Scholes option pricing model, with the expected life adjusted to reflect the effect of post-vesting restrictions. The assumptions used for the Black-Scholes model are listed in footnote 10. This compensation expense is recorded on a straight-line basis over the vesting period of the options. Prior to January 1, 2006, the Company accounted for the stock options using the intrinsic method under the recognition and measurement principles of Accounting Principles Board ("APB") Opinion 25, Accounting for Stock Issued to Employees, and related Interpretations. No compensation expense related to the stock options was reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying Common Stock on the date of grant.

The Company elected to use the modified prospective method to transition to SFAS 123(R). Under this method, prior periods are not restated, but the remaining compensation cost for previously issued options is recorded over the remaining vesting period.

Deferred Warranty

The Company's standard practice is to provide a warranty on its authenticators for one year after the date of purchase. Customers may purchase extended warranties covering periods from one to three years after the standard warranty period. The Company defers the revenue associated with the extended warranty and recognizes it into income on a straight-line basis over the extended warranty period. The Company has historically experienced minimal actual claims over the warranty period.

Earnings per Common Share

Basic earnings per share are based on the weighted average number of shares outstanding and exclude the dilutive effect of unexercised common stock equivalents. Diluted earnings per share is based on the weighted average number of shares outstanding and includes the dilutive effect of unexercised common stock equivalents to the extent they are not anti-dilutive. A reconciliation of the shares included in the basic and fully diluted earnings per share calculations is as follows:

	For the Years Ended December 31,		
	2006	2005	2004
Weighted average common shares outstanding			
Basic	36,230	35,429	32,216
Incremental shares for the effect of dilutive:			
Stock options	1,279	1,577	816
Warrants	82	154	28
Restricted stock awards	174	84	--
Identikey acquisition shares	--	--	68
Dilutive	37,765	37,244	33,128

Shares issuable from securities that could potentially effect diluted earnings per share in the future that were not included in the computation of diluted earnings per share because their effect was anti-dilutive were as follows:

	For the Years Ended December 31,		
	2006	2005	2004
Stock options	25	25	301
Convertible preferred stock	--	--	2,320
Total	25	25	2,621

NOTE 2 - ACQUISITIONS

On October 25, 2006, the Company acquired Unified Threat Management (UTM) specialist Able N.V. of Mechelen, Belgium. VASCO acquired all of the stock of Able N.V., in exchange for cash consideration of E5 million ($6.3 million). The acquisition was financed completely from the Company's cash. Able's key product is the aXs GUARD appliance. This appliance contains 21 different modules, including Digipass strong user authentication, VPN, firewall, anti-virus, hacker detection, statistics & reporting, content scanning and more.

The purchase price included E1.25 million ($1.57 million) which is subject to a bank guaranty and may be returned to the Company in whole or in part if the seller terminates his employment with the Company before four years from the acquisition date. As required by EITF 95-8, Accounting for Contingent Consideration Paid to the Shareholders of an Acquired Enterprise in a Purchase Business Combination, the Company has recorded this portion of the purchase price as deemed compensation in other assets, to be amortized over the required employment period.

On May 11, 2006, the Company acquired all of the issued and outstanding shares of Logico Smart Card Solutions GmbH and Logico Smartcard Solutions Vertriebs, GmbH. (The combined group will be referred to as "Logico".) Logico is an authentication storage specialist with extensive experience in smart card based authentication, located in Vienna, Austria. The Company believes that significant synergies will be created by combining Logico's technology with the Company's technology, customer base and marketing channels. The shares of Logico were acquired for cash payments of E1,236 (equivalent to $1,578). An additional payment of up to E150 (or $198 at the December 31 exchange rate) may be due on March 31, 2007 if certain performance conditions are met.

The aggregate purchase price was $2,168, consisting of the cash payment of $1,578, previously acquired software rights with a net cost of $174 and estimated direct transaction costs of $416.

On February 4, 2005, the Company acquired all of the share capital of A.O.S. Hagenuk B.V. ("AOS") a private limited liability company organized and existing under the laws of the Netherlands. The primary purpose for the acquisition was to obtain engineering expertise which is complimentary to our existing product lines. The base purchase price was EUR 5,000, of which EUR 3,750 was paid in cash and the remainder was paid in the Company's Common Stock. In addition to the base purchase price, a variable amount related to the gross profits collected on the sales of certain equipment may be paid to the seller over a period of two (2) years following the closing.

Able, Logico and AOS will be operated as a wholly-owned subsidiaries of the Company, accounted for using the purchase method in accordance with SFAS No. 141, Business Combinations. The following table summarizes the fair value of the assets acquired and the liabilities assumed at the date of each acquisition. Potential valuation adjustments may be identified up to one year after each acquisition.

