INFORMATION ANALYSIS INC
Form 10-Q
November 16, 2009
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2009

¨ **TRANSISTION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ______ to ______

Commission File Number 0-22405

INFORMATION ANALYSIS INCORPORATED

(Exact name of registrant as specified in its charter)

Virginia	**54-1167364**
(State or other jurisdiction of	**(IRS Employer**
incorporation or organization)	**Identification No.)**
11240 Waples Mill Road, Suite 201, Fairfax, VA	**22030**
(Address of principal executive offices)	**(Zip Code)**

(703) 383-3000

(Registrant s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report.)

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

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

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

Large accelerated filer ¨	Accelerated filer ¨	Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

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

Indicate the number of shares outstanding of each of the issuer s classes of common equity, as of the latest practicable date.

Common Stock, par value $0.01, 11,196,760 shares as of November 13, 2009

Table of Contents

INFORMATION ANALYSIS INCORPORATED

FORM 10-Q

Index

		Page Number
PART I.	FINANCIAL INFORMATION	
Item 1.	Financial Statements (unaudited)	
	Balance Sheets as of September 30, 2009 and December 31, 2008	2
	Statements of Operations and Comprehensive Income for the three months ended September 30, 2009 and September 30, 2008	3
	Statements of Operations and Comprehensive Income for the nine months ended September 30, 2009 and September 30, 2008	4
	Statements of Cash Flows for the nine months ended September 30, 2009 and September 30, 2008	5
	Notes to Unaudited Financial Statements	6
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	13
Item 4.	Controls and Procedures	16
PART II.	OTHER INFORMATION	
Item 4.	Submission of Matters to a Vote of Security Holders	
Item 6.	Exhibits	17
SIGNATURES		17
Exhibit Index		18

INFORMATION ANALYSIS INCORPORATED

BALANCE SHEETS

(Unaudited)

	September 30, 2009	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 941,949	$ 1,549,335
Accounts receivable, net	1,604,843	1,121,709
Prepaid expenses	192,520	469,785
Other assets	1,113	1,028
Total current assets	2,740,425	3,141,857
Fixed assets, net	42,270	55,653
Other assets	6,282	6,281
Total assets	$ 2,788,977	$ 3,203,791
LIABILITIES & STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 465,050	$ 801,782
Accrued payroll and related liabilities	267,938	213,830
Other accrued liabilities	235,458	31,292
Deferred revenue	199,907	602,713
Income taxes payable		1,971
Total current liabilities	1,168,353	1,651,588
Stockholders equity:		
Common stock, par value $0.01, 30,000,000 shares authorized; 12,839,376 shares issued, 11,196,760 outstanding	128,393	128,393
Additional paid-in capital	14,552,740	14,550,067
Accumulated deficit	(12,130,298)	(12,196,046)
Treasury stock, 1,642,616 shares at cost	(930,211)	(930,211)
Total stockholders equity	1,620,624	1,552,203,
Total liabilities and stockholders equity	$ 2,788,977	$ 3,203,791

The accompanying notes are an integral part of the financial statements

Table of Contents

INFORMATION ANALYSIS INCORPORATED

STATEMENTS OF OPERATIONS

AND COMPREHENSIVE INCOME

(Unaudited)

	For the three months ended September 30, 2009	For the three months ended September 30, 2008
Sales		
Professional fees	$ 1,302,031	$ 1,261,155
Software sales	686,375	334,739
Total sales	1,988,406	1,595,894
Cost of sales		
Cost of professional fees	751,295	870,538
Cost of software sales	580,411	234,692
Total cost of sales	1,331,706	1,105,230
Gross profit	656,700	490,664
Selling, general and administrative expenses	535,944	567,384
Income (loss) from operations	120,756	(76,720)
Other income, net	1,353	5,659
Income (loss) before provision for income taxes	122,109	(71,061)
Provision for income taxes		
Net income (loss)	$ 122,109	$ (71,061)
Comprehensive income (loss)	$ 122,109	$ (71,061)
Earnings (loss) per common share:		
Basic:	$ 0.01	($0.01)
Diluted:	$ 0.01	($0.01)
Weighted average common shares outstanding:		
Basic	11,196,760	11,196,760
Diluted	11,208,403	11,196,760

