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TAG IT PACIFIC INC
Form DEF 14A
April 25, 2003

SCHEDULE 14A
(RULE 14A-101)

INFORMATION REQUIRED IN PROXY STATEMENT
SCHEDULE 14A INFORMATION
PROXY STATEMENT PURSUANT TO SECTION 14(A) OF THE SECURITIES
EXCHANGE ACT OF 1934 (AMENDMENT NO. _____)

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- | | | | |
|-------------------------------------|---|--------------------------|---|
| <input type="checkbox"/> | Preliminary Proxy Statement | <input type="checkbox"/> | Confidential, For Use of the Commission Only (as permitted by Rule 14a-6 (e) (2)) |
| <input checked="" type="checkbox"/> | Definitive Proxy Statement | | |
| <input type="checkbox"/> | Definitive Additional Materials | | |
| <input type="checkbox"/> | Soliciting Material Pursuant to Rule 14a-11(c) or Rule 14a-12 | | |

TAG-IT PACIFIC, INC.

(Name of Registrant as Specified in Its Charter)

(Name of Person(s) Filing Proxy Statement, if Other Than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No Fee Required
 Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11:

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

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 Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the form or schedule and the date of its filing.

(1) Amount previously paid:

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(2) Form, Schedule or Registration Statement No.:

(3) Filing party:

(4) Date filed:

TAG-IT PACIFIC, INC.

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

TIME.....	9:00 a.m. Pacific Daylight Time on June 12, 2003
PLACE.....	Tag-It Pacific, Inc.'s Corporate Headquarters at 21900 Burbank Boulevard, Suite 270, Woodland Hills, California 91367.
ITEMS OF BUSINESS.....	(1) To elect three Class III members of the Board of Directors for three-year terms. The persons nominated by our Board of Directors (Messrs. Mark Dyne and Colin Dyne and Ms. Donna Armstrong) are described in the accompanying Proxy Statement. (2) To approve an amendment to the Company's 1997 Stock Plan to increase the maximum number of shares of common stock that may be issued pursuant to awards granted under the plan from 2,277,500 shares to 2,577,500 shares; and (3) To transact such other business as may properly come before the Annual Meeting and any adjournment or postponement.
RECORD DATE.....	You can vote if you were a stockholder of the Company at the close of business on April 18, 2003.

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PROXY VOTING.....

All stockholders are cordially invited to attend the Annual Meeting in person. However, to ensure your representation at the Annual Meeting, you are urged to vote promptly by signing and returning the enclosed Proxy card. IF YOUR SHARES ARE HELD IN STREET NAME, YOU MUST OBTAIN A PROXY, EXECUTED IN YOUR FAVOR, FROM THE HOLDER OF RECORD IN ORDER TO BE ABLE TO VOTE AT THE ANNUAL MEETING.

Woodland Hills, California
April 24, 2003

/s/ Ronda Sallmen

Ronda Sallmen
Chief Financial Officer

IN ORDER TO ENSURE YOUR REPRESENTATION AT THE ANNUAL MEETING, PLEASE COMPLETE, DATE, SIGN AND RETURN THE ACCOMPANYING PROXY IN THE ENCLOSED ENVELOPE AS PROMPTLY AS POSSIBLE. IF YOU RECEIVE MORE THAN ONE PROXY CARD BECAUSE YOU OWN SHARES REGISTERED IN DIFFERENT NAMES OR AT DIFFERENT ADDRESSES, EACH CARD SHOULD BE COMPLETED AND RETURNED.

1

TAG-IT PACIFIC, INC.
21900 BURBANK BOULEVARD, SUITE 270,
WOODLAND HILLS, CALIFORNIA 91367

PROXY STATEMENT

These Proxy materials are delivered in connection with the solicitation by the Board of Directors of Tag-It Pacific, Inc., a Delaware corporation ("Tag-It," the "Company", "we", or "us"), of Proxies to be voted at our 2003 Annual Meeting of stockholders and at any adjournments or postponements.

You are invited to attend our Annual Meeting of stockholders on June 12, 2003, beginning at 9:00 a.m. Pacific Daylight Time. The meeting will be held at the Company's corporate headquarters at 21900 Burbank Boulevard, Suite 270, Woodland Hills, California 91367.

STOCKHOLDERS ENTITLED TO VOTE.

Holders of Tag-It common stock and convertible redeemable series C preferred stock at the close of business on April 18, 2003 are entitled to receive this notice and to vote their shares at the Annual Meeting. As of April 18, 2003, there were 9,619,909 shares of common stock outstanding. Holders of our convertible redeemable series C preferred stock have the right to vote with our common stock based on the number of common shares that the series C preferred shares could be converted into on the record date. As of April 18,

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2003, the outstanding shares of convertible redeemable series C preferred stock were convertible into 607,288 shares of common stock, which shares are entitled to vote with our common stock.

MAILING OF PROXY STATEMENTS.

We anticipate mailing this Proxy Statement and the accompanying Proxy to stockholders on or about May 1, 2003.

PROXIES.

Your vote is important. If your shares are registered in your name, you are a share owner of record. If your shares are in the name of your broker or bank, your shares are held in street name. We encourage you to vote by Proxy so that your shares will be represented and voted at the meeting even if you cannot attend. All share owners can vote by written Proxy card. Your submitting the enclosed Proxy will not limit your right to vote at the Annual Meeting if you later decide to attend in person. IF YOUR SHARES ARE HELD IN STREET NAME, YOU MUST OBTAIN A PROXY, EXECUTED IN YOUR FAVOR, FROM THE HOLDER OF RECORD IN ORDER TO BE ABLE TO VOTE AT THE MEETING. If you are a share owner of record, you may revoke your Proxy at any time before the meeting either by filing with the Secretary of the Company, at its principal executive offices, a written notice of revocation or a duly executed Proxy bearing a later date, or by attending the Annual Meeting and expressing a desire to vote your shares in person. All shares entitled to vote and represented by properly executed Proxies received prior to the Annual Meeting, and not revoked, will be voted at the Annual Meeting in accordance with the instructions indicated on those Proxies. If no instructions are indicated on a properly executed Proxy, the shares represented by that Proxy will be voted as recommended by the Board of Directors.

QUORUM.

The presence, in person or by Proxy, of a majority of the votes entitled to be cast by the stockholders entitled to vote at the Annual Meeting is necessary to constitute a quorum. Abstentions and broker non-votes will be included in the number of shares present at the Annual Meeting for determining the presence of a quorum. Broker non-votes occur when a broker holding customer securities in street name has not received voting instructions from the customer on certain non-routine matters and, therefore, is barred by the rules of the applicable securities exchange from exercising discretionary authority to vote those securities.

2

VOTING.

Each share of Tag-It common stock is entitled to one vote on each matter properly brought before the meeting. In addition, each share of convertible redeemable series C preferred stock is entitled to one vote for each share of common stock into which it is convertible on each matter properly brought before the meeting. Abstentions will be counted toward the tabulation of votes cast on proposals submitted to stockholders and will have the same effect as negative votes, while broker non-votes will not be counted as votes cast for or against such matters.

ELECTION OF DIRECTORS.

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The three nominees for Class III director receiving the highest number of votes at the Annual Meeting will be elected. If any nominee is unable or unwilling to serve as a director at the time of the Annual Meeting, the Proxies will be voted for such other nominee(s) as shall be designated by the current Board of Directors to fill any vacancy. The Company has no reason to believe that any nominee will be unable or unwilling to serve if elected as a director.

AMENDMENT OF THE 1997 STOCK PLAN.

It is proposed to amend the 1997 Stock Plan to increase the number of shares of common stock that the Company may issue pursuant to awards under the 1997 Stock Plan from 2,277,500 shares to 2,577,500 shares. This amendment will require the affirmative vote of a majority of the votes entitled to be cast by holders of outstanding shares of common stock that are present or represented by proxy at the Annual Meeting.

OTHER MATTERS.

At the date this Proxy Statement went to press, we do not know of any other matter to be raised at the Annual Meeting.

In the event a shareholder proposal was not submitted to the Company prior to April 16, 2003, the enclosed Proxy will confer authority on the Proxyholders to vote the shares in accordance with their best judgment and discretion if the proposal is presented at the Meeting. As of the date hereof, no shareholder proposal has been submitted to the Company, and management is not aware of any other matters to be presented for action at the Meeting. However, if any other matters properly come before the Meeting, the Proxies solicited hereby will be voted by the Proxyholders in accordance with the recommendations of the Board of Directors. Such authorization includes authority to appoint a substitute nominee for any Board of Directors' nominee identified herein where death, illness or other circumstance arises which prevents such nominee from serving in such position and to vote such Proxy for such substitute nominee.

3

ITEM 1: ELECTION OF DIRECTORS

Item 1 is the election of three members of the Board of Directors. In accordance with our Certificate of Incorporation, the Board of Directors is grouped into three classes. At each Annual Meeting, directors constituting one class are elected, each for a three-year term. Our bylaws presently provide that the number of directors shall not be less than two nor more than nine, with the exact number to be fixed from time to time by resolution of our Board of Directors. The number of directors is currently fixed at eight.

The Class III directors whose terms expire at the 2003 Annual Meeting are Mark Dyne, Colin Dyne and Donna Armstrong. The Board of Directors has nominated Mark Dyne, Colin Dyne and Donna Armstrong to serve as Class III directors for terms expiring in 2006. The Class I directors are serving terms that expire in 2004, and the Class II directors are serving terms that expire in 2005. Three Class III directors will be elected at the Annual Meeting.

Unless otherwise instructed, the Proxy holders will vote the Proxies received by them for the nominees named below. If any nominee is unable or unwilling to serve as a director at the time of the Annual Meeting, the Proxies

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will be voted for such other nominee(s) as shall be designated by the then current Board of Directors to fill any vacancy. The Company has no reason to believe that any nominee will be unable or unwilling to serve if elected as a director.

The Board of Directors proposes the election of the following nominees as Class III directors:

Mark Dyne
Colin Dyne
Donna Armstrong

If elected, Mark Dyne, Colin Dyne and Donna Armstrong are expected to serve until the 2006 Annual Meeting of stockholders. The three nominees for election as Class III directors at the Annual Meeting who receive the highest number of affirmative votes will be elected.

The principal occupation and certain other information about the nominees, other directors whose terms of office continue after the Annual Meeting, and certain executive officers are set forth on the following pages.

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE "FOR" THE ELECTION OF THE NOMINEES LISTED ABOVE.

DIRECTORS AND EXECUTIVE OFFICERS

The following table sets forth information with respect to nominees, continuing directors and officers of the Company as of April 18, 2003:

NAME	AGE	YEAR FIRST ELECTED OR APPOINTED DIRECTOR	POSITION
----	---	-----	-----
CLASS III DIRECTOR NOMINEES:			

(terms expiring in 2003)			
Mark Dyne (3).....	42	1997	Chairman of the Board of Directors
Colin Dyne (3).....	40	1997	Chief Executive Officer, President and Director
Donna Armstrong.....	41	2001	Director
CONTINUING DIRECTORS:			
CLASS I DIRECTORS			
(terms expiring in 2004)			
Kevin Bermeister.....	42	1999	Director
Brent Cohen.....	44	1998	Director
CLASS II DIRECTORS (1)			
(terms expiring in 2005)			

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Michael Katz.....	61	1998	Director
Jonathan Burstein (2).....	36	1999	Vice President of Operations and Director

OTHER OFFICERS:

Jonathan Markiles.....	38		Secretary and Vice President of Strategic Planning and Business Development
Ronda Sallmen.....	37		Chief Financial Officer

- (1) There is currently a vacancy in the Class II directors.
- (2) Jonathan Burstein is Colin Dyne's and Mark Dyne's brother-in-law.
- (3) Colin Dyne and Mark Dyne are brothers.

5

CLASS III DIRECTOR NOMINEES: TERMS EXPIRING IN 2003

MARK DYNE

Mr. Dyne has served as Chairman of the Board of Directors since 1997. He also serves as Chairman of the Board of Directors of Brilliant Digital Entertainment, Inc., a publicly traded corporation. Mr. Dyne currently serves as the Chief Executive Officer and the Managing Director of EuroPlay Capital Advisors, LLC, a merchant banking and advisory firm. He is a founder and former director of Sega Ozisoft Pty Ltd., a leading distributor of entertainment software in both Australia and New Zealand. Mr. Dyne previously served as Chairman and Chief Executive Officer of Sega Gaming Technology Inc. (USA), a gaming company. Mr. Dyne also served as Chairman and Chief Executive Officer of Virgin Interactive Entertainment Ltd., a distributor of computer software programs and video games based in London, England. Mr. Dyne was a founder and director of Packard Bell NEC Australia Pty. Ltd., a manufacturer and distributor of personal computers through the Australian mass merchant channel.

COLIN DYNE

Mr. Dyne founded Tag-It, Inc., one of our subsidiaries, in 1991 with his father, Harold Dyne, and has served as our President since inception and as our Chief Executive Officer since 1997. Before founding Tag-It, Inc. in 1991, Mr. Dyne worked in numerous positions within

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the stationery products industry, including owning and operating retail stationery businesses and servicing the larger commercial products industry through contract stationery and printing operations. Mr. Dyne is the brother of Mark Dyne.

DONNA ARMSTRONG

Ms. Armstrong was appointed as a member to the Board of Directors in September 2001. From 1996 to present, Ms. Armstrong has been employed by the UK-based thread conglomerate Coats plc where she has held several key positions with the Coats North American businesses, Finance Director of the Coats European businesses and most recently as the Chief Financial Officer of the Coats North American businesses. Ms. Armstrong served as the Accounting Manager for Continental General Tire, a German-owned tire manufacturer, from 1995-1996. Before joining Continental General Tire, Ms. Armstrong was employed with Deloitte & Touche for 11 years where she attained the position of Senior Manager in the Audit Advisory Services practice in Charlotte, North Carolina. In this role, she was responsible for providing audit and business advisory services to private and publicly held companies with primary focus in the manufacturing industry. Ms. Armstrong is a certified public accountant for the state of North Carolina.

6

CLASS I DIRECTORS: TERMS EXPIRING IN 2004

KEVIN BERMEISTER

Mr. Bermeister has served on our Board of Directors since 1999. He has been a director of Brilliant Digital Entertainment, Inc. since August 1996 and has served as its President since October 1996 and as its Chief Executive Officer since the beginning of 2001. Mr. Bermeister is a director of Sega Ozisoft Pty. Ltd. and previously served as its Co-Chief Executive Officer. Mr. Bermeister is a founder of Sega Ozisoft which commenced business in 1982. Mr. Bermeister also is a director of Packard Bell NEC Australia Pty. Ltd. and Jacfun Pty. Ltd. Jacfun owns the Darling Harbour property occupied by the Sega World

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indoor theme park in Sydney, Australia. Mr. Bermeister has served on numerous advisory boards, including Virgin Interactive Entertainment Ltd.

Member: COMPENSATION COMMITTEE, AUDIT COMMITTEE

BRENT COHEN

Mr. Cohen has served on the Board of Directors since 1998. Mr. Cohen has served as president and chief executive officer of US SEARCH since February 2000. From July 1987 through October 1998, Mr. Cohen held senior management positions with Packard Bell NEC (formerly Packard Bell Electronics), including Chief Operating Officer, Chief Financial Officer and President--Consumer and International. Subsequently, Mr. Cohen served on the board of advisors and directors of several companies from October 1998 through January 2000. From January 1980 through December 1982 and from January 1985 through June 1987 Mr. Cohen held various management positions in both the management consulting and auditing practice of Arthur Young & Company (now Ernst & Young). Mr. Cohen holds a Bachelor of Commerce degree, a Graduate Diploma in Accounting and an MBA from the University of Cape Town in South Africa. He is also a chartered accountant.

