

INFORMATION ANALYSIS INC  
Form 10-Q  
May 15, 2012

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

Form 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended March 31, 2012

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934  
For the transition period from \_\_\_\_ to \_\_\_\_

Commission File Number 0-22405

Information Analysis Incorporated  
(Exact Name of Registrant as Specified in Its Charter)

Virginia  
(State or other jurisdiction of  
incorporation or organization)

54-1167364  
(I.R.S. Employer  
Identification No.)

11240 Waples Mill Road  
Suite 201  
Fairfax, Virginia 22030

(703) 383-3000  
(Registrant's telephone number, including area code)

Not applicable  
(Former name, former address and former fiscal year, if changed since last report)

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

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

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

|                         |                       |                           |                          |
|-------------------------|-----------------------|---------------------------|--------------------------|
| Large accelerated filer | <input type="radio"/> | Accelerated filer         | <input type="radio"/>    |
| Non-accelerated filer   | <input type="radio"/> | Smaller reporting company | <input type="checkbox"/> |

(Do not check if a smaller reporting company)

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

As of May 8, 2012, 11,201,760 shares of common stock, par value \$0.01 per share, of the registrant were outstanding.

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Information Analysis Incorporated

Form 10-Q First Quarter 2012

INFORMATION ANALYSIS INCORPORATED

FORM 10-Q

Index

|   | Page<br>Number |
|---|----------------|
| <b>PART I. FINANCIAL INFORMATION</b>  |                |
| Item 1. Financial Statements (unaudited except for the balance sheet as of December 31, 2011) | 3              |
| Balance Sheets as of March 31, 2012 and December 31, 2011                                     | 3              |
| Statements of Operations for the three months ended March 31, 2012 and March 31, 2011         | 4              |
| Statements of Cash Flows for the three months ended March 31, 2012 and March 31, 2011         | 5              |
| Notes to Financial Statements   | 6              |
| Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations  | 13             |
| Item 4. Controls and Procedures   | 15             |
| <b>PART II. OTHER INFORMATION</b>   |                |
| Item 1. Legal Proceedings   | 16             |
| Item 1A. Risk Factors   | 16             |
| Item 2. Unregistered Sales of Equity Securities and Use of Proceeds                           | 16             |
| Item 3. Defaults Upon Senior Securities   | 16             |
| Item 5. Other Information   | 16             |
| Item 6. Exhibits  | 16             |
| <b>SIGNATURES</b>   | <b>18</b>      |

Information Analysis Incorporated

Form 10-Q First Quarter 2012

## PART I - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## INFORMATION ANALYSIS INCORPORATED

BALANCE SHEETS  
(Unaudited)

|   | March 31, 2012 | December 31, 2011 |
|---|----------------|-------------------|
| <b>ASSETS</b>   |                |                   |
| Current assets:   |                |                   |
| Cash and cash equivalents   | \$ 2,414,127   | \$ 1,280,926      |
| Accounts receivable, net  | 702,806        | 2,889,658         |
| Prepaid expenses  | 573,550        | 787,290           |
| Note receivable , current   | 6,726          | 6,668             |
| Total current assets  | 3,697,209      | 4,964,542         |
| Fixed assets, net   | 33,807         | 40,440            |
| Note receivable , long-term   | 2,584          | 4,287             |
| Other assets  | 6,281          | 6,281             |
| Total assets  | \$ 3,739,881   | \$ 5,015,550      |
| <b>LIABILITIES &amp; STOCKHOLDERS' EQUITY</b>   |                |                   |
| Current liabilities:  |                |                   |
| Accounts payable  | \$ 72,074      | \$ 998,160        |
| Commissions payable   | 701,664        | 679,498           |
| Deferred revenue  | 634,322        | 939,783           |
| Accrued payroll and related liabilities   | 235,627        | 247,885           |
| Other accrued liabilities   | 76,979         | 107,235           |
| Income taxes payable  | -              | 2,800             |
| Total current liabilities   | 1,720,666      | 2,975,361         |
| Stockholders' equity:   |                |                   |
| Common stock, par value \$0.01, 30,000,000 shares authorized;<br>12,839,376 shares issued, 11,196,760 outstanding | 128,393        | 128,393           |
| Additional paid-in capital  | 14,575,704     | 14,574,128        |
| Accumulated deficit   | (11,754,671 )  | (11,732,121 )     |
| Treasury stock, 1,642,616 shares at cost  | (930,211 )     | (930,211 )        |
| Total stockholders' equity  | 2,019,215      | 2,040,189         |
| Total liabilities and stockholders' equity  | \$ 3,739,881   | \$ 5,015,550      |