The accompanying notes are an integral part of the financial statements

Table of Contents

Information Analysis Incorporated Third Quarter 2009 Report on Form 10-Q

INFORMATION ANALYSIS INCORPORATED

STATEMENTS OF OPERATIONS

AND COMPREHENSIVE INCOME

(Unaudited)

	For the nine months ended September 30, 2009	For the nine months ended September 30, 2008
Sales		
Professional fees	$ 3,601,267	$ 4,093,179
Software sales	1,186,080	949,294
Total sales	4,787,347	5,042,473
Cost of sales		
Cost of professional fees	2,295,532	3,027,293
Cost of software sales	930,711	681,189
Total cost of sales	3,226,243	3,708,482
Gross profit	1,561,104	1,333,991
Selling, general and administrative expenses	1,503,324	1,618,459
Income (loss) from operations	57,780	(284,468)
Other income, net	7,968	15,556
Income (loss) before provision for income taxes	65,748	(268,912)
Provision for income taxes		
Net income (loss)	$ 65,748	$ (268,912)
Comprehensive income (loss)	$ 65,748	$ (268,912)
Earnings (loss) per common share:		
Basic:	$0.01	($0.02)
Diluted:	$0.01	($0.02)
Weighted average common shares outstanding:		
Basic	11,196,760	11,196,760
Diluted	11,207,820	11,196,760

The accompanying notes are an integral part of the financial statements

Table of Contents

INFORMATION ANALYSIS INCORPORATED

STATEMENTS OF CASH FLOWS

(Unaudited)

	For the nine months ended September 30, 2009	2008
Cash flows from operating activities:		
Net income (loss)	$ 65,748	$ (268,912)
Adjustments to reconcile net income (loss) to net cash used by operating activities:		
Depreciation and amortization	24,692	27,081
Stock compensation	2,673	3,576
Changes in operating assets and liabilities		
Accounts receivable	(483,134)	406,014
Other receivables and prepaid expenses	277,179	(54,680)
Accounts payable and accrued expenses	(78,458)	(267,668)
Deferred revenue	(402,806)	44,231
Income taxes payable	(1,971)	
Net cash used by operating activities	(596,077)	(110,358)
Cash flows from investing activities:		
Purchases of fixed assets	(11,309)	(11,398)
Net cash used by investing activities	(11,309)	(11,398)
Cash flows from financing activities:		
Net cash provided by financing activities		
Net decrease in cash and cash equivalents	(607,386)	(121,756)
Cash and cash equivalents at beginning of the period	1,549,335	1,222,742
Cash and cash equivalents at end of the period	$ 941,949	$ 1,100,986
Supplemental cash flow Information		
Interest paid	$	$

The accompanying notes are an integral part of the financial statements

Table of Contents

Information Analysis Incorporated Third Quarter 2009 Report on Form 10-Q
PART I

Item 1. Financial Statements.

INFORMATION ANALYSIS INCORPORATED

NOTES TO FINANCIAL STATEMENTS

1. Basis of Presentation

The accompanying unaudited financial statements have been prepared in conformity with generally accepted accounting principles (GAAP) for interim financial information and with the instructions for Form 10-Q and Article 8-03 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the rules and regulations of the Securities Exchange Commission. In the opinion of management, the unaudited financial statements include all adjustments necessary (which are of a normal and recurring nature) for the fair presentation of the results of the interim periods presented. These unaudited financial statements should be read in conjunction with our audited financial statements for the year ended December 31, 2008 included in the Annual Report on Form 10-K filed by the Company with the Securities and Exchange Commission on March 31, 2009. The results of operations for any interim period are not necessarily indicative of the results of operations for any other interim period or for a full fiscal year.