Member: COMPENSATION COMMITTEE, AUDIT COMMITTEE

CLASS II DIRECTORS: TERMS EXPIRING IN 2005

MICHAEL KATZ

Mr. Katz has served on our Board of Directors since 1998. Mr. Katz has served as President, Chief Operating Officer and director of Transducer Controls Corporation, a manufacturer of position and pressure transducers, from 1987 to the present. From 1987 to June 2002, Mr. Katz also served as President, Chief Operating Officer and director of Tedea-Huntleigh, Inc., a manufacturer of load-cells and force-transducers. Since 1999, Mr. Katz has also served as Chairman of Lebow Products, a manufacturer of torque-transducers. Mr. Katz holds an MBA and Bachelor of Science degree in mechanical engineering.

Member: AUDIT COMMITTEE

JONATHAN BURSTEIN

Mr. Burstein has served as our Vice President of Operations since 1999 and has served on our Board of Directors since 1999. During this period, Mr.

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Burstein has been responsible for many of the internal operations of the Company, including logistics, purchasing and managing key customer relationships. From 1987 until 1999, Mr. Burstein has been responsible for managing many of our largest customer accounts, including transitioning customers to our Managed Trim Solution e-commerce system. Mr. Burstein is the brother-in-law of Colin Dyne and Mark Dyne.

7

OTHER OFFICERS

JONATHAN MARKILES

Mr. Markiles is our Vice President, Strategic Planning and Business Development, and Secretary. Mr. Markiles joined Tag-It, Inc. in May 1994 as our general manager where he has been responsible for production, distribution and international operations. Before joining Tag-It, Inc., Mr. Markiles received his MBA from the University of Southern California in May 1994. From 1987 until August 1992, Mr. Markiles held various operational positions with Windshields America, Inc., a national chain of autoglass stores.

RONDA SALLMEN

Ms. Sallmen has served as our Chief Financial Officer since she joined us in June 2000. Before joining us, Ms. Sallmen was a senior manager at BDO Seidman, LLP, independent public accountants, where she was the director of the Apparel Industry Practice in Los Angeles, California. In this role, she was responsible for providing audit, transaction support and business advisory services to private and publicly held companies. Ms. Sallmen has over ten years experience in the apparel industry. She was also a member of the advisory board of a leading apparel industry group. Ms. Sallmen is a certified public accountant and a member of the American Institute of Certified Public Accountants and the California State Society of Certified Public Accountants.

Pursuant to the series C preferred stock purchase agreement entered into by us and Coats North America Consolidated, Inc., and for so long as Coats North America Consolidated holds 66 2/3% of the shares of the our series C preferred stock that it purchased in September 2001, we have agreed to use

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commercially reasonable efforts to cause a representative designated by Coats North America Consolidated to be nominated to serve as director of our company. Donna Armstrong currently serves as one of our directors pursuant to this agreement. BOARD MEETINGS AND COMMITTEES.

The Board of Directors held five general meetings, including two meetings of a special committee designated by the Board of Directors, during fiscal 2002. Each director attended at least 75% of all the meetings of the Board of Directors and those committees on which he or she served in fiscal 2002. The Board of Directors maintains an audit committee and a compensation committee.

The audit committee currently consists of Messrs. Bermeister, Cohen and Katz. The compensation committee currently consists of Messrs. Bermeister and Cohen.

The role and responsibilities of the audit committee are set forth in a written charter adopted by the Board. The audit committee approves the engagement of independent public accountants, reviews the scope of the audit to be conducted by the independent public accountants and meets quarterly with the independent public accountants and our Chief Financial Officer to review matters relating to our financial statements, our accounting principles and our system of internal accounting controls. The audit committee reports its recommendations as to the approval of our financial statements to the Board of Directors. All audit committee members are independent directors as defined in the listing standards of the American Stock Exchange. The audit committee held seven meetings during fiscal 2002.

The compensation committee is responsible for considering and making recommendations to the Board of Directors regarding executive compensation and is responsible for administering our stock option plan and executive incentive compensation. The compensation committee held three meetings and acted two additional times by unanimous written consent during fiscal 2002.

8

DIRECTOR COMPENSATION

We currently pay nonemployee directors \$1,500 for their personal attendance at any meeting of the Board of Directors and \$500 for attendance at any telephonic meeting of the Board of Directors or at any meeting of a committee of the Board of Directors. Non-employee directors, Messrs. Bermeister, Cohen and Katz, received 25,000 options each to purchase shares of the Company's common stock in April 2003. We also reimburse directors for their reasonable travel expenses incurred in attending board or committee meetings.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION.

There are no interlocking relationships involving any of our compensation committee members required by the Securities and Exchange Commission to be reported in this Proxy Statement and none of our officers or full-time employees serves on our compensation committee.

EXECUTIVE COMPENSATION

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SUMMARY COMPENSATION TABLE

The following table sets forth, as to the Chief Executive Officer, and as to each of the other most highly compensated officers whose compensation exceeded \$100,000 during the last fiscal year (the "Named Executive Officers"), information concerning all compensation paid for services to the Company in all capacities for each of the three years ended December 31 indicated below.

SUMMARY COMPENSATION TABLE

NAME AND PRINCIPAL POSITION	FISCAL YEAR ENDED DECEMBER 31	ANNUAL COMPENSATION		LONG TERM COMPENSATION
		SALARY	OTHER (1)	NUMBER OF SECURITIES UNDERLYING OPTIONS
Colin Dyne.....	2002	\$438,305	\$ 55,787	100,000
Chief Executive Officer,	2001	326,536	51,680	50,000
President and Director	2000	317,000	54,940	140,000
Jonathan Burstein.....	2002	\$197,980	\$ 21,005	25,000
Vice President of	2001	187,596	22,434	15,000
Operations and Director	2000	167,980	27,942	50,000
Ronda Sallmen (2).....	2002	\$118,592	\$ 11,248	25,000
Chief Financial Officer	2001	142,308	8,833	20,000
	2000	74,505	1,554	55,000
Jonathan Markiles	2002	\$200,000	\$ --	--
Vice President of Strategic	2001	190,769	--	15,000
Planning and Business	2000	178,846	--	30,000
Development and Secretary				

(1) Other compensation indicated in the above table consists of car and expense allowances and medical and disability insurance.

(2) Ms. Sallmen joined the Company in June 2000.

OPTION GRANTS IN FISCAL 2002

The following table sets forth information regarding stock options granted to the Named Executive Officers during the fiscal year ended December 31, 2002. This information includes hypothetical potential gains from stock options granted in fiscal 2002. These hypothetical gains are based entirely on assumed annual growth rates of 5% and 10% in the value of our common stock price over the 10-year life of the stock options granted in fiscal 2002. These assumed rates of growth were selected by the Securities and Exchange Commission for illustrative purposes only and are not intended to predict future stock prices, which will depend upon market conditions and our future performance and prospects.

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OPTION GRANTS IN FISCAL 2002

NAME	NUMBER OF SECURITIES UNDERLYING OPTIONS GRANTED	PERCENT OF TOTAL OPTIONS GRANTED TO EMPLOYEES IN FISCAL YEAR (1)	EXERCISE OR BASE PRICE PER SHARE (2)	EXPIRATION DATE	POTENTIAL REALIZABLE VALUE AT ASSUMED RATE OF STOCK PRICE APPRECIATION FOR OPTION TERM (3)	
					5%	10%
-----	-----	-----	-----	-----	---	---
Colin Dyne.....	100,00 (4)	37.0%	\$ 3.63	12/31/12	\$ 228,289	\$ 578,529
Jonathan Burstein..	25,00 (5)	9.3	3.63	12/31/12	57,072	144,632
Ronda Sallmen.....	25,00 (5)	9.3	3.63	12/31/12	57,072	144,632
Jonathan Markiles..	--	--	--	--	--	--

10

AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR AND FISCAL YEAR-END OPTION VALUES

The following table sets forth, for each of the Named Executive Officers, certain information regarding the number of shares of common stock underlying stock options held at fiscal year-end and the value of options held at fiscal year-end based upon the last reported sales price of the underlying securities on the American Stock Exchange (\$3.63 per share) on December 31, 2002, the last trading day during 2002, as reported by the American Stock Exchange. No options were exercised by the Named Executive Officers during fiscal 2002.

AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR AND FISCAL YEAR-END OPTION VALUES

NAME	SHARES ACQUIRED ON EXERCISE	VALUE REALIZED	NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS AT DECEMBER 31, 2002		VALUE OF UNEXERCISED IN-THE-MONEY OPTIONS DECEMBER 31, 2002	
			EXERCISABLE	UNEXERCISABLE	EXERCISABLE	UNEXERCISABLE
-----	-----	-----	-----	-----	-----	-----
Colin Dyne	--	\$ --	435,000	--	\$ --	\$ --
Jonathan Burstein.	--	--	115,000	25,000	69,900	--
Ronda Sallmen.....	--	--	75,000	25,000	--	--
Jonathan Markiles.	--	--	80,000	--	46,600	--

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EMPLOYMENT CONTRACTS

None of the Named Executive Officers have employment agreements with the Company and their employment may be terminated at any time.

STOCK INCENTIVE PLAN

The Company adopted the Tag-It Pacific, Inc. 1997 Stock Plan (the "1997 Plan") in October 1997. The purpose of the 1997 Plan is to provide incentives and rewards to selected eligible directors, officers, employees and consultants of the Company or its subsidiaries in order to assist the Company and its subsidiaries in attracting, retaining and motivating those persons by providing for or increasing the proprietary interests of those persons in the Company, and by associating their interests in the Company with those of the Company's stockholders. Currently, the maximum number of shares of common stock that may be issued pursuant to awards granted under the 1997 Plan is 2,277,500, subject to certain adjustments to prevent dilution. Any shares of common stock subject to an award which for any reason expires or terminates unexercised are again available for issuance under the 1997 Plan.

The 1997 Plan authorizes its administrator to enter into any type of arrangement with an eligible participant that, by its terms, involves or might involve the issuance of (1) shares of common stock, (2) an option, warrant, convertible security, stock appreciation right or similar right with an exercise or conversion privilege at a price related to the common stock, or (3) any other security or benefit with a value derived from the value of the common stock. Any stock option granted may be an incentive stock option within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended (the "Code") or a nonqualified stock option. The 1997 Plan currently is administered by the Compensation Committee of the Board of Directors of the Company. Subject to the provisions of the 1997 Plan, the Compensation Committee will have full and final authority to select the executives and other employees to whom awards will be granted thereunder, to grant the awards and to determine the terms and conditions of the awards and the number of shares to be issued pursuant thereto. No participant may receive awards representing more than 25% of the aggregate number of shares of common stock that may be issued pursuant to all awards under the 1997 Plan.

As of December 31, 2002, 259,000 shares of common stock remained available for grant of awards to eligible participants under the 1997 Plan.

11

REPORT OF COMPENSATION COMMITTEE

The Compensation Committee is charged with the responsibility of administering all aspects of the Company's executive compensation programs. The committee, which currently is comprised of two independent, non-employee directors, also grants all stock options and otherwise administers the 1997 Plan. In connection with its deliberations, the committee seeks, and is significantly influenced by, the views of the Chief Executive Officer with respect to appropriate compensation levels of the other officers.

TOTAL COMPENSATION. It is the philosophy of the committee that

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executive compensation should be structured to provide an appropriate relationship between executive compensation and performance of the Company and the share price of the common stock, as well as to attract, motivate and retain executives of outstanding abilities and experience. The principal elements of total compensation paid to executives of the Company are as follows:

BASE SALARY. Base salaries are negotiated at the commencement of an executive's employment with the Company, and are designed to reflect the position, duties and responsibilities of each executive officer, the cost of living in the area in which the officer is located, and the market for base salaries of similarly situated executives at other companies engaged in businesses similar to that of the Company. Base salaries may be annually adjusted in the sole discretion of the committee to reflect changes in any of the foregoing factors.

STOCK INCENTIVE PLAN OPTIONS AND AWARDS. Under the 1997 Plan, the committee is authorized to grant any type of award which might involve the issuance of shares of common stock, options, warrants, convertible securities, stock appreciation rights or similar rights or any other securities or benefits with a value derived from the value of the common stock. The number of options granted to an individual is based upon a number of factors, including his or her position, salary and performance, and the overall performance and stock price of the Company.

ANNUAL INCENTIVES. The committee believes that executive compensation should be determined with specific reference to the Company's overall performance and goals, as well as the performance and goals of the division or function over which each individual executive has primary responsibility. In this regard, the committee considers both quantitative and qualitative factors. Quantitative items used by the committee in analyzing the Company's performance include sales and sales growth, results of operations and an analysis of actual levels of operating results and sales to budgeted amounts. Qualitative factors include the committee's assessment of such matters as the enhancement of the Company's image and reputation, expansion into new markets, and the development and success of new strategic relationships and new marketing opportunities.

DETERMINATION OF CHIEF EXECUTIVE OFFICER'S COMPENSATION. The committee believes that the Chief Executive Officer's compensation should be determined with specific reference to the Company's overall performance and goals applying the same quantitative and qualitative factors with which it determines the annual incentives of its other executive officers. The committee set the base salary for the Chief Executive Officer for the fiscal year 2002 at a level which is designed to provide the Chief Executive Officer with a salary which is competitive with salaries paid to chief executive officers of similarly-sized companies in the industry and commensurate with the Chief Executive Officer's experience.

OMNIBUS BUDGET RECONCILIATION ACT IMPLICATIONS FOR EXECUTIVE COMPENSATION. Effective January 1, 1994, under Section 162(m) of the Internal Revenue Code of 1986, as amended (the "Code"), a public company generally will not be entitled to a deduction for non-performance-based compensation paid to certain executive officers to the extent such compensation exceeds \$1.0 million. Special rules apply for "performance-based" compensation, including the approval of the performance goals by the stockholders of the Company.

All compensation paid to the Company's employees in fiscal 2002 will be fully deductible. With respect to compensation to be paid to executives in 2003 and future years, in certain instances such compensation may exceed \$1.0 million. However, in order to maintain flexibility in compensating executive officers in a manner designed to promote varying corporate goals, the Compensation Committee has not adopted a policy that all compensation must be deductible.

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Compensation Committee:

Kevin Bermeister
Brent Cohen

12

REPORT OF AUDIT COMMITTEE

The audit committee of the Board of Directors, which consists of 3 independent directors, as that term is defined in Section 121(A) of the listing standards of the American Stock Exchange, has furnished the report set forth below.

The audit committee assists the Board in overseeing and monitoring the integrity of the Company's financial reporting process, its compliance with legal and regulatory requirements and the quality of its internal and external audit processes. The role and responsibilities of the audit committee are set forth in a written charter adopted by the Board. The audit committee reviews and reassesses the charter annually and recommends any changes to the Board for approval.

The audit committee is responsible for overseeing the Company's overall financial reporting process. In fulfilling its responsibilities for the financial statements for fiscal year 2002, the audit committee:

- Reviewed and discussed the audited financial statements for the year ended December 31, 2002 with management and BDO Seidman, LLP ("BDO"), the Company's independent auditors;
- Discussed with BDO the matters required to be discussed by Statement on Auditing Standards No. 61 relating to the conduct of the audit;
- Received written disclosures and a letter from BDO regarding its independence as required by Independence Standards Board Standard No. 1. The audit committee discussed with BDO their independence; and
- Based on its review of the audited financial statements and discussions with management and BDO, recommended to the Board that the audited financial statements be included in the Company's Annual Report on Form 10-K for the year ended December 31, 2002 for filing with the Securities and Exchange Commission.

The audit committee also considered the status of pending litigation and other areas of oversight relating to the financial reporting and audit process that the committee determined appropriate.

AUDIT FEES

The aggregate fees billed by BDO for professional services rendered for the audit of the Company's annual financial statements for the fiscal year ended December 31, 2002 and the reviews of the financial statements included in the Company's Forms 10-Q for that fiscal year, were \$109,000.

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FINANCIAL INFORMATION SYSTEMS DESIGN AND IMPLEMENTATION FEES

BDO did not bill any fees for professional services rendered for information technology services relating to financial information systems design and implementation for the fiscal year ended December 31, 2002.

ALL OTHER FEES

The aggregate fees billed by BDO for services rendered to the Company other than the services described above under "Audit Fees" and "Financial Information Systems Design and Implementation Fees," for the fiscal year ended December 31, 2002, were \$1,870.