(IN THOUSANDS EXCEPT PER SHARE DATA)

	Able NV	Logico	AOS
Cash	$ 827	$ 34	$ 529
Accounts receivable, net	419	47	466
Inventory	88	23	11
Other current assets	79	20	655
Property and equipment, net	64	176	122
Intangible assets acquired	1,400	870	367
Deemed compensation	1,569	--	--
Deferred tax asset	--	115	--
Total assets acquired	4,446	1,285	2,150
Accounts payable	160	561	47
Deferred revenue	515	200	1,071
Accrued expenses	240	635	156
Defered tax liability - current portion	86	44	28
Defered tax liability - long-term	390	174	--
Total liabiltites assumed	1,391	1,614	1,302
Net assets acquired	3,055	(329)	848
Goodwill	3,233	2,497	6,415
Aggregate purchase price	$6,288	$2,168	$7,263

The total purchase price for each acquisition comprised the following:

	Able NV	Logico	AOS
Cash paid	$6,275	$1,578	$4,374
Company stock (263 shares)	--	--	2,128
Assumed liabilities	--	--	616
Transaction costs	13	416	145
License previously acquired	--	174	--
	$6,288	$2,168	$7,263

The following summarized unaudited pro forma financial information for 2006, 2005 and 2004 assumes the AOS acquisition occurred at January 1, 2004 and the Logico and Able acquisitions occurred at January 1, 2005:

	2006	2005	2004
Net revenues	$78,724	$58,645	$34,449
Net income available to common shareholders	12,402	5,984	1,833
Basic net income per share	0.34	0.17	0.06
Diluted net income per share	0.33	0.16	0.06

The pro forma results include the amortization of intangibles acquired and a reduction of revenue related to the estimated fair value of the deferred revenue acquired. The Company does not record amortization expense related to goodwill, but rather reviews the carrying value of the asset for impairment at least annually in accordance with the provisions of SFAS No. 142, Goodwill and Other Intangible Assets. The pro forma results are not necessarily indicative of the results that would have occurred if the acquisition had actually been completed on January 1, 2006, 2005 or 2004, nor are they necessarily indicative of future consolidated results.

(IN THOUSANDS EXCEPT PER SHARE DATA)

NOTE 3 - INVENTORIES

Inventories, net of write downs of $296 and $239 at December 31, 2006 and 2005, respectively, are comprised of the following:

	December 31, 2006	December 31, 2005
Component parts	$2,450	$ 601
Work-in-process and finished goods	1,825	969
Total	$4,275	$1,570

NOTE 4 - GOODWILL AND OTHER INTANGIBLES

Intangible asset activity for the three years ended December 31, 2006 and the composition of the December 31, 2006 balance is as follows. Additions to capitalized technology in 2006 were the result of the Logico and Able acquisitions.

	Capitalized Technology	Patents & Trademarks	Other (1)	Intangible Assets	Goodwill
Net balance at December 31, 2003	$ 1,378	$ 45	$ --	$ 1,423	$ 250
Additions	150	67	--	217	--
Amortization expense	(394)	(3)	--	(397)	--
Net balance at December 31, 2004	1,134	109	--	1,243	250
Additions	178	371	367	916	6,415
Amortization expense	(355)	(383)	(367)	(1,105)	--
Net balance at December 31, 2005	957	97	0	1,054	6,665
Additions	2,095	90		2,185	5,659
Impairments	0	(20)	0	(20)	0
Net Translation Gain/Loss	387	0		387	361
Amortization expense	(559)	(34)	--	(593)	--
Net balance at December 31, 2006	$ 2,880	$ 133	$ --	$ 3,013	$12,685
December 31, 2006 balance at cost	$ 8,252	$ 186	$ --	$ 8,438	$13,297
Accumulated amortization	(5,759)	(53)	--	(5,812)	(973)
Translation Gain/Loss	387	--	--	387	361
Net balance at December 31, 2006	$ 2,880	$ 133	$ --	$ 3,013	$12,685

(1) 2005 amount reflects an intangible asset for firm purchase orders of AOS at the date of acquisition.

Expected amortization of the intangible assets for the years ended:

December 31, 2007	$1,030
December 31, 2008	512
December 31, 2009	416
December 31, 2010	415
December 31, 2011 and thereafter	629
Subject to amortization	3,002
Trademarks	11
Total intangible assets	$3,013

(IN THOUSANDS EXCEPT PER SHARE DATA)

NOTE 5 - OTHER ASSETS

Other assets at December 31, 2006 and 2005 consist of the following:

	As of December 31, 2006			As of December 31, 2005		
	Cost	Amortization	Net	Cost	Amortization	Net
Instructional Software	$2,448	$ 68	$2,380	$--	$--	$ --
Deemed Compensation	1,649	69	1,580	--	--	--
Total Subject to Amortization	$4,097	$137	3,960	$--	$--	--
Less: Current Portion of Deemed Compensation			(412)			--
Deferred Income Taxes			465			--
Investment in Secured Services, Inc.			--			600
Other assets			193			25
Other Assets, net			$4,206			$625

In 2006, the Company contracted with a film producer to develop 126 hours of instructional video software to be used internally as a staff development tool and to be marketed to potential customers and other parties. The cost of this software was capitalized in accordance with SFAS 86, Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed. This cost will be amortized on a straight line basis over a five year life, or pro rata based on actual sales as a percentage of expected sales, whichever is larger.