The accompanying notes are an integral part of the financial statements

Information Analysis Incorporated

Form 10-Q First Quarter 2012

INFORMATION ANALYSIS INCORPORATED  
STATEMENTS OF OPERATIONS  
(Unaudited)

|  | For the three months ended<br>March 31, |             |
|--|---|-------------|
|  | 2012                                    | 2011        |
| Sales  |   |             |
| Professional fees                            | \$1,165,249                             | \$1,103,327 |
| Software sales                               | 348,741                                 | 320,410     |
| Total sales                                  | 1,513,990                               | 1,423,737   |
| Cost of sales                                |   |             |
| Cost of professional fees                    | 676,634                                 | 593,016     |
| Cost of software sales                       | 304,669                                 | 276,283     |
| Total cost of sales                          | 981,303                                 | 869,299     |
| Gross profit                                 | 532,687                                 | 554,438     |
| Selling, general and administrative expenses | 408,079                                 | 388,729     |
| Commissions on sales                         | 148,649                                 | 176,937     |
| Loss from operations                         | (24,041 )                               | (11,228 )   |
| Other income, net                            | 1,491                                   | 2,133       |
| Loss before provision for income taxes       | (22,550 )                               | (9,095 )    |
| Provision for income taxes                   | -                                       | -           |
| Net loss                                     | \$(22,550 )                             | \$(9,095 )  |
| Earnings per common share:                   |   |             |
| Basic:                                       | \$0.00                                  | \$0.00      |
| Diluted:                                     | \$0.00                                  | \$0.00      |
| Weighted average common shares outstanding:  |   |             |
| Basic  | 11,196,760                              | 11,196,760  |
| Diluted                                      | 11,196,760                              | 11,196,760  |

The accompanying notes are an integral part of the financial statements

Information Analysis Incorporated

Form 10-Q First Quarter 2012

INFORMATION ANALYSIS INCORPORATED  
STATEMENTS OF CASH FLOWS

(Unaudited)

|  | For the three months<br>ended<br>March 31, |             |
|--|--|-------------|
|  | 2012                                       | 2011        |
| Cash flows from operating activities:  |  |             |
| Net loss   | \$(22,550 )                                | \$(9,095 )  |
| Adjustments to reconcile net loss to<br>net cash provided by (used in) operating activities: |  |             |
| Depreciation and amortization  | 6,633                                      | 4,700       |
| Stock option compensation  | 1,576                                      | 3,384       |
| Bad debt expense   | 1,020                                      | -           |
| Changes in operating assets and liabilities  |  |             |
| Accounts receivable  | 2,185,832                                  | (226,970 )  |
| Other receivables and prepaid expenses   | 213,740                                    | 137,104     |
| Accounts payable and accrued expenses  | (971,400 )                                 | 20,372      |
| Deferred revenue   | (305,461 )                                 | (102,682 )  |
| Commissions payable  | 22,166                                     | 55,510      |
| Net cash provided by (used in) operating activities  | 1,131,556                                  | (117,677 )  |
| Cash flows from investing activities:  |  |             |
| Net cash provided by investing activities  | -  | -           |
| Cash flows from financing activities:  |  |             |
| Proceeds from note receivable  | 1,645                                      | 1,588       |
| Net cash provided by financing activities  | 1,645                                      | 1,588       |
| Net increase (decrease) in cash and cash equivalents   | 1,133,201                                  | (116,089 )  |
| Cash and cash equivalents, beginning of the period   | 1,280,926                                  | 1,968,077   |
| Cash and cash equivalents, end of the period   | \$2,414,127                                | \$1,851,988 |
| Supplemental cash flow information   |  |             |
| Interest paid  | \$-  | \$-         |
| Income taxes paid  | \$2,800                                    | \$-         |