The audit committee has considered whether the provision of non-audit services is compatible with maintaining the principal accountant's independence.

Audit Committee:

Kevin Bermeister
Brent Cohen
Michael Katz

13

PERFORMANCE GRAPH

The following graph sets forth the percentage change in cumulative total stockholder return of the common stock of the Company during the period from January 23, 1998 to December 31, 2002, compared with the cumulative returns of the American Stock Exchange Composite Index and The Dow Jones Textiles & Apparel Index. The comparison assumes \$100 was invested on January 23, 1998 in the common stock of the Company and in each of the foregoing indices. The stock price performance on the following graph is not necessarily indicative of future stock price performance.

[PERFORMANCE GRAPH OMITTED]

	Cumulative Total Return				
	January 23, 1998	December 31, 1998	December 31, 1999	December 31, 2000	December 31, 2001
Tag-It Pacific, Inc.	100.00	109.38	140.63	101.58	98.75
AMEX Market Value	100.00	107.33	137.12	140.90	134.27

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Dow Jones Textiles & Apparel	100.00	83.74	81.52	99.06	99.90
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14

CERTAIN TRANSACTIONS WITH DIRECTORS AND EXECUTIVE OFFICERS

Except as disclosed in this Proxy Statement, neither the nominees for election as directors of the Company, the directors or senior officers of the Company, nor any stockholder owning more than five percent of the issued shares of the Company, nor any of their respective associates or affiliates, had any material interest, direct or indirect, in any material transaction to which the Company was a party during fiscal 2002, or which is presently proposed.

TRANSACTIONS INVOLVING OUR OFFICERS, DIRECTORS, OR THEIR IMMEDIATE FAMILY AND AFFILIATES

Pursuant to a consulting agreement, we paid \$150,000 in consulting fees to Diversified Consulting, LLC, a company owned by Audrey Dyne, mother of Colin Dyne and Mark Dyne, for the year ended December 31, 2002. We also paid \$70,800 in consulting fees to Kevin Bermeister, a director, for the year ended December 31, 2002.

As of December 31, 2002, we were indebted to Monto Holdings Pty. Ltd. in the aggregate amount of \$60,919. Mark Dyne, our Chairman, holds a significant equity interest in Monto Holdings Pty. Ltd. Kevin Bermeister, one of our directors, also holds an equity interest in Monto Holdings Pty. Ltd. The loans from Monto Holdings Pty. Ltd. are all evidenced by promissory notes and are due and payable on the fifteenth day following the date on which the holder of the promissory note makes written demand for payment.

Mark Dyne loaned us \$160,000 in August 1999 and \$15,000 in January 1999. This indebtedness is evidenced by unsecured promissory notes, dated August 17, 1999 and January 31, 1999, which are due and payable on demand and bear interest at a rate of 7.0% and 7.5% per annum. During the year ended December 31, 2000, we repaid \$95,205 to Mr. Dyne. In October 2000, Mark Dyne loaned us a further \$500,000. This indebtedness is evidenced by a convertible secured subordinated promissory note, dated October 4, 2000, which is due and payable on demand, bears interest at a rate of 11.0% per annum and convertible at the election of the holder into our common stock at a price of \$4.50 per share. At December 31, 2002, we were indebted to Mr. Dyne in the aggregate amount of \$579,795.

As of December 31, 2002, Colin Dyne was indebted to Tag-It, Inc. as part of a series of loans in the aggregate amount of \$636,669. A portion of this indebtedness is evidenced by a promissory note, dated August 31, 1997, in the principal amount of \$71,542 and a promissory note, dated October 15, 1997, in the principal amount of \$6,089. Both promissory notes are due and payable on demand and bear interest at a rate of 7.5% per annum. The remaining indebtedness is due and payable on demand and bears interest at 8.5% and prime. In addition to these two promissory notes, Colin Dyne loaned the Company \$185,000 in December 2000. The note payable is unsecured, bears interest at a rate of 11% and is due on demand. The aggregate net amount due from Mr. Dyne during the year ended December 31, 2002 amounted to \$451,669.

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As of December 31, 2002, Jonathan Burstein was indebted to Tag-It, Inc. as part of a series of loans in the aggregate amount of \$92,689, the largest aggregate balance during the year ended December 31, 2002. This indebtedness bears interest of 7.5 % and is due and payable on demand.

In a series of transactions on December 28, 2001, January 7, 2002 and January 8, 2002, we entered into stock and warrant purchase agreements with three private investors, including Mark Dyne, the chairman of our board of directors. Pursuant to the stock and warrant purchase agreements, we issued Mr. Dyne an aggregate of 166,666 shares of common stock at a price per share of \$3.00 for aggregate proceeds of \$499,998. Pursuant to the stock and warrant purchase agreements, 83,334 warrants to purchase common stock were issued to Mr. Dyne. The warrants are exercisable immediately after closing, one half of the warrants at \$4.34 per share and the second half at \$4.73 per shares, representing 110% and 120%, respectively, of the market value of our common stock on the date of closing. The exercise price for the warrants shall be adjusted upward by 25% of the amount, if any, that the market price of our common stock on the exercise date exceeds the initial exercise price (as adjusted) up to a maximum exercise price of \$5.25. The warrants have a term of four years. The shares contain restrictions related to the sale or transfer of the shares, registration and voting rights.

On October 4, 2002, we entered into a note payable agreement with Harris Toibb, the beneficial owner of approximately 13% of our common stock at April 18, 2003, in the amount of \$500,000 to fund additional working

15

capital requirements. The note payable was unsecured, due on demand, accrued interest at 4% and was subordinated to UPS Capital. This note was re-paid on February 28, 2003.

TRANSACTIONS INVOLVING STRATEGIC RELATIONSHIPS WITH CUSTOMERS AND SUPPLIERS

In October 1998, KG Investment, LLC, a Los Angeles-based private investment company, purchased 2,390,000 restricted shares of our common stock for an aggregate price of \$2,688,750. KG Investment, LLC, is currently a significant stockholder, owning approximately 25.6% of the outstanding shares of our common stock at December 31, 2002. KG Investment, LLC is also affiliated with Tarrant Apparel Group, our largest customer, because the owners of KG Investment, LLC are Gerard Guez, Chairman of the Board and Chief Executive Officer and a significant stockholder of Tarrant Apparel Group, and Todd Kay, President and a significant stockholder of Tarrant Apparel Group. Total sales to Tarrant for the years ended December 31, 2002, 2001 and 2000 amounted to approximately \$24,947,000, \$18,438,000 and \$23,760,000. As of December 31, 2002, 2001 and 2000, accounts receivable related parties included approximately \$9,362,000, \$4,995,000 and \$8,270,000 due from Tarrant. Terms are net 60 days. During the year ended December 31, 1999, we loaned Mr. Guez \$75,000 in the form of an unsecured promissory note which bears interest at prime and is payable on demand.

In connection with this investment, KG Investment, LLC agreed not to dispose of its shares of common stock before October 16, 2000, except to affiliated parties, without our prior written consent. After October 16, 2000, KG Investment, LLC may sell or transfer any of the shares in accordance with applicable law; provided that we have an assignable right of first refusal to

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purchase the shares upon the same or economically equivalent terms and conditions, if the sale is not made in accordance with the volume restrictions of Rule 144 under the Securities Act of 1933 or in connection with a public offering initiated by us. We granted KG Investment, LLC piggyback registration rights which entitles it to sell its shares of common stock in a registered public offering in the same proportion as shares of common stock sold in the same offering by any of Colin Dyne, Mark Dyne, the Estate of Harold Dyne, Larry Dyne or Jonathan Burstein. During 2002, KG Investments, LLC transferred 195,000 shares to Gerard Guez and 1,195,000 shares to Todd Kay.

On December 22, 2000, we entered into an exclusive supply agreement with Azteca Production International, Inc., AZT International SA D RL, and Commerce Investment Group, LLC. Pursuant to this supply agreement we provide all trim-related products for certain programs manufactured by Azteca Production International. The agreement provides for a minimum aggregate total of \$10,000,000 in annual purchases by Azteca Production International and its affiliates during each year of the three-year term of the agreement, if and to the extent, we are able to provide trim products on a basis that is competitive in terms of price and quality. Under the terms of the supply agreement, we issued 1,000,000 shares of restricted common stock to Commerce Investment Group, LLC, or approximately 10.7% the outstanding shares of our common stock at December 31, 2002. The shares of restricted stock were issued at the market price of our stock at the time of issuance. Total sales to Azteca for the years ended December 31, 2002, 2001 and 2000 amounted to approximately \$16,946,000, \$9,016,000 and \$1,878,000. As of December 31, 2002, 2001 and 2000, accounts receivable related parties included approximately \$5,408,000, \$2,920,000 and \$771,000 due from Azteca. Terms are net 60 days. Transportation fees paid to a company that has common ownership with Azteca for the years ended December 31, 2002 and 2001 amounted to \$225,000 and \$15,000.

In accordance with the series C preferred stock purchase agreement entered into by the Company and Coats North America Consolidated, Inc., an affiliate of Coats, plc, on September 20, 2001, 759,494 shares of series C convertible redeemable preferred stock were issued to Coats North America Consolidated, Inc. in exchange for an equity investment from Coats North America Consolidated of \$3 million cash. Pursuant to the series C preferred stock purchase agreement, and for so long as Coats holds 66 2/3% of the shares of the series C preferred stock, the Company has agreed to use commercially reasonable efforts to cause a representative designated by Coats to be nominated to serve as director of our company. Each holder of the series C preferred shares has the right to vote with the common stock based on the number of common shares that the series C preferred shares could then be converted into on the record date. In connection with the series C preferred stock purchase agreement, the Company also entered into a 10-year co-marketing and supply agreement with Coats that provides for selected introductions into Coats' customer base and the Company's trim packages will exclusively offer thread manufactured by Coats. Total purchases from Coats for the years ended December 31, 2002 and 2001 amounted to approximately \$12,276,000 and \$18,247,000.

16

ITEM 2: PROPOSAL TO AMEND THE 1997 STOCK PLAN

GENERAL

The Board of Directors has approved an amendment (the "Plan Amendment")

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to the Tag-It Pacific, Inc. 1997 Stock Plan to increase the number of shares of common stock available for issuance under the 1997 Plan from 2,277,500 shares to 2,577,500 shares. The 1997 Plan is attached hereto as Appendix A. The Plan Amendment is being submitted to the Company's stockholders for approval.

The Board of Directors approved the Plan Amendment to ensure that a sufficient number of shares of common stock are available for issuance under the 1997 Plan. At April 18, 2003, only 259,000 shares remained available for grants of awards under the 1997 Plan. The Board of Directors believes that the ability to grant stock-based awards is important to the future success of the Company. The grant of stock options and other stock-based awards can motivate high levels of performance and provide an effective means of recognizing employee contributions to the success of the Company. In addition, stock-based compensation can be valuable in recruiting and retaining highly qualified technical and other key personnel who are in great demand as well as rewarding and providing incentives to our current employees. The increase in the number of shares available for awards under the 1997 Plan will enable the Company to continue to realize the benefits of granting stock-based compensation.

At April 18, 2003, the last reported sales price of the common stock on the American Stock Exchange was \$4.22 per share.

SUMMARY OF THE 1997 PLAN

PURPOSE. The purpose of the 1997 Plan is to provide incentives and rewards to selected eligible directors, officers, employees and consultants of the Company or its subsidiaries in order to assist the Company and its subsidiaries in attracting, retaining and motivating those persons by providing for or increasing the proprietary interests of those persons in the Company, and by associating their interests in the Company with those of the Company's stockholders.

ADMINISTRATION. The 1997 Plan may be administered by the Board of Directors, or a committee of two or more directors appointed by the Board of Directors whose members serve at the pleasure of the Board. The 1997 Plan currently is administered by the Compensation Committee of the Board of Directors. The party administering the 1997 Plan is referred to as the "Administrator." Subject to the provisions of the 1997 Plan, the Administrator has full and final authority to (i) select from among eligible directors, officers, employees and consultants, those persons to be granted awards under the 1997 Plan, (ii) determine the type, size and terms of individual awards to be made to each person selected, (iii) determine the time when awards will be granted and to establish objectives and conditions (including, without limitation, vesting and performance conditions), if any, for earning awards, (iv) amend the terms or conditions of any outstanding award, subject to applicable legal restrictions and to the consent of the other party to such award, (v) to determine the duration and purpose of leaves of absences which may be granted to holders of awards without constituting termination of their employment, (vi) authorize any person to execute, on behalf of the Company, any instrument required to carry out the purposes of the 1997 Plan, (vii) by resolution adopted by the Board, to authorize one or more officers of the Company to designate eligible employees of the Company or any of its subsidiaries to be recipients of awards and/or determine the number of such awards to be received by such employees, provided that the resolution so authorizing such officer or officers shall specify the total number of awards such officer or officers may award, and (viii) make any and all other determinations which the Administrator determines to be necessary or advisable in the administration of the 1997 Plan. The Administrator has full power and authority to administer and interpret the 1997 Plan and to adopt, amend and revoke such rules, regulations, agreements, guidelines and instruments for the administration of the 1997 Plan and for the conduct of its business as the Administrator deems necessary or advisable.

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ELIGIBILITY. Any person who is a director, officer, employee or consultant of the Company, or any of its subsidiaries (a "Participant"), is eligible to be considered for the grant of awards under the 1997 Plan. No Participant may receive awards representing more than 25% of the aggregate number of shares of common stock that may be issued pursuant to all awards under the 1997 Plan. At April 18, 2003, approximately 72 officers, directors and employees of the Company were eligible to receive awards under the 1997 Plan.

17

TYPES OF AWARDS. Awards authorized under the 1997 Plan may consist of any type of arrangement with a Participant that, by its terms, involves or might involve or be made with reference to the issuance of shares of the Company's common stock, or a derivative security with an exercise or conversion price related to the common stock or with a value derived from the value of the common stock. Awards are not restricted to any specified form or structure and may include sales, bonuses and other transfers of stock, restricted stock, stock options, reload stock options, stock purchase warrants, other rights to acquire stock or securities convertible into or redeemable for stock, stock appreciation rights, phantom stock, dividend equivalents, performance units or performance shares, or any other type of award which the Administrator shall determine is consistent with the objectives and limitations of the 1997 Plan. An award may consist of one such security or benefit, or two or more of them in tandem or in the alternative.

CONSIDERATION. The common stock or other property underlying an award may be issued for any lawful consideration as determined by the Administrator, including, without limitation, a cash payment, services rendered, or the cancellation of indebtedness. An award may provide for a purchase price of the common stock or other property at a value less than the fair market value of the common stock or other property on the date of grant. In addition, an award may permit the recipient to pay the purchase price of the common stock or other property or to pay such recipient's tax withholding obligation with respect to such issuance, in whole or in part, by delivering previously owned shares of capital stock of the Company or other property, or by reducing the number of shares of common stock or the amount of other property otherwise issuable pursuant to such award.

TERMINATION OF AWARDS. All awards granted under the 1997 Plan expire ten years from the date of grant, or such shorter period as is determined by the Administrator. No option is exercisable by any person after such expiration. If an award expires, terminates or is canceled, the shares of common stock not purchased thereunder shall again be available for issuance under the 1997 Plan.

AMENDMENT AND TERMINATION OF THE 1997 PLAN. The Administrator may amend the 1997 Plan at any time, may suspend it from time to time or may terminate it without approval of the stockholders; provided, however, that stockholder approval is required for any amendment which materially increases the number of shares for which awards may be granted, materially modifies the requirements of eligibility, or materially increases the benefits which may accrue to recipients of awards under the 1997 Plan. However, no such action by the Board of Directors or stockholders may unilaterally alter or impair any award previously granted under the 1997 Plan without the consent of the recipient of the award. In any event, the 1997 Plan shall terminate on October 1, 2007 (ten years following the date it was approved by the Company's stockholders) unless sooner terminated by action of the Board of Directors.