A portion of the acquisition price for Able is contingent upon the seller's continued employment with the Company for a four year period. This amount has been recorded as an other asset and will be amortized over the required employment period. The amount to be amortized in the next year has been classified as a prepaid expense. Amortization expense for the instructional software and the deemed compensation is included in selling expense.

NOTE 6 - INCOME TAXES

At December 31, 2006, the Company had U.S. net operating loss carryforwards approximating $23,086 and foreign net operating loss carryforwards approximating $7,829. Such losses are available to offset future taxable income in the respective jurisdictions. The U.S. loss carryforwards expire in varying amounts beginning in 2018 and continuing through 2023. The foreign loss carryforwards have no expiration dates. Included in the foreign loss carryforwards amount is $3,042 of tax losses acquired in the acquisition of Logico. Utilization of these loss carryforwards would not reduce future tax expense, but would reduce deferred tax assets or goodwill created in the acquisition. In addition, if certain substantial changes in the Company's ownership were deemed to have occurred, there would be an annual limitation on the amount of the U.S. carryforwards that could be utilized.

Income before income taxes was generated in the following jurisdictions:

	For the Years Ended December 31,		
	2006	2005	2004
Domestic	$ 515	$ 634	$1,128
Foreign	18,126	10,894	4,005
Total	$18,641	$11,528	$5,133

(IN THOUSANDS EXCEPT PER SHARE DATA)

The provision for income taxes consists of the following:

	For the Years Ended December 31, 2006	2005	2004
Current:			
Federal	$ 59	$ 20	$ 25
Foreign	5,917	3,713	1,809
Total current	5,976	3,733	1,834
Deferred:			
Foreign	78	94	46
Total deferred	78	94	46
Total	$6,054	$3,827	$1,880

The differences between income tax provision computed using the statutory federal income tax rate of 35% and the provision for income taxes reported in the consolidated statements of operations are as follows:

	For the Years Ended December 31, 2006	2005	2004
Expected tax benefit at statutory rate	$ 6,524	$4,035	$1,797
Change in valuation allowance due to the generation (utilization) of net operating loss carryforwards	(1,104)	(315)	(26)
Foreign taxes at rates other than the federal stautory rate	(575)	92	--
Foreign income taxed in the U.S.	854	--	--
Withholding tax on intercompany interest	398	--	--
Other, net	(43)	15	109
Total	$ 6,054	$3,827	$1,880

The change in valuation allowance due to generation (utilization) of net operating loss carryforwards includes $(120) for the elimination of the valuation reserve on the Australian net operating loss carryforward at December 31, 2006.

The deferred income tax balances are comprised of the following:

	As of December 31, 2006	2005
Deferred tax assets:		
U.S. net operating loss carryforwards	$ 9,004	$ 10,086
Foreign net operating loss carryforwards	2,355	1,562
Research and development expense	501	--
Restricted stock and long-term compensation	181	46
Accrued expenses and other	201	156
Total gross deferred tax assets	12,242	11,850
Less valuation allowance	(11,402)	(11,733)
Net deferred income tax assets	$ 840	$ 117
Deferred tax liabilities:		
Intangible assets - Logico acquisition	$ 187	$ --
Intangible assets - Able acquisition	458	--
Deferred tax liabilities	$ 645	$ --

The net change in the total valuation allowance for the years ended December 31, 2006, 2005 and 2004 was an increase (decrease) of $(331), $(519) and $22, respectively. In assessing the realizability of deferred tax assets, the Company considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the period in which these

(IN THOUSANDS EXCEPT PER SHARE DATA)

temporary differences become deductible. This valuation allowance will be reviewed on a regular basis and adjustments made as appropriate. In 2006, 2005 and 2004, the Company utilized $1,211, $2,134 and $1,178 of its U.S. net operating loss carryforwards. In 2006, the Company also utilized $872 of foreign net operating loss carryforwards, generated $678 of new foreign net operating loss carryforwards and acquired $3,042 of foreign net operating loss carryforwards in the Logico acquisition. The Company has provided a valuation allowance at December 31, 2006 for all of the gross deferred tax assets except for those associated with its Australian and Belgian operating entities. The Company anticipates realizing these deferred tax assets in the future as the Company had earnings in 2006 in excess of the deferred tax assets in Australia and Belgium and expects to generate adequate taxable income in these jurisdictions in 2007. The Company has not provided deferred U.S. taxes on its unremitted foreign earnings because it considers them to be permanently invested. The deferred tax which would be recorded is estimated to be $933.