2. Summary of Significant Accounting Policies

Recent Accounting Pronouncements

In October 2009, the FASB issued Update No. 2009-13, which amends the Revenue Recognition topic of the Codification. This update provides amendments to the criteria in Subtopic 605-25 of the Codification for separating consideration in multiple-deliverable arrangements. As a result of those amendments, multiple-deliverable arrangements will be separated in more circumstances than under existing U.S. GAAP. The amendments establish a selling price hierarchy for determining the selling price of a deliverable and will replace the term *fair value* in the revenue allocation guidance with *selling price* to clarify that the allocation of revenue is based on entity-specific assumptions rather than assumptions of a marketplace participant. The amendments will also eliminate the residual method of allocation and require that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method and will require that a vendor determine its best estimate of selling price in a manner that is consistent with that used to determine the price to sell the deliverable on a standalone basis. These amendments will be effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early adoption permitted. We are currently evaluating the impact the adoption of this update might have on our results of operations and financial condition.

In October 2009, the FASB issued Update No. 2009-14, which amends the Software topic of the Codification. The amendments in this update change the accounting model for revenue arrangements that include both tangible products and software elements. Tangible products containing software components and nonsoftware components that function together to deliver the tangible product s essential functionality are no longer within the scope of the software revenue guidance in Subtopic 985-605 of the Codification. In addition, the amendments in this update require that hardware components of a tangible product containing software components always be excluded from the software revenue guidance. In that regard, the amendments provide additional guidance on how to determine which software, if any, relating to the tangible product also would be excluded from the scope of the software revenue guidance. The amendments also provide guidance on how a vendor should allocate arrangement consideration to deliverables in an arrangement that includes both tangible products and software. The amendments also provide further guidance on how to allocate arrangement consideration when an arrangement includes deliverables both included and excluded from the scope of the software revenue guidance. These amendments will be effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early adoption permitted. We are currently evaluating the impact the adoption of this update might have on our results of operations and financial condition.

In May 2009, the FASB revised the authoritative guidance for subsequent events, which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This guidance is effective for financial statements issued for interim and annual reporting periods ending after June 15, 2009. We adopted this guidance for the period ended June 30, 2009, and have provided the disclosures required for the period ending September 30, 2009.

Table of Contents

2. Summary of Significant Accounting Policies (continued)

Operations

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

Revenue Recognition

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

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

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

For fixed price contracts in which the Company is paid a specific amount to be available to provide a particular service for a stated period of time, revenue is recognized ratably over the service period. The Company applies this method of revenue recognition to sales of maintenance contracts on third party software sales, as on 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.

Sales of third party software products such as Adobe and Micro Focus products are reported on a gross basis with the Company as a principal under guidance from the Financial Accounting Standards Board Emerging Issues Task Force (EITF) Abstract 99-19. This determination was based on the following: 1) the Company has inventory risk as suppliers are not obligated to accept returns, 2) the Company has reasonable latitude, within economic constraints, in establishing price, 3) the Company, in its marketing efforts, frequently aids the customer in determining product specifications, 4) the Company has physical loss 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.

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

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

Government Contracts

Company sales to departments or agencies of the United States 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.

Cash and Cash Equivalents

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

2. Summary of Significant Accounting Policies (continued)

Accounts Receivable

Accounts receivable are recorded at the invoiced amount and do not bear interest. Accounts receivable reported on the Company s balance sheets include unbilled accounts receivable of $3,003 and $0 as of September 30, 2009, and December 31, 2008, respectively. 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 does not have any off-balance sheet credit exposure related to its customers. The allowance for doubtful accounts totaled $11,626 at September 30, 2009, and $9,229 at December 31, 2008.

Fixed Assets

Fixed assets are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized over the 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 current operations.

Stock-Based Compensation

On January 1, 2006, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123R (SFAS 123R), using the modified prospective transition method. The following disclosures are provided pursuant to the requirements of SFAS 123R.

At September 30, 2009, the Company had the stock-based compensation plans described in Note 3 below. Total compensation expense related to these plans was $638 and $1,189 for the three months ended September 30, 2009 and 2008, respectively, of which $0 related to options awarded to non-employees. Total compensation expense related to these plans was $2,673 and $3,576 for the nine months ended September 30, 2009 and 2008, respectively, of which $0 related to options awarded to non-employees.