The accompanying notes are an integral part of the financial statements



Information Analysis Incorporated

Form 10-Q First Quarter 2012

INFORMATION ANALYSIS INCORPORATED

NOTES TO FINANCIAL STATEMENTS

1. Basis of Presentation

The accompanying unaudited financial statements have been prepared in conformity with generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions for Form 10-Q and Article 8-03 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the rules and regulations of the Securities Exchange Commission. In the opinion of management, the unaudited financial statements include all adjustments necessary (which are of a normal and recurring nature) for the fair and not misleading presentation of the results of the interim periods presented. These unaudited financial statements should be read in conjunction with our audited financial statements for the year ended December 31, 2011 included in the Annual Report on Form 10-K filed by the Company with the Securities and Exchange Commission on March 31, 2012. The results of operations for any interim period are not necessarily indicative of the results of operations for any other interim period or for a full fiscal year.

2. Summary of Significant Accounting Policies

Operations

Information Analysis Incorporated (“IAI”, or the “Company”) was incorporated under the laws of the Commonwealth of Virginia in 1979 to develop and market computer applications software systems, programming services, and related software products and automation systems. The Company provides services to customers throughout the United States, with a concentration in the Washington, D.C. metropolitan area.

Revenue Recognition

The Company recognizes revenue when a contract has been executed, the contract price is fixed and determinable, delivery of services or products has occurred, and collectability of the contract price is considered probable and can be reasonably estimated. Revenue is earned under time and materials and fixed-price contracts. For sales of third-party software products, revenue is recognized upon delivery.

Revenue on time and materials contracts is recognized based on direct labor hours expended at contract billing rates and adding other billable direct costs.

For fixed-price contracts that are based on unit pricing, the Company recognizes revenue for the number of units delivered in any given reporting period.

For fixed-price contracts in which the Company is paid a specific amount to be available to provide a particular service for a stated period of time, revenue is recognized ratably over the service period. The Company applies this method of revenue recognition to sales of maintenance contracts on third-party software sales, such as Adobe and Micro Focus software, for which the Company is responsible for “first line support” to the customer and for serving as a liaison between the customer and the third-party maintenance provider for issues the Company is unable to resolve.



The Company engages in fixed-price contracts with the U.S. federal government involving the complex delivery of technology products and services. Accordingly, these contracts are within the scope of the American Institute of Certified Public Accountants Audit and Accounting Guide for Audits of Federal Government Contractors. To the extent contracts are incomplete at the end of an accounting period, revenue is recognized on a proportional performance basis, using costs incurred in relation to total estimated costs.

Sales of third-party software products such as Adobe and Micro Focus products are reported on a gross basis with the Company as a principal under authoritative guidance issued by the Financial Accounting Standards Board (the "FASB"). This determination was based on the following: 1) the Company has inventory risk as suppliers are not obligated to accept returns, 2) the Company has reasonable latitude, within economic constraints, in establishing price, 3) the Company, in its marketing efforts, frequently aids the customer in determining product specifications, 4) the Company has physical loss and inventory risk as title transfers at the shipping point, 5) the Company bears full credit risk, and 6) the amount the Company earns in the transaction is neither a fixed dollar amount nor a fixed percentage.

Information Analysis Incorporated

Form 10-Q First Quarter 2012

## 2. Summary of Significant Accounting Policies (continued)

For software and software-related multiple element arrangements, the Company must: (1) determine whether and when each element has been delivered; (2) determine whether undelivered products or services are essential to the functionality of the delivered products and services; (3) determine the fair value of each undelivered element using vendor-specific objective evidence ("VSOE"), and (4) allocate the total price among the various elements. Changes in assumptions or judgments or changes to the elements in a software arrangement could cause a material increase or decrease in the amount of revenue that the Company reports in a particular period.

The Company determines VSOE for each element based on historical stand-alone sales to third parties or from the stated renewal rate for the elements contained in the initial arrangement. The Company has established VSOE for its third-party software maintenance and support services.

FASB's accounting standards for certain multiple deliverable revenue arrangements require an entity to allocate revenue in an arrangement using best estimated selling price ("BESP") of deliverables if a vendor does not have VSOE of selling price or third-party evidence ("TPE") of selling price, and require an entity to allocate revenue using the relative selling price method.