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EFFECT OF SECTION 16(B) OF THE SECURITIES EXCHANGE ACT OF 1934. The acquisition and disposition of common stock by officers, directors and more than 10% stockholders of the Company ("Insiders") pursuant to awards granted to them under the 1997 Plan may be subject to Section 16(b) of the Securities Exchange Act of 1934. Pursuant to Section 16(b), a purchase of common stock by an Insider within six months before or after a sale of common stock by the Insider could result in recovery by the Company of all or a portion of any amount by which the sale proceeds exceed the purchase price. Insiders are required to file reports of changes in beneficial ownership under Section 16(a) of the Securities Exchange Act of 1934 upon acquisitions and dispositions of shares. Rule 16b-3 provides an exemption from Section 16(b) liability for certain transactions pursuant to certain employee benefit plans. The 1997 Plan is designed to comply with Rule 16b-3.

18

FEDERAL INCOME TAX CONSEQUENCES FOR STOCK OPTIONS

As of April 18, 2003, the only type of award granted by the Company under the 1997 Plan has been stock options. The following is a general discussion of the principal United States federal income tax consequences of both "incentive stock options" within the meaning of Section 422 of the Code ("Incentive Stock Options") and non-statutory stock options ("Non-statutory Stock Options") based upon the United States Internal Revenue Code of 1986, as amended, and the Treasury Regulations promulgated thereunder, all of which are subject to modification at any time. The 1997 Plan does not constitute a qualified retirement plan under Section 401(a) of the Code (which generally covers trusts forming part of a stock bonus, pension or profit-sharing plan funded by employer and/or employee contributions which are designed to provide retirement benefits to participants under certain circumstances) and is not subject to the Employee Retirement Income Security Act of 1974 (the pension reform law which regulates most types of privately funded pension, profit sharing and other employee benefit plans).

CONSEQUENCES TO EMPLOYEES: INCENTIVE STOCK OPTIONS. No income is recognized for federal income tax purposes by an optionee at the time an Incentive Stock Option is granted, and, except as discussed below, no income is recognized by an optionee upon his or her exercise of an Incentive Stock Option. If the optionee makes no disposition of the common stock received upon exercise within two years from the date such option was granted or one year from the date such option is exercised (the "ISO Holding Period Requirements"), the optionee will recognize long-term capital gain or loss when he or she disposes of his or her common stock. Such gain or loss generally will be measured by the difference between the exercise price of the option and the amount received for the common stock at the time of disposition.

If the optionee disposes of the common stock acquired upon exercise of an Incentive Stock Option without satisfying the ISO Holding Period Requirements, any amount realized from such "disqualifying disposition" will be taxed at ordinary income tax rates in the year of disposition to the extent that (i) the lesser of (a) the fair market value of the shares of common stock on the date the Incentive Stock Option was exercised or (b) the fair market value of such shares at the time of such disposition exceeds (ii) the Incentive Stock Option exercise price. Any amount realized upon disposition in excess of the fair market value of the shares of common stock on the date of exercise will be treated as long-term or short-term capital gain depending upon the length of

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time the shares have been held.

The use of stock acquired through exercise of an Incentive Stock Option to exercise an Incentive Stock Option will constitute a disqualifying disposition if the ISO Holding Period Requirements have not been satisfied.

For alternative minimum tax purposes, the excess of the fair market value of the shares of common stock as of the date of exercise over the exercise price of the Incentive Stock Option is included in computing that year's alternative minimum taxable income. However, if the shares of common stock are disposed of in the same year, the maximum alternative minimum taxable income with respect to those shares is the gain on disposition of the shares. There is no alternative minimum taxable income from a disqualifying disposition in subsequent years.

CONSEQUENCES TO EMPLOYEES: NON-STATUTORY STOCK OPTIONS. No income generally is recognized by a holder of Non-statutory Stock Options at the time Non-statutory Stock Options are granted under the 1997 Plan. In general, at the time shares of common stock are issued to a holder pursuant to the exercise of Non-statutory Stock Options, the holder will recognize ordinary income equal to the excess of the fair market value of the shares on the date of exercise over the exercise price.

A holder will recognize gain or loss on the subsequent sale of common stock acquired upon exercise of Non-statutory Stock Options in an amount equal to the difference between the sales price and the tax basis of the common stock, which will include the exercise price paid plus the amount included in the holder's income by reason of the exercise of the Non-statutory Stock Options. Provided the shares of common stock are held as a capital asset, any gain or loss resulting from a subsequent sale will be short-term or long-term capital gain or loss depending upon the length of time the shares have been held.

19

CONSEQUENCES TO THE COMPANY: INCENTIVE STOCK OPTIONS. The Company will not be allowed a deduction for federal income tax purposes at the time of the grant or exercise of an Incentive Stock Option. There are also no federal income tax consequences to the Company as a result of the disposition of common stock acquired upon exercise of an Incentive Stock Option if the disposition is not a "disqualifying disposition." At the time of a disqualifying disposition by an optionee, the Company will be entitled to a deduction for the amount received by the optionee to the extent that such amount is taxable to the optionee at ordinary income tax rates.

CONSEQUENCES TO THE COMPANY: NON-STATUTORY STOCK OPTIONS. Generally, the Company will be entitled to a deduction for federal income tax purposes in the Company's taxable year in which the optionee's taxable year of income inclusion ends and in the same amount as the optionee is considered to have realized ordinary income in connection with the exercise of Non-statutory Stock Options.

EQUITY COMPENSATION PLAN INFORMATION

The following table sets forth certain information as of December 31, 2002 regarding equity compensation plans (including individual compensation arrangements) under which our equity securities are authorized for issuance:

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	NUMBER OF SECURITIES TO BE ISSUED UPON EXERCISE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS	WEIGHTED-AVERAGE EXERCISE PRICE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS	NUMBER OF S REMAINING A FOR FUTURE UNDER EQ COMPENSATIO
	-----	-----	-----
Equity compensation plans approved by security holders.....	1,733,500	\$3.48	544,0
Equity compensation plans not approved by security holders.....	608,122	\$4.35	
	-----		-----
Total.....	2,341,622	\$3.71	544,0
	=====		=====

See Note 13 to the Consolidated Financial Statements in Item 8 of the Company's Annual Report on Form 10-K filed for the fiscal year ended December 31, 2002 for information regarding the material features of the above plans. Each of the above plans provides that the number of shares with respect to which options and warrants may be granted, and the number of shares of Common Stock subject to an outstanding option or warrant, shall be proportionately adjusted in the event of a subdivisions or consolidation of shares or the payment of a stock dividend on Common Stock.

REQUIRED VOTE

The approval of the Plan Amendment requires the affirmative vote of a majority of the votes entitled to be cast by the holders of shares of the Company's common stock present or represented and entitled to vote on this matter at the Annual Meeting. An abstention will be counted toward the tabulation of votes cast and will have the same effect as a vote against the proposal. A broker non-vote, however, will not be treated as a vote cast for or against approval of the proposal.

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT THE STOCKHOLDERS VOTE "FOR" THE APPROVAL OF THE PLAN AMENDMENT.

PRINCIPAL STOCKHOLDERS

The following table presents information regarding the beneficial ownership of our common stock as of April 18, 2003:

- o each person who is known to us to be the beneficial owner of more than 5.0% of our outstanding common stock;
- o each of our directors;
- o the Named Executive Officers; and

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o all of our directors and executive officers as a group

Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission that deem shares to be beneficially owned by any person who has or shares voting or investment power with respect to such shares. Shares of common stock under warrants or options currently exercisable or exercisable within 60 days of the date of this information are deemed outstanding for purposes of computing the percentage ownership of the person holding such warrants or options but are not deemed outstanding for computing the percentage ownership of any other person. As a result, the percentage of outstanding shares of any person as shown in this table does not necessarily reflect the person's actual ownership or voting power with respect to the number of shares of common stock actually outstanding at April 18, 2003. Unless otherwise indicated, the persons named in this table have sole voting and sole investment power with respect to all shares shown as beneficially owned, subject to community property laws where applicable.

The address of each person listed is in our care, at 21900 Burbank Boulevard, Suite 270, Woodland Hills, California 91367, unless otherwise set forth below such person's name.

NAME OF BENEFICIAL OWNER	NUMBER OF SHARES	PERCENT OF CLASS

DIRECTORS:		
Colin Dyne (1).....	2,192,580	21.6%
Mark Dyne (2).....	1,090,512	10.8%
Kevin Bermeister (3).....	222,117	2.3%
Jonathan Burstein (4).....	223,288	2.3%
Brent Cohen (5).....	70,000	*
Michael Katz (6).....	50,000	*
NON-DIRECTOR NAMED EXECUTIVE OFFICERS:		
Jonathan Markiles (7)	133,248	1.4%
Ronda Sallmen (8)	87,500	*
5% HOLDERS:		
KG Investment, LLC 3151 East Washington Blvd. Los Angeles, CA 90023.....	2,390,000	24.8%
Harris Toibb 307 21st Street Santa Monica, CA 90402 (9).....	1,290,498	13.0%
Commerce Investment Group, LLC 5804 E. Slauson Ave., Commerce, CA 90046 ...	1,000,000	10.4%
The Estate of Harold Dyne (10).....	757,507	7.8%
Coats North America Consolidated, Inc. Two Lake Point Plaza 4135 South Stream Blvd. Charlotte, NC 28217 (11)	607,288	5.9%

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Talon, Inc.

c/o Grupo Industrial Cierres Ideal

Paseo de la Reforma Num. 2608 PH

Col. Lomas Altas

Mexico D.F., 11950	500,000	5.2%
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Directors and executive officers as a group (9 persons) (12)	4,069,245	36.5%
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* Less than one percent.

- (1) Includes 535,000 shares of common stock reserved for issuance upon exercise of stock options which currently are exercisable and 1,000,000 shares of common stock owned by Commerce Investment Group, LLC which are voted by Colin Dyne pursuant to a voting agreement.
- (2) Includes 268,000 shares of common stock reserved for issuance upon exercise of stock options which currently are exercisable, 83,334 shares of common stock reserved for issuance upon exercise of warrants which currently are exercisable and 111,111 shares of common stock reserved for issuance upon conversion of debt which is currently convertible.
- (3) Includes 65,000 shares of common stock reserved for issuance upon exercise of stock options which currently are exercisable.
- (4) Includes 127,500 shares of common stock reserved for issuance upon exercise of stock options which currently are exercisable.
- (5) Consists of 70,000 shares of common stock reserved for issuance upon exercise of stock options which currently are exercisable.
- (6) Consists of 50,000 shares of common stock reserved for issuance upon exercise of stock options which currently are exercisable.
- (7) Includes 80,000 shares of common stock reserved for issuance upon exercise of stock options which currently are exercisable and 39,235 shares of common stock reserved for issuance upon exercise of warrants which currently are exercisable.
- (8) Consists of 87,500 shares of common stock reserved for issuance upon exercise of stock options which are currently exercisable.
- (9) Includes 333,332 shares of common stock reserved for issuance upon exercise of warrants which are currently exercisable.
- (10) Harold Dyne served as our President until his death in October 1999. The estate of Mr. Dyne exercises beneficial ownership over shares which he previously held. The shares consist of 659,507 shares of common stock held by H&A Dyne Holdings, LP and 98,000 shares of common stock reserved for issuance upon exercise of stock options which currently are exercisable.
- (11) Consists of 759,494 shares of series C convertible redeemable preferred stock, convertible into 607,288 shares of common stock. The shares are convertible at the election of the holder after September 20, 2003 and are entitled to vote with our common stock based on the number of common shares that the series C preferred shares could be converted into on the record date.
- (12) Includes 1,283,000 shares of common stock reserved for issuance upon exercise of stock options which currently are exercisable, 1,000,000 shares of common stock owned by Commerce Investment Group, LLC which are voted by Colin Dyne pursuant to a voting agreement, 111,111 shares of common stock reserved for issuance upon conversion of debt which is currently convertible and 122,569 shares of common stock reserved for issuance upon exercise of warrants which currently are exercisable.

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The information as to shares beneficially owned has been individually furnished by the respective directors, named executive officers, and other stockholders of the company, or taken from documents filed with the Securities and Exchange Commission.

SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934 requires the Company's executive officers, directors, and persons who own more than ten percent of a registered class of the Company's equity securities to file reports of ownership and changes in ownership with the Securities and Exchange Commission. Executive officers, directors and greater-than-ten percent stockholders are required by Securities and Exchange Commission regulations to furnish the Company with all Section 16(a) forms they file. Based solely on its review of the copies of the forms received by it and written representations from certain reporting persons that they have complied with the relevant filing requirements, the Company believes that, during the year ended December 31, 2002, all of the Company's executive officers, directors and greater-than-ten percent stockholders complied with all Section 16(a) filing requirements with the exception of the following: Colin Dyne, Jonathan Burstein and Ronda Sallmen each filed a Form 5 on February 12, 2003 reporting one transaction occurring on December 31, 2002, which transactions should have been previously reported on a Form 4.

STOCKHOLDER PROPOSALS

Any stockholder who intends to present a proposal at the 2004 Annual Meeting of stockholders for inclusion in the Company's Proxy Statement and Proxy form relating to such Annual Meeting must submit such proposal to the Company at its principal executive offices by February 14, 2004. In addition, in the event a stockholder proposal is not received by the Company by April 16, 2004, the Proxy to be solicited by the Board of Directors for the 2004 Annual Meeting will confer discretionary authority on the holders of the Proxy to vote the shares if the proposal is presented at the 2004 Annual Meeting without any discussion of the proposal in the Proxy Statement for such meeting.

SEC rules and regulations provide that if the date of the Company's 2004 Annual Meeting is advanced or delayed more than 30 days from the date of the 2003 Annual Meeting, stockholder proposals intended to be included in the proxy materials for the 2004 Annual Meeting must be received by the Company within a reasonable time before the Company begins to print and mail the proxy materials for the 2004 Annual Meeting. Upon determination by the Company that the date of the 2004 Annual Meeting will be advanced or delayed by more than 30 days from the date of the 2003 Annual Meeting, the Company will disclose such change in the earliest possible Quarterly Report on Form 10-Q.

INDEPENDENT PUBLIC ACCOUNTANTS

BDO Seidman, LLP, independent public accountants, were selected by the Board of Directors to serve as independent public accountants of the Company for fiscal 2002 and have been selected by the Board of Directors to serve as independent auditors for fiscal 2003. Representatives of BDO Seidman, LLP are expected to be present at the Annual Meeting, and will be afforded the opportunity to make a statement if they desire to do so, and will be available to respond to appropriate questions from stockholders.

SOLICITATION OF PROXIES

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It is expected that the solicitation of Proxies will be by mail. The cost of solicitation by management will be borne by the Company. The Company will reimburse brokerage firms and other persons representing beneficial owners of shares for their reasonable disbursements in forwarding solicitation material to such beneficial owners. Proxies may also be solicited by certain of the Company's directors and officers, without additional compensation, personally or by mail, telephone, telegram or otherwise.

23

ANNUAL REPORT ON FORM 10-K

THE COMPANY'S ANNUAL REPORT ON FORM 10-K, WHICH HAS BEEN FILED WITH THE SECURITIES AND EXCHANGE COMMISSION FOR THE YEAR ENDED DECEMBER 31, 2002, WILL BE MADE AVAILABLE TO STOCKHOLDERS WITHOUT CHARGE UPON WRITTEN REQUEST TO RONDA SALLMEN, CHIEF FINANCIAL OFFICER, TAG-IT PACIFIC, INC., 21900 BURBANK BOULEVARD, SUITE 270, WOODLAND HILLS, CALIFORNIA 91367.

ON BEHALF OF THE BOARD OF DIRECTORS

/s/ Ronda Sallmen

Ronda Sallmen
Chief Financial Officer

Tag-It Pacific, Inc.,
21900 Burbank Boulevard, Suite 270,
Woodland Hills, California 91367

April 24, 2003

24

APPENDIX "A"

AMENDED AND RESTATED

1997 STOCK OPTION PLAN

1. PURPOSE OF THE PLAN.

The purpose of this 1997 Stock Plan (the "Plan") is to provide incentives and rewards to selected eligible directors, officers, employees and consultants of Tag-It Pacific, Inc. (the "Company") or its subsidiaries in order to assist the Company and its subsidiaries in attracting, retaining and motivating those persons by providing for or increasing the proprietary interests of those persons in the Company, and by associating their interests in the Company with those of the Company's stockholders.