Earnings Per Share

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

Subsequent Events

FASB Accounting Standards Codification Topic 855, Subsequent Events addresses events which occur after the balance sheet date but before the issuance of financial statements. An entity must record the effects of subsequent events that provide evidence about conditions that existed at the balance sheet date and must disclose but not record the effects of subsequent events which provide evidence about conditions that existed after the balance sheet date. Additionally, Topic 855 requires disclosure relative to the date through which subsequent events have been evaluated and whether that is the date on which the financial statements were issued or were available to be issued. The additional disclosures required by this standard are included in Note 4.

3. Stock Options and Warrants

The Company uses the Black-Scholes model to estimate grant date fair value. Under the modified prospective transition method adopted by the Company, the Company did not recognize any stock-based compensation expense for 2009 or 2008 relating to option awards granted prior to January 1, 2006, as all of these option grants were 100% vested. Stock-based compensation expense for all share-based payment awards granted after December 31, 2005 is based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. The Company recognizes these compensation costs only for those shares expected to vest on a straight-line basis over the requisite service period of the awards, generally, the option vesting term of six months to two years.

3. Stock Options and Warrants (continued)

The Company evaluated the model input assumptions used in estimating grant date fair value. The Company examined its historical pattern of option exercises in an effort to identify a discernable pattern and concluded that the expected term for options awarded in 2009 and in 2008 is estimated to be five years, with the exception of stock options granted to non-employees, which have an expected term equal to the term of the option, since these do not expire when employment ceases. The Company also concluded that its historical realized volatility, calculated using historical stock prices of the Company over a period preceding the issue equal to the expected term of the option, is an appropriate measure of expected volatility. The interest rate used in the pricing model is based on the U.S. Treasury yield curve in effect at the time of the grant on issues with remaining terms equal to the estimated expected term used in the model. In addition, the Company has estimated a forfeiture rate based on historical data and current assumptions.

During the three months ended September 30, 2009, the Company granted options to certain employees to purchase an aggregate of 1,500 shares of the Company s common stock, with a per share weighted average fair value of $0.08 at the measurement date, and did not grant any options to non-employees. During the three months ended September 30, 2008, the Company granted options to certain employees to purchase an aggregate of 10,000 shares of the Company s common stock, with a per share weighted average fair value of $0.08, and did not grant options to non-employee consultants.

During the nine months ended September 30, 2009, the Company granted options to certain employees to purchase an aggregate of 34,000 shares of the Company s common stock, with a per share weighted average fair value of $0.04 at the measurement date, and granted options to certain non-employee consultants to purchase an aggregate of 1,000 shares of the Company s common stock, with a per share weighted average fair value of $0.09 at the measurement. During the nine months ended September 30, 2008, the Company granted options to certain employees to purchase an aggregate of 41,500 shares of the Company s common stock, with a per share weighted average fair value of $0.13, and did not grant options to non-employee consultants.

The fair values of option awards granted in the three months ended and nine months ended September 30, 2009 and 2008, were estimated using the Black Sholes option pricing model with the following assumptions:

	Three Months		Nine Months	
	2009	**2008**	**2009**	**2008**
Risk free interest rate	2.46%	3.30%	1.60 3.72%	2.78 3.49%
Dividend yield	0%	0%	0%	0%
Expected term	5 years	5 years	5-10 years	5 years
Expected volatility	61.4%	61.2%	59.1 105.6%	61.2 64.4%

The Company had a stock option plan, which became effective September 25, 1996, and expired May 29, 2006 (the 1996 Plan). The 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 within prescribed time periods when employment ceases, whichever comes first, and vested over periods determined by the Board of Directors. There were 624,000 unexpired exercisable options remaining from the 1996 Plan at September 30, 2009.

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, directors and certain non-employees. The maximum number of shares for which equity awards may be granted under the 2006 Plan is 950,000. Options under the 2006 Plan expire no later than ten years from the date of grant or within prescribed time periods when employment ceases, whichever comes first, and vest over periods determined by the Board of Directors. The average vesting periods for options granted to employees under the 2006 Plan for the three months ended and the nine months ended September 30, 2009 and 2008, were eighteen months. The exercise price of each option equals the quoted market price of the Company s stock on the date of grant.