The Company's contracts with agencies of the U.S. federal government are subject to periodic funding by the respective contracting agency. Funding for a contract may be provided in full at inception of the contract or ratably throughout the contract as the services are provided. In evaluating the probability of funding for purposes of assessing collectability of the contract price, the Company considers its previous experiences with its customers, communications with its customers regarding funding status, and the Company's knowledge of available funding for the contract or program. If funding is not assessed as probable, revenue recognition is deferred until realization is deemed probable.

Payments received in advance of services performed are recorded and reported as deferred revenue. Services performed prior to invoicing customers are recorded as unbilled accounts receivable and are presented on the Company's balance sheets in the aggregate with accounts receivable.

Revenue derived as commission for facilitating a sales transaction in which a customer introduced by the Company makes a purchase directly from the Company's supplier or another designated reseller is recognized when the commission payment is received. Since the Company is not a direct party in the sales transaction, payment by the supplier is the Company's confirmation that the sale occurred.

### Government Contracts

Company sales to departments or agencies of the U.S. federal government are subject to audit by the Defense Contract Audit Agency (DCAA), which could result in the renegotiation of amounts previously billed. Because the Company has not entered into any cost plus fixed fee contracts since 1997, management believes there is minimal risk of an audit by DCAA resulting in a material misstatement of previously reported financial statements.

### Segment Reporting

In accordance with authoritative guidance issued by the FASB, the Company has concluded that it operates in one business segment, providing products and services to modernize client information systems.

### Cash and Cash Equivalents

For the purposes of the statement of cash flows, the Company considers all highly liquid investments with maturities of ninety days or less at the time of purchase to be cash equivalents. Balances at times exceed federally insured limits, but management does not consider this to be a significant concentration of credit risk.

### Accounts Receivable

Accounts receivable consist of trade accounts receivable and do not bear interest. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company reviews its allowance for doubtful accounts monthly. Accounts with receivable balances past due over 90 days are reviewed individually for collectability. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The Company does not have any off-balance sheet credit exposure related to its customers. The Company has recorded an allowance for doubtful accounts of \$101,021 at March 31, 2012 and \$141,721 at December 31, 2011.

Information Analysis Incorporated

Form 10-Q First Quarter 2012

## 2. Summary of Significant Accounting Policies (continued)

### Note Receivable

Note receivable consists of a note to a non-officer employee of the Company. The note bears interest compounded at 3.5%, requires equal semi-monthly payments, and will mature on August 10, 2013.

### Fixed Assets

Fixed assets are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the assets. Maintenance and minor repairs are charged to operations as incurred. Gains and losses on dispositions are recorded in current operations.

### Stock-Based Compensation

At March 31, 2012, the Company had the stock-based compensation plans described in Note 3 below. Total compensation expenses related to these plans were \$1,576 and \$3,384 for the quarters ended March 31, 2012 and 2011, respectively, of which \$550 and \$0 related to options awarded to non-employees. The Company estimates the fair value of options granted using a Black-Scholes valuation model to establish the expense. When stock-based compensation is awarded to employees, the expense is recognized ratably over the vesting period. When stock-based compensation is awarded to non-employees, the expense is recognized immediately.

### Earnings Per Share

The Company's earnings per share calculations are based upon the weighted average of shares of common stock outstanding. The dilutive effect of stock options, warrants and convertible notes are included for purposes of calculating diluted earnings per share, except for periods when the Company reports a net loss, in which case the inclusion of such equity instruments would be antidilutive.

### Recently Adopted Accounting Pronouncements

In May 2011, the FASB issued ASU 2011-04, "Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs." to allow for common fair value measurement and disclosure requirements in GAAP and IFRS. Consequently, the wording used to describe many of the requirements in GAAP for measuring fair value and for disclosing information about fair value measurements has changed. FASB does not intend for the changes to result in a change in the application of the requirements in the fair value standard. ASU 2011-04 clarifies the FASB's intent about the application of existing fair value measurement requirements. ASU 2011-04 is effective for interim and annual periods beginning after December 15, 2011. We applied ASU 2011-04 prospectively, and it did not have a material impact on our financial statements and processes.