2. ADMINISTRATION OF THE PLAN.

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The Plan shall be administered by the Board of Directors of the Company (the "Board"), or a committee of the Board (the "Committee") whose members shall serve at the pleasure of the Board. If administration is delegated to the Committee, the Committee shall have, in connection with the administration of the Plan, the powers theretofore possessed by the Board (and references in this Plan to the Board shall thereafter be to the Committee), subject, however, to such resolutions, not inconsistent with the provisions of the Plan as may be adopted from time to time by the Board.

The Board shall have all the powers vested in it by the terms of the Plan, including authority (i) to select from among eligible directors, officers, employees and consultants, those persons to be granted "Awards" (as defined below) under the Plan; (ii) to determine the type, size and terms of individual Awards (which need not be identical) to be made to each person selected; (iii) to determine the time when Awards will be granted and to establish objectives and conditions (including, without limitation, vesting and performance conditions), if any, for earning Awards; (iv) to amend the terms or conditions of any outstanding Award, subject to applicable legal restrictions and to the consent of the other party to such Award; (v) to determine the duration and purpose of leaves of absences which may be granted to holders of Awards without constituting termination of their employment for purposes of their Awards; (vi) to authorize any person to execute, on behalf of the Company, any instrument required to carry out the purposes of the Plan; (vii) by resolution adopted by the Board, to authorize one or more officers of the Company to do one or both of the following: (a) designate eligible employees of the Company or any of its subsidiaries to be recipients of Awards and (b) determine the number of such Awards to be received by such employees, provided that the resolution so authorizing such officer or officers shall specify the total number of Awards such officer or officers may award; and (viii) to make any and all other determinations which it determines to be necessary or advisable in the administration of the Plan. The Board shall have full power and authority to administer and interpret the Plan and to adopt, amend and revoke such rules, regulations, agreements, guidelines and instruments for the administration of the Plan and for the conduct of its business as the Board deems necessary or advisable. The Board's interpretation of the Plan, and all actions taken and determinations made by the Board pursuant to the powers vested in it hereunder, shall be conclusive and binding on all parties concerned, including the Company, its stockholders, any participants in the Plan and any other employee of the Company or any of its subsidiaries.

3. PERSONS ELIGIBLE UNDER THE PLAN.

Any person who is a director, officer, employee or consultant of the Company, or any of its subsidiaries (a "Participant"), shall be eligible to be considered for the grant of Awards under the Plan.

4. AWARDS.

(a) COMMON STOCK AND DERIVATIVE SECURITY AWARDS. Awards authorized under the Plan shall consist of any type of arrangement with a Participant that is not inconsistent with the provisions of the Plan and that,

A-1

by its terms, involves or might involve or be made with reference to the issuance of (i) shares of the Common Stock, \$.001 par value per share, of the Company (the "Common Stock") or (ii) a "derivative security" (as that term is

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defined in Rule 16a-1(c) of the Rules and Regulations of the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended, as the same may be amended from time to time) with an exercise or conversion price related to the Common Stock or with a value derived from the value of the Common Stock.

(b) TYPES OF AWARDS. Awards are not restricted to any specified form or structure and may include, but need not be limited to, sales, bonuses and other transfers of stock, restricted stock, stock options, reload stock options, stock purchase warrants, other rights to acquire stock or securities convertible into or redeemable for stock, stock appreciation rights, phantom stock, dividend equivalents, performance units or performance shares, or any other type of Award which the Board shall determine is consistent with the objectives and limitations of the Plan. An Award may consist of one such security or benefit, or two or more of them in tandem or in the alternative.

(c) CONSIDERATION. Common Stock may be issued pursuant to an Award for any lawful consideration as determined by the Board, including, without limitation, a cash payment, services rendered, or the cancellation of indebtedness.

(d) GUIDELINES. The Board may adopt, amend or revoke from time to time written policies implementing the Plan. Such policies may include, but need not be limited to, the type, size and term of Awards to be made to participants and the conditions for payment of such Awards.

(e) TERMS AND CONDITIONS. Subject to the provisions of the Plan, the Board, in its sole and absolute discretion, shall determine all of the terms and conditions of each Award granted pursuant to the Plan, which terms and conditions may include, among other things:

- (i) any provision necessary for such Award to qualify as an incentive stock option under Section 422 of the Internal Revenue Code of 1986, as amended (the "Code") (an "Incentive Stock Option");
- (ii) a provision permitting the recipient of such Award to pay the purchase price of the Common Stock or other property issuable pursuant to such Award, or to pay such recipient's tax withholding obligation with respect to such issuance, in whole or in part, by delivering previously owned shares of capital stock of the Company (including "pyramiding") or other property, or by reducing the number of shares of Common Stock or the amount of other property otherwise issuable pursuant to such Award; or
- (iii) a provision conditioning or accelerating the receipt of benefits pursuant to the Award, or terminating the Award, either automatically or in the discretion of the Board, upon the occurrence of specified events, including, without limitation, a change of control of the Company, an acquisition of a specified percentage of the voting power of the Company, the dissolution or liquidation of the Company, a sale of substantially all of the property and assets of the Company or an event of the type described in Section 7 of the Plan.

(f) SUSPENSION OR TERMINATION OF AWARDS. If the Company believes that a Participant has committed an act of misconduct as described below, the Company may suspend the Participant's rights under any then outstanding Award pending a determination by the Board. If the Board determines that a Participant has committed an act of embezzlement, fraud, nonpayment of any obligation owed to the Company or any subsidiary, breach of fiduciary duty or deliberate disregard of the Company's rules resulting in loss, damage or injury to the Company, or if a Participant makes an unauthorized disclosure of trade secret or confidential information of the Company, engages in any conduct constituting unfair competition, or induces any customer of the Company to breach a contract with

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the Company, neither the Participant nor his or her estate shall be entitled to exercise any rights whatsoever with respect to such Award. In making such determination, the Board shall act fairly and shall give the Participant a reasonable opportunity to appear and present evidence on his or her behalf to the Board.

(g) MAXIMUM GRANT OF AWARDS TO ANY PARTICIPANT. No Participant shall receive Awards representing more than 25% of the aggregate number of shares of Common Stock that may be issued pursuant to all Awards under the Plan as set forth in Section 5 hereof.

A-2

5. SHARES OF COMMON STOCK SUBJECT TO THE PLAN.

The aggregate number of shares of Common Stock that may be issued or issuable pursuant to all Awards under the Plan (including Awards in the form of Incentive Stock Options and Non-Statutory Stock Options) shall not exceed an aggregate of 2,277,500 shares of Common Stock, subject to adjustment as provided in Section 7 of the Plan. Shares of Common Stock subject to the Plan may consist, in whole or in part, of authorized and unissued shares or treasury shares. Any shares of Common Stock subject to an Award which for any reason expires or is terminated unexercised as to such shares shall again be available for issuance under the Plan. For purposes of this Section 5, the aggregate number of shares of Common Stock that may be issued at any time pursuant to Awards granted under the Plan shall be reduced by: (i) the number of shares of Common Stock previously issued pursuant to Awards granted under the Plan, other than shares of Common Stock subsequently reacquired by the Company pursuant to the terms and conditions of such Awards and with respect to which the holder thereof received no benefits of ownership, such as dividends; and (ii) the number of shares of Common Stock which were otherwise issuable pursuant to Awards granted under this Plan but which were withheld by the Company as payment of the purchase price of the Common Stock issued pursuant to such Awards or as payment of the recipient's tax withholding obligation with respect to such issuance.

6. PAYMENT OF AWARDS.

The Board shall determine the extent to which Awards shall be payable in cash, shares of Common Stock or any combination thereof. The Board may, upon request of a Participant, determine that all or a portion of a payment to that Participant under the Plan, whether it is to be made in cash, shares of Common Stock or a combination thereof, shall be deferred. Deferrals shall be for such periods and upon such terms as the Board may determine in its sole discretion.

7. DILUTION AND OTHER ADJUSTMENT.

In the event of any change in the outstanding shares of the Common Stock or other securities then subject to the Plan by reason of any stock split, reverse stock split, stock dividend, recapitalization, merger, consolidation, combination or exchange of shares or other similar corporate change, or if the outstanding securities of the class then subject to the Plan are exchanged for or converted into cash, property or a different kind of securities, or if cash, property or securities are distributed in respect of such outstanding securities as a class (other than cash dividends), then the Board may, but it shall not be required to, make such equitable adjustments to the Plan and the Awards thereunder (including, without limitation, appropriate and proportionate adjustments in (i) the number and type of shares or other securities or cash or

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other property that may be acquired pursuant to Incentive Stock Options and other Awards theretofore granted under the Plan, (ii) the maximum number and type of shares or other securities that may be issued pursuant to Incentive Stock Options and other Awards thereafter granted under the Plan; and (iii) the maximum number of securities with respect to which Awards may thereafter be granted to any Participant in any fiscal year) as the Board in its sole discretion determines appropriate, including any adjustments in the maximum number of shares referred to in Section 5 of the Plan. Such adjustments shall be conclusive and binding for all purposes of the Plan.

8. MISCELLANEOUS PROVISIONS.

(a) DEFINITIONS. As used herein, "subsidiary" means any current or future corporation which would be a "subsidiary corporation," as that term is defined in Section 424(f) of the Code, of the Company; and the term "or" means "and/or."

(b) CONDITIONS ON ISSUANCE. Securities shall not be issued pursuant to Awards unless the grant and issuance thereof shall comply with all relevant provisions of law and the requirements of any securities exchange or quotation system upon which any securities of the Company are listed, and shall be further subject to approval of counsel for the Company with respect to such compliance. Inability of the Company to obtain authority from any regulatory body having jurisdiction, which authority is determined by Company counsel to be necessary to the lawful issuance and sale of any security or Award, shall relieve the Company of any liability in respect of the nonissuance or sale of such securities as to which requisite authority shall not have been obtained.

(c) RIGHTS AS STOCKHOLDER. A participant under the Plan shall have no rights as a holder of Common Stock with respect to Awards hereunder, unless and until certificates for shares of such stock are issued to the participant.

A-3

(d) ASSIGNMENT OR TRANSFER. Subject to the discretion of the Board, and except with respect to Incentive Stock Options which are not transferable except by will or the laws of descent and distribution, Awards under the Plan or any rights or interests therein shall be assignable or transferable.

(e) AGREEMENTS. All Awards granted under the Plan shall be evidenced by written agreements in such form and containing such terms and conditions (not inconsistent with the Plan) as the Board shall from time to time adopt.

(f) WITHHOLDING TAXES. The Company shall have the right to deduct from all Awards hereunder paid in cash any federal, state, local or foreign taxes required by law to be withheld with respect to such awards and, with respect to awards paid in stock, to require the payment (through withholding from the participant's salary or otherwise) of any such taxes. The obligation of the Company to make delivery of Awards in cash or Common Stock shall be subject to the restrictions imposed by any and all governmental authorities.

(g) NO RIGHTS TO AWARD. No Participant or other person shall have any right to be granted an Award under the Plan. Neither the Plan nor any action taken hereunder shall be construed as giving any Participant any right to be retained in the employ of the Company or any of its subsidiaries or shall interfere with or restrict in any way the rights of the Company or any of its subsidiaries, which are hereby reserved, to discharge a Participant at any time for any reason whatsoever, with or without good cause.

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(h) COSTS AND EXPENSES. The costs and expenses of administering the Plan shall be borne by the Company and not charged to any Award nor to any Participant receiving an Award.

(i) FUNDING OF PLAN. The Plan shall be unfunded. The Company shall not be required to establish any special or separate fund or to make any other segregation of assets to assure the payment of any Award under the Plan.

9. AMENDMENTS AND TERMINATION.

(a) AMENDMENTS. The Board may at any time terminate or from time to time amend the Plan in whole or in part, but no such action shall adversely affect any rights or obligations with respect to any Awards theretofore made under the Plan. However, with the consent of the Participant affected, the Board may amend outstanding agreements evidencing Awards under the Plan in a manner not inconsistent with the terms of the Plan.

(b) STOCKHOLDER APPROVAL. To the extent that Section 422 of the Code, other applicable law, or the rules, regulations, procedures or listing agreement of any national securities exchange or quotation system, requires that any amendment of the Plan be approved by the stockholders of the Company, no such amendment shall be effective unless and until it is approved by the stockholders in such a manner and to such a degree as is required.

(c) TERMINATION. Unless the Plan shall theretofore have been terminated as above provided, the Plan (but not the awards theretofore granted under the Plan) shall terminate on and no awards shall be granted after October 1, 2007.

10. EFFECTIVE DATE.

The Plan is effective on October 1, 1997, the date on which it was adopted by the Board of Directors of the Company and the holders of the majority of the Common Stock of the Company.

11. GOVERNING LAW.

The Plan and any agreements entered into thereunder shall be construed and governed by the laws of the State of Delaware applicable to contracts made within, and to be performed wholly within, such state, without regard to the application of conflict of laws rules thereof.

A-4

TAG-IT PACIFIC, INC.
PROXY FOR ANNUAL MEETING OF STOCKHOLDERS

THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS

The undersigned, a stockholder of Tag-It Pacific, Inc., a Delaware corporation (the "Company"), hereby nominates, constitutes and appoints Colin Dyne and Ronda Sallmen, or either one of them, as proxy of the undersigned, each with full power of substitution, to attend, vote and act for the undersigned at the Annual Meeting of Stockholders of the Company, to be held on June 12, 2003, and any postponements or adjournments thereof, and in connection therewith, to vote and represent all of the shares of the Company which the undersigned would

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be entitled to vote with the same effect as if the undersigned were present, as follows:

A VOTE FOR ALL PROPOSALS IS RECOMMENDED BY THE BOARD OF DIRECTORS:

Proposal 1. To elect the following two nominees as Class III directors:

Mark Dyne Colin Dyne Donna Armstrong

FOR ALL NOMINEES LISTED ABOVE (except as marked to the contrary below)

WITHHELD for all nominees listed above

(INSTRUCTION: To withhold authority to vote for any individual nominee, write that nominee's name in the space below:)

The undersigned hereby confer(s) upon the proxies and each of them discretionary authority with respect to the election of directors in the event that any of the above nominees is unable or unwilling to serve.

Proposal 2. To amend the Company's 1997 Stock Plan to increase the maximum number of shares of common stock which may be issued pursuant to awards granted under the plan.

FOR AGAINST ABSTAIN

The undersigned hereby revokes any other proxy to vote at the Annual Meeting, and hereby ratifies and confirms all that said attorneys and proxies, and each of them, may lawfully do by virtue hereof. With respect to matters not known at the time of the solicitation hereof, said proxies are authorized to vote in accordance with their best judgment.

THIS PROXY WILL BE VOTED IN ACCORDANCE WITH THE INSTRUCTIONS SET FORTH ABOVE OR, TO THE EXTENT NO CONTRARY DIRECTION IS INDICATED, WILL BE TREATED AS A GRANT OF AUTHORITY TO VOTE FOR ALL PROPOSALS. IF ANY OTHER BUSINESS IS PRESENTED AT THE ANNUAL MEETING, THIS PROXY CONFERS AUTHORITY TO AND SHALL BE VOTED IN ACCORDANCE WITH THE RECOMMENDATIONS OF THE PROXIES.

The undersigned acknowledges receipt of a copy of the Notice of Annual Meeting dated April 24, 2003 and the accompanying Proxy Statement relating to the Annual Meeting.

Dated: _____, 2003

Signature: _____

Signature: _____

Signature(s) of Stockholder(s)
(See Instructions Below)

The Signature(s) hereon should correspond exactly with the name(s) of the Stockholder(s) appearing on the Share Certificate. If stock is held jointly, all joint owners should sign. When signing as attorney, executor, administrator, trustee or guardian, please give full title as such. If signer is a corporation, please sign the full corporation name, and give title of signing officer.