NOTE 7 - DEFERRED WARRANTY

The Company's standard practice is to provide a warranty on its Digipasses for two years after the date of purchase. Customers may purchase extended warranties covering periods from one to four years after the standard warranty period. The Company defers the revenue associated with the extended warranty and recognizes it into income on a straight-line basis over the extended warranty period.

Deferred warranty at December 31, 2006, which will be earned in 2007 is $149, and is included in current deferred revenue. The long-term deferred warranty revenue as of December 31, 2006 will be recognized as income as follows:

Year	Amount
2008	$168
2009	90
2010	34
2011	10
Total	$302

The company maintains a reserve for the potential cost of future warranty claims related to its standard warranty. Activity in the claims reserve account was as follows:

Warranty reserve at December 31, 2005	$259
Net provision (reversal) for claims	(86)
Product or cash issued to settle claims	(92)
Warranty reserve at December 31, 2006	$ 81

NOTE 8 - DEBT

The Company maintains an overdraft agreement with Fortis Banque/Bank of Belgium. Under terms of the agreement, the Company can borrow an amount equal to 80% of its Belgian subsidiary's defined accounts receivable up to a maximum of 3,500 U.S. Dollars or Euros. Borrowings under the overdraft agreement accrue interest at an annual rate of 5.7% and the Company is obligated to pay a quarterly commitment fee of 0.125%. As of December 31, 2006, borrowings under the agreement totaled $2,154. The assets, excluding inventory, of the Belgian subsidiary secure the agreement and while it has no specific termination date, it can be terminated with thirty (30) days notice. The agreement is governed by the General Lending Conditions for Corporate Customers, registered in Brussels, Belgium on December 20, 2001.

Interest expense related to debt was $232, $120 and $0 for the years ended December 31, 2006, 2005 and 2004, respectively.

NOTE 9 - STOCKHOLDERS' EQUITY

Preferred Stock

On February 17, 2005, the Company, in accordance with the Designation of Rights and Preferences of the Series D 5% Cumulative Convertible Voting Preferred Stock (the "Series D Preferred Stock"), issued a call for mandatory conversion of all outstanding shares of the Series D Preferred Stock. The accrued dividends through the conversion date of $14 were paid. In addition, 5,075 shares of Common Stock were issued as dividends to the Series D preferred stockholders in the first quarter of 2005.

(IN THOUSANDS EXCEPT PER SHARE DATA)

On September 11, 2003, the Company sold 0.8 shares of Series D 5% Cumulative Convertible Voting Preferred Stock (the "Series D Preferred Stock") and 600 detachable warrants to purchase Common Stock. The Series D Preferred Stock carried a 5% dividend and was convertible into 4,000 shares of Common Stock at a fixed price of $2.00 per share. The implied value of the Series D Preferred Stock was $5,714 calculated based upon the annual dividend rate divided by a required rate of return. The warrants are exercisable, over a five-year period, at $3.47 per share and were valued at $1,455 using the Black-Scholes pricing model. Of the net proceeds from the sale, $5,786 was allocated to the Series D Preferred Stock and $1,474 was allocated to the warrants based upon their relative fair values. In addition, a beneficial conversion value was calculated for the Series D Preferred Stock as the difference between the price of the Company's Common Stock at the transaction date and the conversion price of the Series D Preferred Stock. The amount of the beneficial conversion, $3,720, is analogous to a preferred dividend and was recorded to accumulated deficit. In 2004, 592 shares of the Series D Preferred Stock were converted resulting in the issuance of 2,960 shares of the Company's Common Stock. See Common Stock.

Common Stock

On July 15, 2003, the Company reached an agreement with Ubizen N.V. ("Ubizen") whereby VASCO purchased and redeemed all 150,000 shares of the Series C Convertible Preferred Stock (the "Series C Preferred Stock") and 1,239,474 Common Stock Purchase Warrants owned by Ubizen. Under the terms of the Purchase Agreement, the Company paid $4,000 to Ubizen and issued 2,000 shares of the Company's Common Stock on July 25, 2003 at a fair value of $4,000. The Common Stock issued by the Company was subject to a lock-up period wherein the lock-up expired in increments of 500 shares each on October 15, 2003, January 15, 2004, April 15, 2004 and July 15, 2004. The shares were subject to volume trading restrictions through January 1, 2005.