### Income Taxes

Deferred tax assets and liabilities are computed based on the difference between the financial statement and tax basis of assets and liabilities and are measured by applying enacted tax rates and laws for the taxable years in which those differences are expected to reverse. In addition, a valuation allowance is required to be recognized if it is believed more likely than not that a deferred tax asset will not be fully realized. Authoritative guidance prescribes a recognition threshold of more likely than not, and a measurement attribute for all tax positions taken or expected to be taken on a

tax return, in order for those positions to be recognized in the financial statements. The Company continually reviews tax laws, regulations and related guidance in order to properly record any uncertain tax liabilities.

#### Fair Value of Financial Instruments

The Company's financial instruments include trade receivables, note receivable, and accounts payable. Management believes the carrying value of financial instruments approximates their fair value, unless disclosed otherwise in the accompanying notes.

Information Analysis Incorporated

Form 10-Q First Quarter 2012

## 2. Summary of Significant Accounting Policies (continued)

## Subsequent Events

The Company has evaluated the period from March 31, 2012, the date of the financial statements, through the date of the issuance and filing of the financial statements, and has determined that no material subsequent events have occurred that would affect the information presented in these financial statements or require additional disclosure.

## 3. Stock Options

The Company granted stock options to certain of our employees under two plans. The 1996 Stock Option Plan was adopted in 1996 (“1996 Plan”) and had options granted under it through May 29, 2006. In 2006, the Board of Directors approved and the shareholders ratified the 2006 Stock Incentive Plan (“2006 Plan”).

As determined by the members of the Compensation Committee, the Company generally grants options under the 2006 Plan at the estimated fair value at the date of grant, based upon all information available to it at the time.

The Company recognizes compensation costs only for those shares expected to vest on a straight-line basis over the requisite service period of the awards, generally, the option vesting term of six months to two years. There were 60,000 option awards granted to employees and 5,000 option awards granted to non-employees in the three months ended March 31, 2012 and there were 10,000 option awards granted to employees and no option awards granted to non-employees in the three months ended March 31, 2011. The fair values of option awards granted in the three months ended March 31, 2012 and 2011, were estimated using a Black-Scholes option pricing model using the following assumptions:

|                         | Three Months ended<br>March 31, |         |
|-------------------------|---------------------------------|---------|
|                         | 2012                            | 2011    |
| Risk free interest rate | 1.20 –<br>2.31%                 | 2.30%   |
| Dividend yield          | 0%                              | 0%      |
| Expected term           | 5-10<br>years                   | 5 years |
| Expected volatility     | 62.8 –<br>67.9%                 | 61.9%   |

## 2006 Stock Incentive Plan

The Company has a stock incentive plan, which became effective May 18, 2006, and expires May 17, 2016 (the “2006 Plan”). The 2006 Plan provides for the granting of equity awards to key employees, including officers and directors. The maximum number of shares for which equity awards may be granted under the 2006 Plan is 950,000. Options under the 2006 Plan expire no later than ten years from the date of grant or when employment ceases, whichever comes first, and vest over periods determined by the Board of Directors. The average vesting periods for options granted to employees under the 2006 Plan in the three months ended March 31, 2012 and 2011, were eight months and twenty-four months, respectively. The exercise price of each option equals at least the quoted market price of the Company’s stock on the date of grant.

### 1996 Stock Option Plan

The 1996 Plan provided for the granting of options to purchase shares of our common stock to key employees, including officers and directors. The maximum number of shares for which options could be granted under the 1996 Plan was 3,075,000. Options expire no later than ten years from the date of grant or when employment ceases, whichever comes first, and vest over periods determined by the Board of Directors. There were 389,000 and 411,000 unexpired exercisable options remaining from the 1996 Plan at March 31, 2012 and December 31, 2011, respectively.