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Please indicate by checking this box if you anticipate attending the Annual Meeting.

PLEASE MARK, SIGN, DATE AND RETURN THE PROXY CARD
PROMPTLY USING THE ENCLOSED ENVELOPE

e of their products and services than we can. Should we not be able to maintain our competitive advantages in light of these factors, it could have a material negative impact on our results of operations.

If we are unable to accurately estimate the cost of services and the timeline for completion of contracts, the profitability of our contracts may be materially and adversely affected.

Our commercial and federal government contracts are typically awarded on a competitive basis. Our bids are based upon, among other items, the cost to provide the services. To generate an acceptable return on our investment in these contracts we must be able to accurately estimate our costs to provide the services required by the contract and be able to complete the contracts in a timely manner. If we fail to accurately estimate our costs or the time required to complete a contract the profitability of our contracts may be materially and adversely affected.

Contracts on which we utilize subcontractors or suppliers may be adversely affected if our subcontractors or suppliers fail to perform required obligations under the contract.

We frequently utilize subcontract labor on contracts where we bid as partners, we lack a specific type of expertise, or where the subcontractor has brought the opportunity to us. If our subcontractors or suppliers fail to perform as specified, it may adversely affect our contracts and subject us to loss of the contracts, unintended expenses, and/or the inability to secure future contracts due to our nonperformance.

Our federal government contracts typically have terms of one or more base years and one or more option years. Federal governmental agencies generally have the right not to exercise options to extend a contract. A decision to terminate or not to exercise options to extend our existing contracts could have a material adverse effect on our business, prospects, financial condition and results of operations.

We are dependent on key personnel to maintain our profitability and grow our business.

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

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

We are dependent upon third-party software and software maintenance suppliers, making us vulnerable to supply shortages and lapses in support.

We obtain software licenses and related software maintenance contracts for resale from third-party suppliers. Any delay in our suppliers' fulfillment of our orders could impair our ability to deliver products and maintenance to customers and, accordingly, could have a material adverse effect on business, results of operations, financial condition, and reputation.

Failure to adequately integrate prospective new businesses or acquisitions could materially impact and disrupt our business.

We are seeking to expand our business and may acquire or make investments in companies or businesses offering complementary products, services and technologies in the future. Acquisitions and investments typically involve numerous risks including, but not limited to difficulties in integrating operations, technologies, services and personnel and diversion of financial and managerial resources from existing operations. To manage this prospective growth effectively, we may need to implement additional management information systems capabilities, further develop our operating, administrative, financial and accounting systems and controls, improve coordination among accounting, finance, marketing and operations and hire and train additional personnel. Should these prospective integrations prove more difficult and time consuming than anticipated, it could negatively impact our results of operations.

Fluctuations in our results of operations from period to period may cause fluctuations in our stock price.

Our financial results vary from quarter to quarter based on certain factors such as the timing of significant orders, contract funding approvals and contract completions, some of which are beyond our control. As a consequence, our quarterly and annual revenue and operating results may fluctuate from period to period, and period comparisons may therefore not be meaningful. Such fluctuations in the future could contribute to corresponding fluctuations in our stock price and in certain cases cause the trading price of our stock to decline.

The exercise of outstanding options to purchase our common stock could substantially dilute shareholders' investments.

Under the terms of outstanding options to acquire our common stock issued to employees and others, the holders thereof are given an opportunity to profit from a rise in the market price of our common stock that, upon the exercise of such options, could result in dilution in the interests of our other shareholders.

Our business potential could be impacted by our failure to adequately protect our intellectual property.

Our success depends in part on our ability to obtain and maintain proprietary protection for our technologies, products, and processes, and our ability to operate without infringing the proprietary rights of other parties. We may not be able to obtain copyright, patent or other protection for our proprietary technologies or for certain processes developed by our employees. Legal standards relating to intellectual property rights in computer software are still developing and this area of the law is evolving with new technologies. Any copyrights, patents or other registrations may not sufficiently protect us against competitors with similar technology. In addition, our intellectual property rights may be challenged, narrowed, invalidated or circumvented. Our intellectual property rights do not guarantee any competitive advantage. Because our success in part relies upon our technologies, if proper protection is not available or can be circumvented, our business may be negatively impacted.

There is a limited public market for our common stock.

Our common stock is presently quoted on the OTC Bulletin Board under the symbol “IAIC”, and the securities are traded through broker-dealers. Because our stock trades on the OTC Bulletin Board rather than on a national securities exchange, a shareholder may find it difficult to either dispose of or obtain quotations as to the price of our common stock. There has historically been a low trading volume of our shares which may have an adverse impact on a shareholder’s ability to execute transactions of our shares.

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

Our forward-looking statements and projections may prove to be inaccurate.

Our actual financial results likely will be different from those projected due to the inherent nature of projections and may be better or worse than projected. Given these uncertainties, you should not rely on forward-looking statements. The forward-looking statements contained in this Form 10-K speak only as of the date of this Form 10-K. We expressly disclaim a duty to provide updates to forward-looking statements after the date of this Form 10-K to reflect the occurrence of subsequent events, changed circumstances, changes in our expectations, or the estimates and assumptions associated with them. The forward-looking statements in this Form 10-K are intended to be subject to the safe harbor protection provided by the federal securities laws.

ITEM 2. PROPERTIES.

Our offices are located at 11240 Waples Mill Road, Fairfax, VA 22030. We hold a lease for 4,434 square feet. This lease expires on May 31, 2017. We believe that our current facility is suitable and adequate to meet our current needs, and that suitable additional or substitute space will be available as needed to accommodate expansion of our operations.

ITEM 3. LEGAL PROCEEDINGS.

There are presently no pending legal proceedings to which we are a party or to which any of our property is subject and, to the best of our knowledge, no such actions against us are contemplated or threatened.

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

PART II

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

Market Information

Our Common Stock trades on the Over-the-Counter Bulletin Board under the symbol IAIC. The following table sets forth, for the fiscal periods indicated, the high and low bid prices of the Common Stock, as reported by Yahoo Finance:

	Fiscal Year Ended December 31, 2012				Fiscal Year Ended December 31, 2011			
	Quarter Ended:				Quarter Ended:			
	3/31/12	6/30/12	9/30/12	12/31/12	3/31/11	6/30/11	9/30/11	12/31/11
High	\$0.19	\$0.15	\$0.18	\$0.17	\$0.19	\$0.20	\$0.22	\$0.24
Low	\$0.15	\$0.15	\$0.13	\$0.10	\$0.15	\$0.15	\$0.17	\$0.13

The quotations on which the above data are based reflect inter-dealer prices without adjustment for retail mark-up, mark-down or commission, and may not necessarily represent actual transactions.

Because our stock trades on the OTC Bulletin Board rather than on a national securities exchange, a shareholder may find it difficult to either dispose of or obtain quotations as to the price of our common stock. There has historically been a low trading volume of our shares which may have an adverse impact on a shareholder's ability to execute transactions of our shares.

Holders

As of December 31, 2012, we had 111 holders of record of our Common Stock.

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

Dividends

We have never paid any cash dividends on our common stock and do not anticipate paying cash dividends within the foreseeable future. Our management anticipates that all earnings, if any, will be retained for development of our business. Any future dividends will be subject to the discretion of the board of directors and will depend on, among other things, future earnings, our operating and financial condition, our capital requirements and general business conditions.

Securities Authorized for Issuance under Equity Compensation Plans

The following table contains information regarding securities authorized and available for issuance under our equity compensation plans for certain employees, directors, and consultants.

Equity Compensation Plan Information

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 plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders ^{1,2}	1,032,500	\$ 0.29	1,272,500
Equity compensation plans not approved by security holders	-	-	-
Total	1,032,500	\$ 0.29	1,272,500

¹ 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 employees and directors. The maximum number of shares for which equity awards may be granted under the 2006 Plan is 1,950,000. Options under the 2006 Plan expire no later than ten years from the date of grant or 90 days after employment ceases, whichever comes first, and vest over periods determined by the Board of Directors.

² The Company had a stock option plan, which became effective June 25, 1996, and expired May 29, 2006 (the “1996 Plan”). The 1996 Plan provided for the granting of stock options to employees 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 90 days after employment ceases, whichever comes first, and vest over periods determined by the Board of Directors.

Recent Sales of Unregistered Securities

We had no sales of unregistered securities during 2012 that have not been previously disclosed in a Current Report on Form 8-K or Quarterly Reports on Form 10-Q.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

We did repurchase any of our equity securities during 2012.

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

The following discussion should be read in conjunction with the attached financial statements and notes thereto. Reference is made to "Cautionary Statement Regarding Forward-Looking Statements" on page 1 hereof, which describes important factors that could cause actual results to differ from expectations and non-historical information contained herein.

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

Overview

During 2012 our sales and marketing efforts were focused to capitalize on our expertise in these areas – electronic forms software, conversion, modernization, accessibility, web-enablement, services and tools to address the legacy modernization/conversion market, including third party tools, legacy and post-conversion database support, development and support of database-backed web portals, other web-based solutions, and management consulting services.

In 2012 we had net income of \$100,423. Our stockholders' equity was \$2,148,009 at December 31, 2012. Our gross margins decreased by \$31,272 on a decrease in revenue of \$763,222. The revenue decrease is due to decreases in sales of third-party software products and related maintenance contracts. Gross margins as a percentage of sales were consistent with 2011 for professional services and decreased from 14.6% to 14.0% for software sales. Our expenses related to selling, general and administrative infrastructure increased 7.7% in 2012, and increased from 20.0% to 23.9% as a percentage of sales. Commission expense decreased 13.4% due primarily to the decrease in software sales.

Cash and cash equivalents increased \$1,342,090, primarily due to one large product-related receivable outstanding at December 31, 2011 and collected in 2012. We were able to maintain and to grow our investment in interest bearing accounts, and we were able to operate throughout 2012 without borrowing against our line of credit.

Results of Operations

The following table sets forth, for the periods indicated, selected information from our Statements of Operations, expressed as a percentage of revenue:

	Years Ended			
	December 31, 2012		December 31, 2011	
Revenue	100.0	%	100.0	%
Cost of revenues	65.8	%	68.8	%
Gross profit	34.2	%	31.2	%
Operating expenses				
Selling, general and administrative	(23.9	%)	(20.0	%)
Commissions expense	(9.0	%)	(9.3	%)
Income from operations	1.3	%	1.9	%
Other income	0.1	%	0.1	%
Income before income taxes	1.4	%	2.0	%
Provision for income taxes	(0.0	%)	(0.0	%)
Net income	1.4	%	2.0	%

2012 Compared to 2011

Revenue. Total revenue for 2012 decreased \$763,000, or 9.8%, to \$7.06 million from \$7.82 million in 2011. Revenue from professional services fees increased \$326,000, or 6.9%, to \$5.03 million in 2012 from \$4.70 million in 2011. Revenue from software sales decreased \$1.09 million, or 34.9%, to \$2.03 million in 2012 from \$3.12 million in 2011. Revenue from software sales comprised 28.8% of total sales in 2012, compared to 39.9% of total sales in 2011. Our

software sales decreases were due to contract expirations and decreases in customer maintenance renewals due to competition and enterprise-wide consolidations of licenses and maintenance agreements.

Gross Profit. Gross profit decreased \$31,000, or 1.3% in 2012 versus 2011. Gross profit as a percentage of revenue increased to 34.2% of revenue in 2012 from 31.2% of revenue in 2011. The increase in gross profit as a percentage of revenue is due to the increase in the ratio of professional fees revenue to software sales revenue. Gross profit from professional fees was 42.3% in 2012 on 71.2% of total revenues while gross profit from software sales was 14.0% on 28.8% of total sales. In 2011, gross profit from professional fees was 42.3% on 60.1% of total revenues while gross profit from software sales was 14.6% on 39.9% of total sales. Professional services gross margin was \$2.13 million in 2012, compared to \$1.99 million in 2011. Software sales gross margin decreased from \$456,000 in 2011 to \$284,000 in 2012. Gross margin for software sales decreased due to decreases in new product and maintenance sales and maintenance renewals.

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

Selling, General and Administrative. Selling, general and administrative expense for 2012 increased \$121,000 to \$1.69 million, or 23.9% of revenue, from \$1.56 million, or 20.0% of revenue, in 2011. The increase is primarily due to increases in non-revenue-producing labor costs. These consisted of an increase in overhead labor related to periods of U.S. federal government customer budget uncertainties and to a short-term business development project that did not yield anticipated results.

Commission Expense. Commission expense in 2012 was \$632,000, or 9.0% of revenue, versus \$729,000, or 9.3% in 2011. Commission expenses vary with income generated from contracts sold by our commission-based sales associates.

Recent Accounting Pronouncements

From time to time, new accounting pronouncements are issued by the Financial Accounting Standards Board (the "FASB"), or other standard setting bodies that the Company adopts as of the specified effective date. The Company does not believe that the impact of recently issued accounting standards that are not yet effective will have a material effect on its financial position or results of operations upon adoption.

Liquidity and Capital Resources

Our beginning cash and cash equivalents balance, when combined with our cash flow from operations, were sufficient to provide financing for our operations. For 2012, net cash provided by operating, investing and financing activities was \$1,342,090. Our net cash provided of \$1,342,090, when added to a beginning balance of \$1,280,926, yielded cash and cash equivalents of \$2,623,016 at December 31, 2012. Our accounts receivable balances decreased \$2,151,614, and our accounts payable balances decreased \$886,575, primarily due to outstanding product-related invoices at the 2011 year end. We had no non-current liabilities at December 31, 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, 2013. As of December 31, 2012, no amounts were outstanding under this line of credit. We did not borrow against this line of credit in 2012.

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

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.

Off-Balance Sheet Arrangements

We do not have any off balance sheet arrangements that have or are likely to have a material current or future effect on our financial condition, or changes in financial condition, liquidity or capital resources or expenditures.

Critical Accounting Policies and Estimates

Our significant accounting policies are described in Note 1 to our accompanying financial statements. We consider the accounting policies related to revenue recognition to be critical to the understanding of our results of operations. Our critical accounting policies also include the areas where we have made what we consider to be particularly difficult, subjective or complex judgments in making estimates, and where these estimates can significantly impact our financial results under different assumptions and conditions. We prepare our financial statements in conformity with accounting principles generally accepted in the United States. As such, we are required to make certain estimates, judgments and assumptions that we believe are reasonable based upon the information available. These estimates, judgments and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the periods presented. Actual results could be different from these estimates.

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

Revenue Recognition

We earn revenue from both professional services and sales of software and related support. We recognize 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 from professional services is earned under time and materials and fixed-price contracts. For sales of third-party software products, we recognize revenue upon product delivery, with any maintenance related revenues recognized ratably over the maintenance period.

We recognize revenue on time and materials contracts 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, we recognize revenue for the number of units delivered in any given reporting period.

For fixed-price contracts in which we are paid a specific amount to be available to provide a particular service for a stated period of time, we recognize revenue ratably over the service period. We apply this method of revenue recognition to renewals of maintenance contracts on third-party software sales from prior years and to separable maintenance elements of sales of third-party software that include fixed terms of maintenance, such as Adobe and Micro Focus software, for which we are 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 we are unable to resolve.

We report revenue on both gross and net bases on a transaction by transaction analysis using authoritative guidance issued by the FASB. We consider the following factors to determine the gross versus net presentation: if we (i) act as principal in the transaction; (ii) take title to the products; (iii) have risks and rewards of ownership, such as the risk of loss for collection, delivery or return; and (iv) act as an agent or broker (including performing services, in substance, as an agent or broker) with compensation on a commission or fee basis. Generally, sales of third-party software products such as Adobe and Micro Focus products are reported on a gross basis, with our company acting as the principal in these arrangements. This determination is based on the following: 1) we have inventory risk as suppliers are not obligated to accept returns, 2) we have reasonable latitude, within economic constraints, in establishing price, 3) in our marketing efforts, we frequently aid the customer in determining product specifications, 4) we have physical loss and inventory risk as title transfers at the shipping point, 5) we bear full credit risk, and 6) the amount we earn in the transaction is neither a fixed dollar amount nor a fixed percentage. Generally, revenue derived for facilitating a sales transaction of Adobe products in which a customer introduced by us makes a purchase directly from our supplier or another designated reseller is recognized net when the commission payment is received, since we are merely acting as an agent in these arrangements. Since we are not a direct party in the sales transaction, payment by the supplier is our confirmation that the sale occurred.