Warrants

Warrant activity for the years ended December 31, 2006, 2005 and 2004 is summarized below:

	Number of Shares	Exercise Price
Outstanding at December 31, 2003	600,000	3.47
Exercised	(13,500)	3.47
Outstanding at December 31, 2004	586,500	3.47
Exercised	(447,250)	3.47
Outstanding at December 31, 2005	139,250	3.47
Exercised	(25,500)	3.47
Outstanding at December 31, 2006	113,750	3.47

NOTE 10 - STOCK COMPENSATION PLAN

The Company's 1997 Stock Compensation Plan, as amended and restated in 1999, ("Compensation Plan") is designed and intended to provide performance incentives to the employees of the Company. The Compensation Plan is administered by the Compensation Committee as appointed by the Board of Directors of the Company ("Compensation Committee").

The Compensation Plan permits the award of stock compensation in various forms including, but not limited to stock options, restricted stock, and other stock-based awards to employees and non-employee directors, consultants and other key persons of the Company. The Compensation Plan is intended to be a nonqualified plan.

Stock Options

All options granted to employees have been for a period of from six to ten years, are granted at a price equal to the fair market value of the Common Stock on the date of the grant and have typically vested 25% on the first anniversary of the grant, with an additional 25% vesting on each subsequent anniversary of the grant. Alternative vesting schedules may include either date or event-based vesting.

All options granted to non-employees have been granted at a price equal to the fair market value of the Common Stock on the date of the grant, and have contained vesting requirements and/or restrictions as determined by the Compensation Committee at the time of grant.

(IN THOUSANDS EXCEPT PER SHARE DATA)

As of December 31, 2006, the Compensation Plan was authorized to issue options representing up to 7,309,257 shares of the Company's Common Stock. The authorized shares under the Compensation Plan represent 20% of the issued and outstanding shares of the Company.

As of January 1, 2006, the Company adopted Statement of Financial Accounting Standards ("SFAS") 123(R), Stock-Based Compensation. This statement requires the Company to estimate the fair value of stock options granted to employees, directors and others and to record compensation expense equal to the estimated fair value. The fair value of stock options at the date of grant is estimated using the Black-Scholes option pricing model, with the expected life adjusted to reflect the effect of post-vesting restrictions. This compensation expense is recorded on a straight-line basis over the vesting period of the options. Prior to January 1, 2006, the Company accounted for the stock options using the intrinsic method under the recognition and measurement principles of Accounting Principles Board ("APB") Opinion 25, Accounting for Stock Issued to Employees, and related Interpretations. No compensation expense related to the stock options was reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying Common Stock on the date of grant. The effect of adopting SFAS 123(R) was to reduce income in 2006 by $681.

All options granted under the plan were issued at market value on the date of grant, with terms of six to ten years and vesting periods ranging from one to five years. The Company issues new shares for option exercises or stock grants. The following table summarizes option activity for the year ended December 31, 2006 and options outstanding at December 31, 2006:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Term (Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2006	2,218	$3.27	5.98	$14,773
Exercised	(229)	2.99	4.62	1,549
Forfeited or expired	(48)	5.79	5.35	230
Outstanding at December 31, 2006	1,941	3.24	5.07	16,789
At December 31, 2006:				
Fully vested, exercisable options	1,754	$3.07	5.01	$15,475
Options expected to vest	159	4.65	5.61	1,146
Expected forfeitures	28	5.86	5.30	168
Total	1,941	3.24	5.07	$16,789

The following table summarizes vesting activity for the year ended December 31, 2006. The unrecognized compensation cost at December 31, 2006 is expected to be recognized over a weighted average period of 1.9 years.

	Shares	Weighted Average Grant Date Fair Value	Weighted Average Remaining Term (Years)	Unrecognized Compensation Cost
Non-vested shares at January 1, 2006	510	$3.43	6.80	$1,085
Vested	(292)	3.07	6.45	
Forfeited	(31)	2.49	6.18	
Non-vested shares at December 31, 2006	187	3.93	5.57	522

(IN THOUSANDS EXCEPT PER SHARE DATA)

Restricted Stock

In addition to stock options, the Company has granted restricted stock awards. Compensation expense is recorded for restricted stock awards based on the market value of the stock at the date of the grant, amortized ratably over the vesting period. This treatment was required by SFAS 123(R) and prior statements.

In 2006 and 2005, the Company granted restricted stock awards for 119 and 90 common shares, respectively, to employees and directors. Awards to directors vest annually over one year and awards to employees vest annually over a four year period. If the service period requirements are not met, these shares are subject to forfeiture. Compensation cost equal to the market value of the stock on the date granted will be recorded on a straight-line basis over the vesting period. There were 175 restricted shares outstanding at December 31, 2006. The following table summarizes restricted stock activity for the year ended December 31, 2006 and restricted stock outstanding at December 31, 2006:

	Shares	Weighted Average Remaining Term (Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2006	84	3.04	$ 833
Shares vested and issued	(22)		226
Shares awarded	119		1,135
Forfeited	(6)		65
Outstanding at December 31, 2006	175	2.24	2,075

As of December 31, 2006. $914 of compensation cost associated with unvested restricted stock awards attributable to future service had not yet been recognized.