Option activity under the foregoing option plans as of September 30, 2009, and changes during the three months ended September 30, 2009 and 2008, were as follows:

Table of Contents

Information Analysis Incorporated Third Quarter 2009 Report on Form 10-Q

3. Stock Options and Warrants (continued)

	Options outstanding	
	Number of shares	**Weighted average price per share**
Balance at December 31, 2008	1,089,000	$ 0.35
Options granted	12,500	0.07
Options exercised, expired or forfeited	21,000	0.40
Balance at March 31, 2009	1,080,500	0.35
Options granted	21,000	0.09
Options exercised, expired or forfeited	83,000	0.57
Balance at June 30, 2009	1,018,500	0.34
Options granted	1,500	0.15
Options exercised, expired or forfeited	1,000	0.17
Balance at September 30, 2009	1,019,000	0.33

	Options outstanding	
	Number of shares	**Weighted average price per share**
Balance at December 31, 2007	1,109,000	$ 0.41
Options granted	4,000	0.28
Options exercised, expired or forfeited	8,500	0.51
Balance at March 31, 2008	1,104,500	0.41
Options granted	27,500	0.27
Options exercised, expired or forfeited	3,000	0.36
Balance at June 30, 2008	1,129,000	0.40
Options granted	10,000	0.14
Options exercised, expired or forfeited		n/a
Balance at September 30, 2008	1,139,000	0.40

The following table summarizes information about options at September 30, 2009:

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**
1,019,000	$ 0.33	5.0	$ 3,060	963,750	$ 0.34	4.8	$ 270

Nonvested stock options as of September 30, 2009, and changes during the three months ended September 30, 2009 and 2008, were as follows:

	Nonvested	
	Number of shares	Weighted average grant date fair value
Balance at December 31, 2008	46,000	$ 0.14
Granted	12,500	0.04
Vested	3,500	0.19
Expired before vesting	1,000	0.25
Balance at March 31, 2009	54,000	0.11
Granted	21,000	0.05
Vested	15,750	0.15
Balance at June 30, 2009	59,250	0.08
Granted	1,500	0.08
Vested	5,000	0.08
Expired before vesting	500	0.09
Balance at September 30, 2009	55,250	0.08

Table of Contents

Information Analysis Incorporated Third Quarter 2009 Report on Form 10-Q

3. Stock Options and Warrants (continued)

	Nonvested	
	Number of shares	**Weighted average grant date fair value**
Balance at December 31, 2007	25,500	$ 0.34
Granted	4,000	0.16
Vested	3,500	0.33
Expired before vesting	1,500	0.21
Balance at March 31, 2008	24,500	0.32
Granted	27,500	0.27
Vested	11,000	0.60
Expired before vesting	2,000	0.26
Balance at June 30, 2008	39,000	0.29
Granted	10,000	0.08
Vested	2,000	0.28
Balance at September 30, 2008	47,000	0.14

As of September 30, 2009, unrecognized compensation cost associated with non-vested share based employee compensation approximated $1,773, which is expected to be recognized over a weighted average period of 6 months.

The Board of Directors has also granted warrants to directors, employees and others. There were no warrants issued in 2009 or 2008. There were no warrants exercised in 2009 or in 2008. As of September 30, 2009 and 2008, outstanding warrants were 12,000. The purchase price for shares issued upon exercise of these warrants is $0.01 per share. These warrants are immediately exercisable.

4. Subsequent Events

Management has evaluated subsequent events through the date the financial statements were issued, which was November 14, 2009, the date of Information Analysis Incorporated s Quarterly Report on Form 10-Q for the period ended September 30, 2009.