Information Analysis Incorporated

Form 10-Q First Quarter 2012

## 3. Stock Options (continued)

The status of the options issued under the foregoing option plans as of March 31, 2012, and changes during the three months ended March 31, 2012 and 2011, were as follows:

|   | Options outstanding |                                  |
|---|---------------------|----------------------------------|
|   | Number of shares    | Weighted average price per share |
| Balance at December 31, 2011            | 1,003,000           | \$ 0.31                          |
| Options granted                         | 65,000              | 0.15                             |
| Options exercised, expired or forfeited | 28,000              | 0.36                             |
| Balance at March 31, 2012               | 1,040,000           | \$ 0.30                          |

|   | Options outstanding |                                  |
|---|---------------------|----------------------------------|
|   | Number of shares    | Weighted average price per share |
| Balance at December 31, 2010            | 1,119,000           | \$ 0.30                          |
| Options granted                         | 10,000              | 0.16                             |
| Options exercised, expired or forfeited | 4,500               | 0.27                             |
| Balance at March 31, 2011               | 1,124,500           | \$ 0.30                          |

The following table summarizes information about options at March 31, 2012:

| Options outstanding |                                 |  |                           | Options exercisable |                                 |  |                           |
|---------------------|---------------------------------|--|---------------------------|---------------------|---------------------------------|--|---------------------------|
| Total shares        | Weighted average exercise price | Weighted average remaining contractual life in years | Aggregate intrinsic value | Total shares        | Weighted average exercise price | Weighted average remaining contractual life in years | Aggregate intrinsic value |
| 1,040,000           | \$0.30                          | 4.71   | \$ 2,170                  | 939,500             | \$0.31                          | 4.19   | \$ 2,170                  |

Nonvested stock awards as of March 31, 2012 and changes during the three months ended March 31, 2012, were as follows:

| Nonvested        |  |
|------------------|--|
| Number of shares | Weighted average grant date fair value |



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|                              |         |         |
|------------------------------|---------|---------|
| Balance at December 31, 2011 | 60,000  | \$ 0.09 |
| Granted                      | 65,000  | 0.08    |
| Vested                       | 18,500  | 0.11    |
| Expired before vesting       | 6,000   | 0.09    |
| Balance at March 31, 2012    | 100,500 | \$ 0.08 |

As of March 31, 2012 and 2011, unrecognized compensation cost associated with non-vested share-based employee and non-employee compensation totaled \$6,382 and \$2,431, respectively, which are expected to be recognized over weighted average periods of 5 months and 6 months, respectively.

Information Analysis Incorporated

Form 10-Q First Quarter 2012

## 4. Earnings Per Share

Basic earnings per share excludes dilution and is computed by dividing income available to common shareholders by the weighted-average number of shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock, except for periods when the Company reports a net loss because the inclusion of such items would be antidilutive.

The following is a reconciliation of the amounts used in calculating basic and diluted net loss per common share.

|  | Net<br>Income | Shares     | Per Share<br>Amount |
|--|---------------|------------|---------------------|
| Basic net loss per common share for the three months ended March 31, 2012:   |               |            |                     |
| Income available to common stockholders                                      | \$ (22,550 )  | 11,196,760 | \$ 0.00             |
| Effect of dilutive stock options   | --            | --         | --                  |
| Diluted net loss per common share for the three months ended March 31, 2012: | \$ (22,550 )  | 11,196,760 | \$ 0.00             |
| Basic net loss per common share for the three months ended March 31, 2011:   |               |            |                     |
| Income available to common stockholders                                      | \$ (9,095 )   | 11,196,760 | \$ 0.00             |
| Effect of dilutive stock options   | --            | --         | --                  |
| Diluted net loss per common share for the three months ended March 31, 2011: | \$ (9,095 )   | 11,196,760 | \$ 0.00             |

Information Analysis Incorporated

Form 10-Q First Quarter 2012

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Cautionary Statement Regarding Forward-Looking Statements

This Form 10-Q contains forward-looking statements regarding our business, customer prospects, or other factors that may affect future earnings or financial results that are subject to the safe harbor created by the Private Securities Litigation Reform Act of 1995. Such statements involve risks and uncertainties which could cause actual results to vary materially from those expressed in the forward-looking statements. Investors should read and understand the risk factors detailed in our Form 10-K for the fiscal year ended December 31, 2011 and in other filings with the Securities and Exchange Commission.