Long-term Incentive Compensation Plan

In 2006, the Company initiated a long-term compensation program under the provisions of the Compensation Plan. The long-term incentive plan provides awards to key employees that can be earned if the Company achieves certain cumulative earnings per share targets over a three year period. The awards amounts are designated as a specific dollar amount, but at the option of the Company, can be paid in either stock or cash. If paid in stock, the Company will determine the price of the stock on the date the awards are earned and issue the corresponding number of freely tradable shares to the employees.

The Company granted awards totaling $1,330 in 2006. Compensation expense for long-term incentive plan awards is recognized ratably over the period beginning with the effective date of the grant and ending on December 31 of the targeted three-year period. Employees forfeit their awards if they terminate from the Company prior to the end of the three-year target period. The amounts expensed are reported as long-term liabilities on the balance sheet until such awards are payable within the succeeding twelve-month period, at which time the accrued liability will be reflected in current liabilities until paid.

(IN THOUSANDS EXCEPT PER SHARE DATA)

The following table summarizes compensation expense recorded under the stock compensation plans and, for periods prior to January 1, 2006, illustrates the effect on net income and net income per share if the Company had applied the fair value recognition provisions of SFAS 123, Accounting for Stock-Based Compensation, to stock-based employee compensation:

	2006	2005	2004
Compensation expense included in income:			
Stock options	$ 681	$ --	$ --
Restricted stock	577	135	--
Long-term compensation plan	356	--	--
Total	1,614	135	--
Income tax benefit	--	--	--
Effect on net income	$1,614	$ 135	$ --
Proforma stock compensation disclosures previously required by SFAS 123:			
Net income available to common shares:			
As reported		$ 7,687	$ 3,021
Compensation expense, net of tax		(726)	(1,065)
Proforma		$ 6,961	$ 1,956
Basic net income per share:			
As reported		$ 0.22	$ 0.09
Proforma		0.20	0.06
Fully diluted net income per share:			
As reported		$ 0.21	$ 0.09
Proforma		0.19	0.06
Weighted average fair value of options granted	None Granted	$ 4.27	$ 1.59
Assumptions used to value options granted:			
Expected volatility	--	69%	104%
Expected term	--	6 - 7 years	1-5.6 years
Risk free interest rate	--	4.21 - 4.23%	4.08% - 4.27%
Expected dividends	--	--	--
Intrinsic value of options exercised	$1,549	$ 4,385	$ 249
Fair value of shares vested	896	2,048	1,709

In 2002, the Company loaned Belgian employees who received stock options in 1999 and 2000, 142 Euros to pay taxes assessed on those options by the Belgian Government. Even though stock options granted to all employees were granted at prices equal to the fair market value of the Common Stock on the date of the grant, Belgian employees who were recipients of stock options were assessed taxes based on the value determined under Belgian tax legislation dated March 26, 1999. The total amounts advanced in 2002 were based on each recipient's specific tax assessment. Due to the uncertainty of collecting the amounts loaned to the employees, the notes have been fully reserved for as of December 31, 2006 and 2005.

(IN THOUSANDS EXCEPT PER SHARE DATA)

NOTE 11 - SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

	For the Years ended December 31,		
	2006	2005	2004
Supplemental disclosure of cash flow information:			
Interest paid	63	$ 91	$ 17
Income taxes paid	$3,915	$2,641	$1,294
Supplemental disclosure of non-cash investing activities:			
Common stock issued in connection with acquisition	$ --	$2,128	$ --
Accrued capitalized technology	$ --	$ 150	$ 150
Supplemental disclosure of non-cash financing activities:			
Common stock issued to redeem Series D preferred stock upon conversion of preferred shares (in shares)	--	1,040	2,960
Common stock issued to redeem Series D preferred stock	$ --	$1,504	$4,282
Dividends accrued on preferred stock	$ --	$ --	$ (27)
Common stock issued as dividends to Series D preferred stock shareholders (5 and 65 shares in 2005 and 2004)	$ --	$ 27	$ 144

NOTE 12 - EMPLOYEE BENEFIT PLAN

The Company maintains a defined contribution pension plan for its U. S. employees established pursuant to the provisions of Section 401(k) of the Internal Revenue Code, which provides benefits for eligible employees of the Company. In January 2001, the Company amended its benefit plan to allow Company-matching. For the years ended December 31, 2006, 2005 and 2004, the Company contributed $57, $31 and $21, respectively, to this plan.