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

For software and software-related multiple element arrangements, we 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 we report in a particular period.

We determine 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. We have established VSOE for our third-party software maintenance and support services.

Our 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, ratably throughout the contract as the services are provided, or subject to funds made available incrementally by legislators. In evaluating the probability of funding for purposes of assessing collectability of the contract price, we consider our previous experiences with our customers, communications with our customers regarding funding status, and our 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 our balance sheets in the aggregate with accounts receivable.

Effects of Inflation

In the opinion of management, inflation has not had a material effect on our operations.

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

<u>Report of Independent Registered Public Accounting Firm</u>	17
<u>Report of Independent Registered Public Accounting Firm</u>	18
<u>Balance Sheets as of December 31, 2012 and 2011</u>	19
<u>Statements of Operations and Comprehensive Income for the years ended December 31, 2012 and 2011</u>	20
<u>Statements of Changes in Stockholders' Equity for the years ended December 31, 2012 and 2011</u>	21
<u>Statements of Cash Flows for the years ended December 31, 2012 and 2011</u>	22
<u>Notes to Financial Statements</u>	23

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and
Stockholders of Information Analysis Incorporated

We have audited the accompanying balance sheet of Information Analysis Incorporated as of December 31, 2012, and the related statements of operations, changes in stockholders' equity and cash flows for the year ended December 31, 2012. Information Analysis Incorporated's management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements 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 the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Information Analysis Incorporated as of December 31, 2012, and the results of its operations and its cash flows for the year ended December 31, 2012 in conformity with accounting principles generally accepted in the United States of America.

/s/ CohnReznick LLP

Vienna, Virginia
March 29, 2013

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
Information Analysis Incorporated

We have audited the accompanying balance sheet of Information Analysis Incorporated as of December 31, 2011, and the related statements of operations, changes in stockholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements 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 the financial statements are free of material misstatement. The Company has determined that it is not required to have, nor were we engaged to perform, an audit of its internal controls over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Information Analysis Incorporated as of December 31, 2011, and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ Reznick Group, P.C.

Vienna, Virginia
March 30, 2012

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

INFORMATION ANALYSIS INCORPORATED
BALANCE SHEETS

	December 31, 2012	December 31, 2011
ASSETS		
Current assets		
Cash and cash equivalents	\$2,623,016	\$1,280,926
Accounts receivable, net	738,044	2,889,658
Prepaid expenses and other current assets	191,406	787,290
Note receivable, current	2,410	6,668
Total current assets	3,554,876	4,964,542
Property and equipment, net of accumulated depreciation and amortization of \$292,301 and \$264,837	39,226	40,440
Note receivable, long-term	3,885	4,287
Other assets	6,281	6,281
Total assets	\$3,604,268	\$5,015,550
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$111,585	\$998,160
Commissions payable	806,133	679,498
Accrued payroll and related liabilities	269,716	247,885
Deferred revenue	220,424	939,783
Other accrued liabilities	48,401	107,235
Income taxes payable	-	2,800
Total current liabilities	1,456,259	2,975,361
Stockholders' equity		
Common stock, \$0.01 par value, 30,000,000 shares authorized, 12,844,376 and 12,839,376 shares issued, 11,201,760 and 11,196,760 shares outstanding as of December 31, 2012 and December 31, 2011, respectively	128,443	128,393
Additional paid-in capital	14,581,475	14,574,128
Accumulated deficit	(11,631,698)	(11,732,121)
Treasury stock, 1,642,616 shares at cost at December 31, 2012 and 2011	(930,211)	(930,211)
Total stockholders' equity	2,148,009	2,040,189
Total liabilities and stockholders' equity	\$3,604,268	\$5,015,550

The accompanying notes are an integral part of the financial statements

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

INFORMATION ANALYSIS INCORPORATED
STATEMENTS OF OPERATIONS AND
COMPREHENSIVE INCOME

	For the years ended December 31,	
	2012	2011
Revenues		
Professional fees	\$5,026,676	\$4,700,679
Software sales	2,030,877	3,120,096
Total revenues	7,057,553	7,820,775
Cost of revenues		
Cost of professional fees	2,899,297	2,714,118
Cost of software sales	1,747,274	2,664,403
Total cost of revenues	4,646,571	5,378,521
Gross profit	2,410,982	2,442,254
Selling, general and administrative expenses	1,685,156	1,564,370
Commissions expense	631,698	729,075
Income from operations	94,128	148,809
Other income	6,295	7,392
Income before provision for income taxes	100,423	156,201
Provision for income taxes	-	2,800
Net income	\$100,423	\$153,401
Comprehensive income	\$100,423	\$153,401
Net Income per common share – basic	\$0.01	\$0.01
Net Income per common share – diluted	\$0.01	\$0.01
Weighted average common shares outstanding		
Basic	11,200,025	11,196,760
Diluted	11,210,939	11,224,410

The accompanying notes are an integral part of the financial statements

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

INFORMATION ANALYSIS INCORPORATED
STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Shares of Common Stock Issued	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Treasury Stock	Total
Balances, December 31, 2010	12,839,376	\$128,393	\$14,567,422	\$(11,885,522)	\$(930,211)	\$1,880,082
Net Income	-	-	-	153,401	-	153,401
Stock option compensation	-	-	6,706	-	-	6,706
Balances, December 31, 2011	12,839,376	\$128,393	\$14,574,128	\$(11,732,121)	\$(930,211)	\$2,040,189
Net Income	-	-	-	100,423	-	100,423
Stock option compensation	-	-	7,047	-	-	7,047
Stock option exercise	5,000	50	300	-	-	350
Balances, December 31, 2012	12,844,376	\$128,443	\$14,581,475	\$(11,631,698)	\$(930,211)	\$2,148,009

The accompanying notes are an integral part of the financial statements

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

INFORMATION ANALYSIS INCORPORATED
STATEMENTS OF CASH FLOWS

	For the years ended December 31,	
	2012	2011
Cash flows from operating activities:		
Net income	\$ 100,423	\$ 153,401
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	27,464	19,464
Stock option compensation	7,047	6,706
Bad debt expense	1,401	52,376
Changes in operating assets and liabilities		
Accounts receivable	2,150,213	(2,170,220)
Prepaid expenses and other current assets	595,884	(216,342)
Accounts payable and accrued expenses	(923,578)	962,494
Deferred revenue	(719,359)	287,192
Commissions payable	126,635	232,739
Income taxes payable	(2,800)	2,800
Net cash provided by (used in) operating activities	1,363,330	(669,390)
Cash flows from investing activities:		
Acquisition of furniture and equipment	(26,250)	(24,199)
Payments received on notes receivable – employees	14,660	6,438
Increase in notes receivable – employees	(10,000)	-
Net cash used in investing activities	(21,590)	(17,761)
Cash flows from financing activities:		
Proceeds from the exercise of stock options	350	-
Net cash provided by financing activities	350	-
Net increase (decrease) in cash and cash equivalents	1,342,090	(687,151)
Cash and cash equivalents, beginning of the year	1,280,926	1,968,077
Cash and cash equivalents, end of the year	\$ 2,623,016	\$ 1,280,926
Supplemental cash flow information		
Interest paid	\$-	\$-
Income taxes paid	\$ 2,800	\$-

The accompanying notes are an integral part of the financial statements

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

INFORMATION ANALYSIS INCORPORATED
NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Operations

Information Analysis Incorporated (“the Company”) was incorporated under the corporate 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.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”) 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 these estimates.

Revenue Recognition

The Company earns revenue from both professional services and sales of software and related support. 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 from professional services is earned under time and materials and fixed-price contracts. For sales of third-party software products, revenue is recognized upon product delivery, with any maintenance related revenues recognized ratably over the maintenance period.

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 renewals of maintenance contracts on third-party software sales from prior years and to separable maintenance elements of sales of third-party software that include fixed terms of maintenance, 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 reports revenue on both a gross and net basis on a transaction by transaction analysis using authoritative guidance issued by the Financial Accounting Standards Board (the “FASB”). The Company considers the following factors to determine the gross versus net presentation: if the Company (i) acts as principal in the transaction; (ii) takes title to the products; (iii) has risks and rewards of ownership, such as the risk of loss for collection, delivery

or return; and (iv) acts as an agent or broker (including performing services, in substance, as an agent or broker) with compensation on a commission or fee basis. Generally, sales of third-party software products such as Adobe and Micro Focus products are reported on a gross basis with the Company acting as the principal in these arrangements. This determination is 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. Generally, revenue derived for facilitating a sales transaction of Adobe products in which a customer introduced by the Company makes a purchase directly from the Company's supplier or another designated reseller is recognized net when the commission payment is received since the Company is merely acting as an agent in these arrangements. 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.

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

INFORMATION ANALYSIS INCORPORATED
NOTES TO FINANCIAL STATEMENTS

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.

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, ratably throughout the contract as the services are provided, or subject to funds made available incrementally by legislators. 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.

Segment Reporting

The Company has concluded that it operates in one business segment, providing products and services to modernize client information systems.

Government Contracts

The Company's 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.

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

INFORMATION ANALYSIS INCORPORATED
NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (continued)

Cash and Cash Equivalents

The Company considers all highly liquid investments with maturities of ninety days or less at the time of purchase to be cash equivalents. Deposits are maintained with a federally insured bank. 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 Company typically does not require collateral from its customers. 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 \$381 and \$141,721 at December 31, 2012 and 2011, respectively.

Note Receivable

The Company has a note receivable and accrued interest from an employee of \$6,295 and \$10,955 at December 31, 2012 and 2011, respectively. The note bears interest at 3.5% and is payable semi-monthly over 36 months from the date of the note. Interest income recognized was not material for all periods presented.

Property and Equipment

Property and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the assets. Furniture and fixtures are depreciated over the lesser of the useful life or five years, off-the-shelf software is depreciated over the lesser of three years or the term of the license, custom software is depreciated over the least of five years, the useful life, or the term of the license, and computer equipment is depreciated over three years. Leasehold improvements are amortized over the estimated term of the lease or the estimated life of the improvement, whichever is shorter. Maintenance and minor repairs are charged to operations as incurred. Gains and losses on dispositions are recorded in operations.

Stock-Based Compensation

At December 31, 2012, the Company had the stock-based compensation plans described in Note 9 below. Total compensation expense related to these plans was \$7,047 and \$6,706 for the years ended December 31, 2012 and 2011, respectively, of which \$550 and \$0, respectively, 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 over the period of performance.

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

INFORMATION ANALYSIS INCORPORATED
NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (continued)

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.

Earnings Per Share

The Company's earnings per share calculations are based upon the weighted average number of shares of common stock outstanding. The dilutive effect of stock options, warrants and other equity instruments 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.

Concentration of Credit Risk

The Company's prime contracts and subcontracts with agencies of the U.S. federal government accounted for 87% and 89% of the Company's revenues during 2012 and 2011, respectively. The Company has prime contracts with one U.S. federal government agency that accounted for 28% and 48% of the Company's 2012 and 2011 revenue, respectively. Also, the Company has subcontracts with other companies for which work is done for a U.S. federal agency that account for 22% and 19% of the Company's 2012 revenue and 16% and 1% of the 2011 revenue.

The Company sold third party software and maintenance contracts under agreements with two major suppliers. These sales accounted for 27% of total revenue in 2012 and 40% of revenue in 2011.

At December 31, 2012, the Company's accounts receivable included receivables from one U.S. federal agency that represented 11% of the Company's outstanding accounts receivable and from two companies under which we subcontract for services to U.S. federal agencies that represented 42% and 18% of the Company's outstanding accounts receivable, respectively. At December 31, 2011, the Company's accounts receivable included receivables from various departments within one U.S. federal agency that collectively represented 75% of the Company's outstanding accounts receivable.

Reclassifications

Certain prior year balances have been reclassified to conform to the presentation of the current year.

Recent Accounting Pronouncements

From time to time, new accounting pronouncements are issued by the FASB, or other standard setting bodies that the Company adopts as of the specified effective date. The Company does not believe that the impact of recently issued accounting standards that are not yet effective will have a material effect on its financial position or results of operations upon adoption.

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

INFORMATION ANALYSIS INCORPORATED
NOTES TO FINANCIAL STATEMENTS

2. Receivables

Accounts receivable at December 31, 2012 and 2011, consist of the following:

	2012	2011
Billed-federal government	\$ 664,533	\$ 2,961,279
Billed-commercial and other	73,892	70,100
Total billed	738,425	3,031,379
Unbilled	-	-
Allowance for doubtful accounts	(381)	(141,721)
Accounts receivable, net	\$ 738,044	\$ 2,889,658

Billed receivables from the federal government include amounts due from both prime contracts and subcontracts where the federal government is the end customer. Unbilled receivables are for services provided through the balance sheet date that are expected to be billed and collected within one year.

3. Fair Value Measurements

The Company defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value which are the following:

Level 1—Quoted prices in active markets for identical assets or liabilities;

Level 2—Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and

Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The following table represents the fair value hierarchy for our financial assets (cash equivalents and marketable securities) measured at fair value on a recurring basis as of December 31, 2012 and 2011 (in thousands):

	Level 1	Level 2	Level 3
December 31, 2012			
Money market accounts	\$ 2,003	\$ -	\$ -
Total	\$ 2,003	\$ -	\$ -

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December 31, 2011

Money market accounts	\$ 1,022	\$ -	\$ -
Total	\$ 1,022	\$ -	\$ -

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

INFORMATION ANALYSIS INCORPORATED
NOTES TO FINANCIAL STATEMENTS

3. Fair Value Measurements (continued)

Money market accounts are highly liquid investments. The pricing information on these investment instruments are readily available and can be independently validated as of the measurement date. This approach results in the classification of these securities as Level 1 of the fair value hierarchy.

The carrying amount of financial instruments such as accounts receivable, accounts payable, and accrued liabilities approximate the related fair value due to the short-term maturities of these instruments. The carrying amount of notes receivable approximate fair value based on interest rates currently available.

4. Fixed Assets

A summary of fixed assets and equipment at December 31, 2012 and 2011, consist of the following:

	2012	2011
Furniture and equipment	\$ 93,391	\$ 93,391
Computer equipment and software	238,136	211,886
Subtotal	331,527	305,277
Less: accumulated depreciation and amortization	(292,301)	(264,837)
Total	\$ 39,226	\$ 40,440

Depreciation expense for the years ended December 31, 2012 and 2011, was \$27,464 and \$19,464, respectively.

5. Revolving Line of Credit

On December 20, 2005, the Company entered into a revolving line of credit agreement with TD Bank providing for demand or short-term borrowings up to \$1,000,000. The credit agreement includes an interest rate indexed to 3.00% above the British Bankers' Association London Interbank Offered Rate (BBA LIBOR). The line of credit was renewed on November 30, 2012, and expires on December 1, 2013. Draws against the line are limited by varying percentages of the Company's eligible accounts receivable. The bank is granted a security interest in all company assets if there are borrowings under the line of credit. Interest on outstanding balances is payable monthly. The effective rate at December 31, 2012, was 3.21%. At December 31, 2011, the effective rate was 4.02%.

The bank has a first priority security interest in the Company's receivables and a direct assignment of its U.S. federal government contracts. Under the line of credit agreement, the Company is bound by certain covenants, including maintaining positive net income as tested on an annual basis, maintaining a minimum tangible net worth, and producing a number of periodic financial reports for the benefit of the bank. There was no outstanding balance on the line of credit at December 31, 2012 or 2011.