We operate in a rapidly changing environment that involves a number of risks, some of which are beyond our control. This list highlights some of the risks which may affect future operating results. These are the risks and uncertainties we believe are most important for you to consider. Additional risks and uncertainties, not presently known to us, which we currently deem immaterial or which are similar to those faced by other companies in our industry or business in general, may also impair our business operations. If any of the following risks or uncertainties actually occurs, our business, financial condition and operating results would likely suffer. These risks include, among others, the following:

- changes in the funding priorities of the U.S. federal government;
- changes in the way the U.S. federal government contracts with businesses;
  - terms specific to U.S. federal government contracts;
- our failure to keep pace with a changing technological environment;
  - intense competition from other companies;
- inaccuracy in our estimates of the cost of services and the timeline for completion of contracts;
  - non-performance by our subcontractors and suppliers;
    - our dependence on key personnel;
- our dependence on third-party software and software maintenance suppliers;
  - our failure to adequately integrate businesses we may acquire;
- fluctuations in our results of operations and the resulting impact on our stock price;
  - the exercise of outstanding options and warrants;
  - our failure to adequately protect our intellectual property;
  - the limited public market for our common stock; and
- our forward-looking statements and projections may prove to be inaccurate.

In some cases, you can identify forward-looking statements by terms such as “may,” “will,” “should,” “could,” “would,” “expect,” “plans,” “anticipates,” “believes,” “estimates,” “projects,” “predicts,” “intends,” “potential” and similar expressions intended to identify forward-looking statements. These statements reflect our current views with respect to future events and are based on assumptions and subject to risks and uncertainties. Given these uncertainties, you should not place undue reliance on these forward-looking statements. We discuss many of these risks in greater detail under the heading “Risk Factors” in Item 1A. Also, these forward-looking statements represent our estimates and assumptions only as of the date of this report. Except as required by law, we assume no obligation to update any forward-looking statements after the date of this report.

Our Business

Founded in 1979, IAI is in the business of modernizing client information systems, developing and maintaining information technology systems, and performing consulting services to government and commercial organizations. We have performed software conversion projects for over 100 commercial and government customers, including Computer Sciences Corporation, IBM, Computer Associates, Sprint, Citibank, U.S. Department of Homeland Security, U.S. Treasury Department, U.S. Department of Agriculture, U.S. Department of Energy, U.S. Army, U.S. Air Force, U.S. Department of Veterans Affairs, and the Federal Deposit Insurance Corporation. Today, we primarily apply our technology, services and experience to legacy software migration and modernization for commercial companies and government agencies, and to developing web-based solutions for agencies of the U.S. federal government.

Four of our customers, two of which are U.S. government agencies with which we contract directly, one of which is a company with which we contract for services to U.S. government agencies, and one commercial customer, represent material portions of our revenue. These customers accounted for 34.0% and 15.9%, 27.1%, and 12.4%, respectively, of revenue in the first three months of 2012.

Information Analysis Incorporated

Form 10-Q First Quarter 2012

Three Months Ended March 31, 2012 versus Three Months Ended March 31, 2011

#### Revenue

Our revenues in the first quarter of 2012 were \$1,513,990, compared to \$1,423,737 in 2011, an increase of 6.3%. Professional services revenue was \$1,165,249 versus \$1,103,327, an increase of 5.6%, and software product and maintenance revenue was \$348,741 versus \$320,410, an increase of 8.8%. The increase in professional services revenue was due to new contracts and to increases in activity in some of our existing contracts in excess of the contracts that expired and decreased activity since March 31, 2011. The increase in our software product and maintenance revenue was primarily due to a new maintenance contract that was received in the fourth quarter of 2011.

#### Gross Margins

Gross margin was \$532,687, or 35.2% of sales, in the first quarter of 2012 versus \$554,438, or 38.9% of sales, in the first quarter of 2011. For the quarter ended March 31, 2012, \$488,615 of the gross margin was attributable to professional services at a gross margin percentage of 41.9%, and \$44,072 of the gross margin was attributable to software sales at a gross margin percentage of 12.6%. In the same quarter in 2011, we reported gross margins of \$510,311, or 46.3% of sales for professional services and \$44,127, or 13.8% of sales for software sales. Gross margin on professional services decreased in terms of both dollars and as a percentage of sales due to the maturity of or decreased activity of some more highly profitable contracts, while new contracts and contracts with increases in activity were in large part on less profitable contracts. Gross margin on software sales remained constant in dollars at \$44,072. However, this was on increased revenue of \$28,331. The decrease in gross margin as a percentage of software sales is due to a decrease in renewals on higher-margin maintenance contracts and smaller margins on some of our more recent product and maintenance contracts. Software product sales and associated margins are subject to considerable fluctuation from period to period, based on the product mix sold.