The Company also maintains a pension plan for its Belgian employees, in compliance with Belgian law. The plan is a defined contribution plan, but has a minimum return guarantee under Belgian law. Returns guaranteed by the pension plan administrator are essentially equal to the legal requirement. For the years ended December 31, 2006, 2005 and 2004, the Company contributed $206, $160 and $127, respectively, to this plan.

NOTE 13 - GEOGRAPHIC AND CUSTOMER INFORMATION

The Company records revenue in country that has responsibility for the transaction. Information regarding geographic areas for the years ended December 31, 2006, 2005 and 2004 is as follows:

	United States	Europe	Other	Total
2006				
Revenue	$7,397	$47,449	$21,216	$76,062
Gross profit	6,196	31,566	13,941	51,703
Long-lived assets	628	19,442	792	20,862
2005				
Revenue	$3,687	$39,219	$11,673	$54,579
Gross profit	3,232	25,253	7,443	35,928
Long-lived assets	755	7,706	901	9,362
2004				
Revenue	$3,105	$24,245	$ 2,543	$29,893
Gross profit	2,816	15,891	2,002	20,709
Long-lived assets	942	913	1,273	3,128

For the years 2006, 2005 and 2004, the Company's top 10 customers contributed 49%, 64% and 60%, respectively, of total worldwide revenues. In 2006, one customer accounted for 10.3% of revenues. In 2005, two customers accounted for 13.5% and 11.3% of revenues. In 2004, three customers accounted for 12.6%, 12.0% and 11.8% of revenues.

(IN THOUSANDS EXCEPT PER SHARE DATA)

NOTE 14 - COMMITMENTS AND CONTINGENCIES

The Company leases office space and automobiles under operating lease agreements expiring at various times through 2015. Future minimum rental payments required under non-cancelable leases are as follows:

Year	Amount
2007	$1,654
2008	1,503
2009	1,223
2010	927
2011	695
Thereafter	338
Total	$6,340

Rent expense under operating leases aggregated approximately $1,229, $836 and $851 for the years ended December 31, 2006, 2005 and 2004, respectively. Rent expense is recorded on a straight-line basis over the life of the lease agreement.

From time to time, the Company has been involved in litigation incidental to the conduct of its business. Currently, the Company is not a party to any lawsuit or proceeding that, in management's opinion, is likely to have a material adverse effect on its business, financial condition or results of operations.

NOTE 15 - RESTRUCTURING

During the fourth quarter of 2002, the Company recorded restructuring charges of $319 related to operations in France and excess space in its U.S. headquarters. In 2005, the Company resolved all issues associated with the closure of the French operation and reversed reserves that were no longer needed, some of which had been recorded prior to the decision to close the operation, resulting in a gain of $172. In 2004, $32 was reversed from restructuring accruals as a result of the renegotiation of the Corporate Headquarters' office lease.

(IN THOUSANDS EXCEPT PER SHARE DATA)

NOTE 16 - QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

No material fourth quarter adjustments were recorded in 2006 or 2005. The quarterly results of operations are as follows:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2006				
Net sales	$13,690	$18,512	$18,707	$25,153
Gross profit	9,451	11,862	12,785	17,605
Operating expenses	6,551	7,780	7,809	10,621
Operating income	2,900	4,082	4,976	6,984
Net income	1,170	3,034	3,287	5,096
Net income per share:				
Basic	$ 0.03	$ 0.08	$ 0.09	$ 0.14
Fully diluted	0.03	0.08	0.09	0.13
2005				
Net sales	$11,443	$12,345	$13,272	$17,519
Gross profit	7,220	8,049	8,134	11,035
Operating expenses	5,298	5,764	5,596	6,827
Operating income	1,922	2,285	2,538	4,208
Net income	1,407	1,581	1,751	2,962
Net income per share:				
Basic	$ 0.04	$ 0.04	$ 0.05	$ 0.08
Fully diluted	0.04	0.04	0.05	0.08

Due to rounding in earnings per share, the sum of the quarters may not be equal to the full year.

SCHEDULE II
VASCO DATA SECURITY INTERNATIONAL, INC.
VALUATION AND QUALIFYING ACCOUNTS

	Beginning Balance	Bad Debt Expense (Recovery)	Accounts Written Off	Ending Balance
Allowance for Doubtful Accounts For Trade Accounts Receivable				
Year ended December 31, 2006	$156	$ 522	$ --	$678
Year ended December 31, 2005	160	31	(35)	156
Year ended December 31, 2004	471	(108)	(203)	160

See accompanying independent auditors' report

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized, on March 15, 2007.

VASCO Data Security International, Inc.