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

INFORMATION ANALYSIS INCORPORATED
NOTES TO FINANCIAL STATEMENTS

6. Commitments and Contingencies

Operating Leases

The Company leases facilities under long-term operating lease agreements through May 2017. Rent expense was \$89,597 and \$88,894 for the years ended December 31, 2012 and 2011, respectively.

The future minimum rental payments to be made under long-term operating leases are as follows:

Year ending		
December 31,:	2013	\$88,954
	2014	99,255
	2015	102,232
	2016	105,299
	2017	44,414
Total minimum rent payments		\$440,154

The above minimum lease payments reflect the base rent under the lease agreements. However, these base rents can be adjusted each year to reflect the Company's proportionate share of increases in the building's operating costs and the Company's proportionate share of real estate tax increases on the leased property.

7. Income Taxes

The tax effects of significant temporary differences representing deferred tax assets at December 31, 2012 and 2011, are as follows:

	2012	2011
Deferred tax assets:		
Net operating loss carryforward	\$ 5,501,500	\$ 5,559,500
Accrued vacation and commissions	312,200	261,800
Fixed assets	48,100	46,100
Allowance for doubtful accounts	100	53,400
AMT tax credit carryforward	6,600	9,500
Other	9,700	8,200
Subtotal	5,878,200	5,938,500
Valuation allowance	(5,878,200)	(5,938,500)
Total	\$ -	\$ -

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

INFORMATION ANALYSIS INCORPORATED
NOTES TO FINANCIAL STATEMENTS

7. Income Taxes (continued)

The provision for income taxes is at an effective rate different from the federal statutory rate due principally to the following:

	December 31,	
	2012	2011
Income before taxes	\$ 100,423	\$ 156,201
Income tax expense (benefit) on above amount at federal statutory rate	34,100	53,100
State income tax expense (benefit), net of federal expense (benefit)	4,000	6,200
Permanent differences	7,600	5,600
Other	14,600	(800)
Change in valuation allowance	(60,300)	(61,300)
Provision for income taxes	\$ -	\$ 2,800

Income tax expense for the years ended December 31, 2012 and 2011 consists of the following:

	December 31,	
	2012	2011
Current income taxes		
Federal	\$ 83,900	\$ 179,000
State	9,900	21,100
Alternative minimum tax	-	2,800
Benefit from utilization of net operating losses	(93,800)	(200,100)
	-	2,800
Deferred taxes	-	-
	\$ -	\$ 2,800

The Company has recorded a valuation allowance to the full extent of its currently available net deferred tax assets which the Company determined to be not more-likely-than-not realizable. The Company has net operating loss carryforwards of approximately \$14.5 million, which expire, if unused, between the years 2017 and 2028.

The Company may have been deemed to have experienced changes in ownership which may impose limitations on its ability to utilize net operating loss carryforwards under Section 382 of the Internal Revenue Code. However, as the deferred tax asset is fully offset by a valuation allowance, the Company has not yet conducted a Section 382 study to determine the extent of any such limitations.

The Company has analyzed its income tax positions using the criteria required by U.S. GAAP and concluded that as of December 31, 2012 and 2011, it has no material uncertain tax positions and no interest or penalties have been accrued. The Company has elected to recognize any estimated penalties and interest on its income tax liabilities as a component of its provision for income taxes.

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

INFORMATION ANALYSIS INCORPORATED
NOTES TO FINANCIAL STATEMENTS

8. Retirement Plans

The Company has a Cash or Deferred Arrangement Agreement (CODA), which satisfies the requirements of section 401(k) of the Internal Revenue Code. This defined contribution retirement plan covers substantially all employees. Participants can elect to have up to the maximum percentage allowable of their salaries reduced and contributed to the plan. The Company may make matching contributions equal to a discretionary percentage of the participants' elective deferrals. In 2012 and in 2011, the Company matched 25% of the first 6% of the participants' elective deferrals. The Company may also make additional contributions to all eligible employees at its discretion. The Company did not make additional contributions during 2012 or 2011. Expenses for matching contributions for the years ended December 31, 2012 and 2011 were \$30,680 and \$20,303, respectively. The balance of funds forfeited by former employees from unvested employer matching contribution accounts may be used to offset current and future employer matching contributions.

9. Stock Options and Warrants

The Company granted stock options to certain 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 such options vest over periods of six months to two years. The fair values of option awards granted in 2012 and 2011 were estimated using the Black-Sholes option pricing model under the following assumptions:

	2012		2011	
Risk free interest rate	0.62% -		1.65% -	
Dividend yield	2.31	%	2.30	%
Expected term	5-10 years		5 years	
Expected volatility	62.8 - 67.9%		61.7 - 61.9%	

2006 Stock Incentive Plan

The 2006 Plan became effective May 18, 2006, and expires May 17, 2016. 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 1,950,000. 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 period for options granted to employees under the 2006 Plan in the years ended December 31, 2012 and 2011, were twelve months and nineteen months, respectively. The exercise price of each option equals the quoted market price of the Company's stock on the date of grant.

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

INFORMATION ANALYSIS INCORPORATED
NOTES TO FINANCIAL STATEMENTS

9. Stock Options and Warrants (continued)

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 360,000 and 411,000 unexpired exercisable options remaining from the 1996 Plan at December 31, 2012 and 2011, respectively.

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

	Options outstanding	
	Number of shares	Weighted average price per share
Balance at December 31, 2010	1,119,000	\$ 0.30
Options granted	45,500	0.17
Options exercised, expired or forfeited	161,500	0.20
Balance at December 31, 2011	1,003,000	0.31
Options granted	109,500	0.14
Options exercised	5,000	0.07
Options expired or forfeited	75,000	0.30
Balance at December 31, 2012	1,032,500	\$ 0.29

The following table summarizes information about options at December 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
1,032,500	\$0.29	4.32	\$ 1,770	920,250	\$0.31	3.73	\$ 1,770

Nonvested stock awards as of December 31, 2012 and changes during the year ended December 31, 2012, were as follows:

Nonvested	
Number of shares	Weighted average

		grant date fair value
Balance at December 31, 2011	60,000	\$ 0.09
Granted	109,500	0.08
Vested	41,250	0.10
Expired before vesting	16,000	0.08
Balance at December 31, 2012	112,250	0.08

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

INFORMATION ANALYSIS INCORPORATED
NOTES TO FINANCIAL STATEMENTS

9. Stock Options and Warrants (continued)

As of December 31, 2012 and 2011, unrecognized compensation cost associated with non-vested share based employee and non-employee compensation totaled \$3,094 and \$2,225, respectively, which is expected to be recognized over a weighted average period of 5 months and 7 months, respectively.

Warrants

The Board of Directors may also grant warrants to directors, employees and others. There were no warrants issued nor exercised during the years ended December 31, 2012 and 2011. As of December 31, 2012 and 2011, there were no outstanding warrants.

10. 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 income per common share.

	Net Income	Shares	Per Share Amount
Basic net income per common share for the year ended December 31, 2012:			
Income available to common stockholders	\$ 100,423	11,200,025	\$ 0.01
Effect of dilutive stock options		10,914	--
Diluted net income per common share for the year ended December 31, 2012:	\$ 100,423	11,210,939	\$ 0.01
Basic net income per common share for the year ended December 31, 2011:			
Income available to common stockholders	\$ 153,401	11,196,760	\$ 0.01
Effect of dilutive stock options		27,650	--
Diluted net income per common share for the year ended December 31, 2011:	\$ 153,401	11,224,410	\$ 0.01

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

ITEM 9A. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control over Financial Reporting

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

Management’s Annual Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting. 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. 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.

Management, including the Chief Executive Officer and Chief Financial Officer, has conducted an evaluation of the effectiveness of our internal control over financial reporting as of the Evaluation Date, based on the criteria for effective internal control described in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on its assessment, management concluded that our internal control over financial reporting was effective as of the Evaluation Date.

This Annual Report does not include an attestation report of our independent registered public accounting firm regarding internal control over financial reporting. Management’s report was not subject to attestation by our independent registered public accounting firm.

This report shall not be deemed to be filed for purposes of Section 18 of the Exchange Act, or otherwise subject to the liabilities of that section, and is not incorporated by reference into any filing of Information Analysis Incorporated, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

(The information required by this Item is incorporated by reference from the corresponding sections and subsections of our Definitive Proxy Statement to be filed pursuant to Section 14(a) of the Exchange Act with respect to our 2013 Annual Meeting of Stockholders.

ITEM 11. EXECUTIVE COMPENSATION.

(The information required by this Item is incorporated by reference from the corresponding sections and subsections of our Definitive Proxy Statement to be filed pursuant to Section 14(a) of the Exchange Act with respect to our 2013 Annual Meeting of Stockholders.

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

(The information required by this Item is incorporated by reference from the corresponding sections and subsections of our Definitive Proxy Statement to be filed pursuant to Section 14(a) of the Exchange Act with respect to our 2013 Annual Meeting of Stockholders.

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

(The information required by this Item is incorporated by reference from the corresponding sections and subsections of our Definitive Proxy Statement to be filed pursuant to Section 14(a) of the Exchange Act with respect to our 2013 Annual Meeting of Stockholders.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.

(The information required by this Item is incorporated by reference from the corresponding sections and subsections of our Definitive Proxy Statement to be filed pursuant to Section 14(a) of the Exchange Act with respect to our 2013 Annual Meeting of Stockholders.

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES.

(a)(1) Financial Statements

(as presented in Item 8 of this Annual Report)	Page
Report of Independent Registered Public Accounting Firm	17
Report of Independent Registered Public Accounting Firm	18
Balance Sheets as of December 31, 2012 and 2011	19
Statements of Operations and Comprehensive Income for the years ended December 31, 2012 and 2011	20
Statements of Changes in Stockholders' Equity for the years ended December 31, 2012 and 2011	21
Statements of Cash Flows for the years ended December 31, 2012 and 2011	22
Notes to Financial Statements	23

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

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.

INFORMATION ANALYSIS INCORPORATED
(Registrant)

March 29, 2013

By: /s/ Sandor Rosenberg
Sandor Rosenberg, President

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Sandor Rosenberg and Richard S. DeRose, jointly and severally, his attorney-in-fact, each with the full power of substitution, for such person, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney-in-fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he might do or could do in person hereby ratifying and confirming all that each of said attorneys-in-fact and agents, or his substitute, may do or cause to be done by virtue hereof.

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

Signature	Title	Date
By: /s/ Sandor Rosenberg Sandor Rosenberg	Chairman of the Board, Chief Executive Officer and President	March 29, 2013
By: /s/ Charles A. May, Jr. Charles A. May	Director	March 29, 2013
By: /s/ Bonnie K. Wachtel Bonnie K. Wachtel	Director	March 29, 2013
By: /s/ James D. Wester James D. Wester	Director	March 29, 2013
By: /s/ Richard S. DeRose Richard S. DeRose	Chief Financial Officer, Secretary and Treasurer	March 29, 2013
By: /s/ Matthew T. Sands Matthew T. Sands	Controller	March 29, 2013

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

Exhibit Index

Exhibit No.	Description	Location
3.1	Amended and Restated Articles of Incorporation effective March 18, 1997	Incorporated by reference from the Registrant's Form 10-KSB/A for the fiscal year ending December 31, 1996 and filed on July 3, 1997
3.2	Articles of Amendment to the Articles of Incorporation	Incorporated by reference from the Registrant's Form 10-KSB/A for the fiscal year ending December 31, 1997 and filed on March 30, 1998
3.3	Amended By-Laws of the Company	Incorporated by reference from the Registrant's Form S-18 dated November 20, 1986 (Commission File No. 33-9390).
4.1	Copy of Stock Certificate	Incorporated by reference from the Registrant's Form 10-KSB/A for the fiscal year ending December 31, 1997 and filed on March 30, 1998
10.1	Office Lease for 18,280 square feet at 11240 Waples Mill Road, Fairfax, Virginia 22030.	Incorporated by reference from the Registrant's Form 10-KSB/A for the fiscal year ending December 31, 1996 and filed on July 3, 1997
10.2	Company's 401(k) Profit Sharing Plan through Aetna Life Insurance and Annuity Company (now ING).	Incorporated by reference from the Registrant's Form 10-KSB/A for the fiscal year ending December 31, 1996 and filed on July 3, 1997
10.3	1996 Stock Option Plan	Incorporated by reference from the Registrant's Form S-8 filed on June 25, 1996
10.4	Modification of Office Lease to 12,345 square feet at 11240 Waples Mill Road, Fairfax, Virginia 22030	Incorporated by reference from the Registrant's Form 10-QSB for the period ended March 31, 2001 and filed on May 11, 2001
10.5	Second Modification of Lease, dated February 10, 2004, to 4,434 square feet at 11240 Waples Mill Road, Fairfax, Virginia 22030	Incorporated by reference from the Registrant's Form 10-KSB for the period ended December 31, 2003, and filed on March 30, 2004
10.6	Termination and/or change in control arrangement for Richard S. DeRose dated June 18, 1997	Incorporated by reference from the Registrant's Form 10-KSB for the year ended December 31, 2004, and filed on March 30, 2005
10.7	Line of Credit Agreement with TD Bank, N.A. (formerly Commerce Bank, N.A.)	Incorporated by reference from the Registrant's Form 10-KSB for the year ended December 31, 2005, and filed on March 31, 2006
10.8	Information Analysis Incorporated 2006 Stock Incentive Plan	Incorporated by reference from the Registrant's definitive proxy statement on Schedule 14A filed on April 19, 2006
10.9	Third Modification of Lease, dated November 8, 2006, to extend term of lease three years.	Incorporated by reference from the Registrant's Form 10-KSB for the period ended December 31, 2006, and filed on April 2, 2007

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|-------|--|---|
| 10.10 | Modification Agreement regarding Line of Credit Agreement with TD Bank, N.A., successor to Commerce Bank, N.A., dated July 18, 2008. | Incorporated by reference from the Registrant's Form 10-K for the period ended December 31, 2008, and filed on March 31, 2009 |
| 10.11 | Fourth Modification of Lease, dated November 12, 2009, to extend term of lease three years. | Incorporated by reference from the Registrant's Form 10-K for the period ended December 31, 2009, and filed on March 31, 2010 |
| 10.12 | Modification Agreement regarding Line of Credit Agreement with TD Bank, N.A., successor to Commerce Bank, N.A., dated December 29, 2009. | Incorporated by reference from the Registrant's Form 10-K for the period ended December 31, 2009, and filed on March 31, 2010 |

TABLE OF CONTENTS

Information Analysis Incorporated

2012 Annual Report on Form 10-K

Exhibit No.	Description	Location
10.13	Modification Agreement regarding Line of Credit Agreement with TD Bank, N.A., successor to Commerce Bank, N.A., dated December 13, 2010.	Incorporated by reference from the Registrant's Form 10-K for the period ended December 31, 2010, and filed on March 31, 2011
10.14	Modification Agreement regarding Line of Credit Agreement with TD Bank, N.A., successor to Commerce Bank, N.A., dated November 30, 2011.	Incorporated by reference from the Registrant's Form 10-K for the period ended December 31, 2011, and filed on March 30, 2012
<u>10.15</u>	Modification Agreement regarding Line of Credit Agreement with TD Bank, N.A., successor to Commerce Bank, N.A., dated November 30, 2012.	Filed with this Form 10-K
<u>10.16</u>	Fifth Modification of Lease, dated February 6, 2013, to extend term of lease four years.	Filed with this Form 10-K
<u>23.1</u>	Consent of Independent Registered Public Accounting Firm, CohnReznick LLP	Filed with this Form 10-K
<u>23.2</u>	Consent of Independent Registered Public Accounting Firm, Reznick Group, P.C.	Filed with this Form 10-K
<u>31.1</u>	Rule 13a-14(a) / 15a-14(a) Certification by Chief Executive Officer	Filed with this Form 10-K
<u>31.2</u>	Rule 13a-14(a) / 15a-14(a) Certification by Chief Financial Officer	Filed with this Form 10-K
<u>32.1</u>	Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed with this Form 10-K
<u>32.2</u>	Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed with this Form 10-K