#### Selling, General and Administrative

Selling, general and administrative expenses, exclusive of sales commissions, were \$408,079, or 27.0% of revenues, in the first quarter of 2012 versus \$388,729, or 27.5% of revenues, in the first quarter of 2011. These expenses increased \$19,350, or 5.0%, due largely to increases in overhead labor and fringe benefits applied to overhead labor.

Commission expense was \$148,649, or 9.8% of revenues, in the first quarter of 2012 versus \$176,937, or 12.4% of revenues, in the first quarter of 2011. This decrease of \$28,288, or 16.0%, is due to the decrease in incentives earned by our sales and marketing personnel, which fluctuate with gross margins and operating income at varying rates for each salesperson.

#### Net loss

Net loss for the three months ended March 31, 2012, was \$22,550, or 1.5% of revenue, versus net loss of \$9,095, or 0.6% of revenue, for the same period in 2011. The increase in losses is due to new business and retained business having lesser aggregate margins than the contracts that expired or decreased activity, as well as increases in overhead labor due to decreases in activity on certain types of contracts for which personnel must be readily available.

#### Liquidity and Capital Resources

Our cash and cash equivalents balance, when combined with our cash flow from operations during the first three months of 2012, were sufficient to provide financing for our operations. Our net cash provided by combining our operating and financing activities in the first three months of 2012 was \$1,133,201. Our net cash provided, when added to a beginning balance of \$1,280,926 yielded cash and cash equivalents of \$2,414,127 as of March 31, 2012. Our accounts receivable balances decreased \$2,185,832 and our accounts payable balances decreased

\$971,400, primarily due to product-related invoices that were outstanding at the prior year end. We had no non-current liabilities as of March 31, 2012.

Information Analysis Incorporated

Form 10-Q First Quarter 2012

We have a revolving line of credit with a bank providing for demand or short-term borrowings of up to \$1,000,000. The line became effective December 20, 2005, and expires on December 1, 2012. As of March 31, 2012, no amounts were outstanding under this line of credit. At March 31, 2012, \$481,000 was available under this line of credit based on our outstanding accounts receivable.

Given our current cash position and operating plan, we anticipate that we will be able to meet our cash requirements for the next twelve months and beyond.

We presently lease our corporate offices on a contractual basis with certain timeframe commitments and obligations. We believe that our existing offices will be sufficient to meet our foreseeable facility requirement. Should we need additional space to accommodate increased activities, management believes we can secure such additional space on reasonable terms.

We have no material commitments for capital expenditures.

We have no off-balance sheet arrangements.

#### ITEM 4. CONTROLS AND PROCEDURES

##### Disclosure Controls and Procedures

Our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, and people performing similar functions, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act), as of March 31, 2012 (the "Evaluation Date"). Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the Evaluation Date, our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and (ii) is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

##### Changes in Internal Controls over Financial Reporting

There were no changes in the Company's internal control over financial reporting during the quarter ended March 31, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

##### Inherent Limitations on Effectiveness of Controls.

Because of the inherent limitations in all control systems, no control system can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. These inherent limitations include the realities that judgments in decision making can be faulty and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of a person, by collusion of two or more people or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and may not be detected. Notwithstanding these

limitations, we believe that our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives.



Information Analysis Incorporated

Form 10-Q First Quarter 2012

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 1A. RISK FACTORS

“Item 1A. Risk Factors” of our annual report on Form 10-K for the year ended December 31, 2011 includes a discussion of our risk factors. There have been no material changes from the risk factors described in our annual report on Form 10-K for the year ended December 31, 2011.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

31.1 Certification of Chief Executive Officer Pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934

31.2 Certification of Chief Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934

32.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

In accordance with the requirements of the Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Information Analysis Incorporated  
(Registrant)

Date: May 15, 2012

By: /S/ Sandor Rosenberg  
Sandor Rosenberg,  
Chairman of the Board, Chief Executive  
Officer ,  
and President

Date: May 15, 2012

By: /S/ Richard S. DeRose  
Richard S. DeRose,  
Executive Vice  
President, Treasurer, and Chief Financial  
Officer