/s/ T. Kendall Hunt

T. Kendall Hunt
Chief Executive Officer

PURSUANT TO THE REQUIREMENTS OF THE SECURITIES EXCHANGE ACT OF 1934, THIS REPORT HAS BEEN SIGNED BY THE FOLLOWING PERSONS ON BEHALF OF THE REGISTRANT IN THE CAPACITIES INDICATED ON MARCH 15, 2007.

POWER OF ATTORNEY

Each of the undersigned, in his capacity as an officer or director, or both, as the case may be, of VASCO Data Security International, Inc. does hereby appoint T. Kendall Hunt, and each of them severally, his true and lawful attorneys or attorney to execute in his name, place and stead, in his capacity as director or officer, or both, as the case may be, this Annual Report on Form 10-K for the fiscal year ended December 31, 2005 and any and all amendments thereto and to file the same with all exhibits thereto and other documents in connection therewith with the Securities and Exchange Commission. Each of said attorneys shall have power to act hereunder with or without the other attorney and shall have full power and authority to do and perform in the name and on behalf of each of said directors or officers, or both, as the case may be, every act whatsoever requisite or necessary to be done in the premises, as fully and to all intents and purposes as to which each of said officers or directors, or both, as the case may be, might or could do in person, hereby ratifying and confirming all that said attorneys or attorney may lawfully do or cause to be done by virtue hereof.

SIGNATURE	TITLE
/s/ T. Kendall Hunt T. Kendall Hunt	Chief Executive Officer and Chairman (Principal Executive Officer)
/s/ Jan Valcke Jan Valcke	President and Chief Operating Officer (Principal Operating Officer)
/s/ Clifford K. Bown Clifford K. Bown	Chief Financial Officer and Secretary (Principal Financial Officer and Principal Accounting Officer)
/s/ Michael P. Cullinane Michael P. Cullinane	Director
/s/ Jean K. Holley Jean K. Holley	Director
/s/ John R. Walter John R. Walter	Director
/s/ John N. Fox, Jr. John N. Fox, Jr.	Director

EXHIBIT 23

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors
VASCO Data Security International, Inc.:

We consent to the incorporation by reference in the registration statements on Form S-8 (No. 333-62829), on Form S-3 (333-46256) and on Form S-1 (333-124458) of VASCO Data Security International, Inc. and subsidiaries of our reports dated March 15, 2007, with respect to the consolidated balance sheets of VASCO Data Security International, Inc. and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2006, and the related financial statement schedule, management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2006 and the effectiveness of internal control over financial reporting as of December 31, 2006, which reports are included in the December 31, 2006 annual report on Form 10-K of VASCO Data Security International, Inc.

Our report on the consolidated financial statements refers to the Company's adoption of the provisions of Statement of Financial Accounting Standards No. 123R, Share-Based Payment, modifying share-based compensation in 2006.

/s/ KPMG LLP

Chicago, Illinois
March 15, 2007

EXHIBIT 31.1

Certification of Principal Executive Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, T. Kendall Hunt, the principal executive officer of VASCO Data Security International, Inc., certify that:

1. I have reviewed this annual report on Form 10-K of VASCO Data Security International, Inc.;

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

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

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

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

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

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

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

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

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

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

Dated: March 15, 2007

/s/ T. Kendall Hunt

T. Kendall Hunt
Chief Executive Officer and Chairman of the Board of Directors
(Principal Executive Officer)

EXHIBIT 31.2

Certification of Principal Financial Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Clifford K. Bown, the principal financial officer of VASCO Data Security International, Inc., certify that:

1. I have reviewed this annual report on Form 10-K of VASCO Data Security International, Inc.;

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

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

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

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

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

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

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

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

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

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

Dated: March 15, 2007

/s/ Clifford K. Bown

Clifford K. Bown
Chief Financial Officer
(Principal Financial Officer and
Principal Accounting Officer)

EXHIBIT 32.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER
Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to
Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the filing with the Securities and Exchange Commission of the Annual Report of VASCO Data Security International, Inc. (the "Company") on Form 10-K for the period ending December 31, 2005 (the "Report"), I, T. Kendall Hunt, Chief Executive Officer and Chairman of the Board of Directors of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

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

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

/s/ T. Kendall Hunt
- ------------------------------------
T. Kendall Hunt
Chief Executive Officer and Chairman
of the Board of Directors

March 15, 2007

EXHIBIT 32.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER
Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to
Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the filing with the Securities and Exchange Commission of the Annual Report of VASCO Data Security International, Inc. (the "Company") on Form 10-K for the period ending December 31, 2005 (the "Report"), I, Clifford K. Bown, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

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

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

/s/ Clifford K. Bown
- ------------------------------------
Clifford K. Bown
Chief Financial Officer

March 15, 2007