Table of Contents

Information Analysis Incorporated Third Quarter 2009 Report on Form 10-Q

5. Earnings Per Share

Earnings per share are presented in accordance with SFAS No. 128, Earnings Per Share. This statement requires dual presentation of basic and diluted earnings per share on the face of the income statement. 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 three months ended September 30, 2009:			
Income available to common stockholders	$ 122,109	11,196,760	$ 0.01
Effect of dilutive stock options		500	
Effect of dilutive stock warrants		11,143	
Diluted net income per common share for the three months ended September 30, 2009:	$ 122,109	11,208,403	$ 0.01
Basic net loss per common share for the three months ended September 30, 2008:			
Income available to common stockholders	($71,061)	11,196,760	($0.01)
Effect of dilutive stock options and warrants			
Diluted net loss per common share for the three months ended September 30, 2008:	($71,061)	11,196,760	($0.01)
Basic net income per common share for the nine months ended September 30, 2009:			
Income available to common stockholders	$ 65,748	11,196,760	$ 0.01
Effect of dilutive stock options		60	
Effect of dilutive stock warrants		11,000	
Diluted net income per common share for the nine months ended September 30, 2009:	$ 65,748	11,207,820	$ 0.01
Basic net loss per common share for the nine months ended September 30, 2008:			
Income available to common stockholders	($268,912)	11,196,760	($0.02)
Effect of dilutive stock options and warrants			
Diluted net loss per common share for the nine months ended September 30, 2008:	($268,912)	11,196,760	($0.02)

Table of Contents

Information Analysis Incorporated Third Quarter 2009 Report on Form 10-Q

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations
Cautionary Statement Regarding Forward-Looking Statements

This Form 10-Q contains forward-looking statements regarding our business, customer prospects, or other factors that may affect future earnings or financial results that are subject to the safe harbor created by the Private Securities Litigation Reform Act of 1995. Such statements involve risks and uncertainties which could cause actual results to vary materially from those expressed in the forward-looking statements. Investors should read and understand the risk factors detailed in our Form 10-K for the fiscal year ended December 31, 2008 and in other filings with the Securities and Exchange Commission. These risks include, among others, the following:

our failure to keep pace with a changing technological environment;

intense competition from other companies;

inaccuracy in our estimates of the cost of services and the timeline for completion of contracts;

changes in the way the US government contracts with businesses and changes in the budgetary priorities;

non-performance by our subcontractors and suppliers;

terms specific to US government contracts;

our dependence on key personnel;

our failure to adequately integrate businesses we may acquire;

fluctuations in our results of operations and its impact on our stock price;

the exercise of outstanding options and warrants;

our failure to adequately protect our intellectual property;

the limited public market for our common stock;

our forward-looking statements and projections may prove to be inaccurate; and incurring losses could affect our ability to finance our operations.

Our Business

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

We have determined that two of our customers from whom we subcontract for services to federal agencies currently represent material portions of our revenue. These customers accounted for 15.2% and 10.0% of revenue in the third quarter.

Three Months Ended September 30, 2009 versus Three Months Ended September 30, 2008

Revenue

Our revenues in the third quarter of 2009 were $1,988,406, compared to $1,595,894 in 2008, an increase of 24.6%. Professional services revenue was $1,302,031 versus $1,261,155, an increase of 3.2%, and software product revenue was $686,375 versus $334,739, an increase of 105.0%. The increase in professional services revenue is due an increase in our electronic forms-related services. The increase in software product revenue is primarily due to a number of one-time product sales. Software product sales are subject to considerable fluctuation from period to period, based on the aggregate of demand, customer funding, and customer lead time.

Gross Margins

Gross margin was $656,700, or 33.0% of sales, in the third quarter of 2009 versus $490,664, or 30.7% of sales, in the third quarter of 2008. $550,736 of the gross margin was attributable to professional services at a gross margin percentage of 42.3%, and $105,964 of the gross margin was attributable to software sales at a gross margin percentage of 15.4%. In the same quarter in 2008, we reported gross margins of $390,617, or 31.0% of sales for professional services and $100,047, or 29.9% of sales for software sales. Professional services gross margin and gross margin as a percentage of sales increased due to the combination of the the addition or expansion of contracts with more desirable margins and expiration of lower-margin contracts. Our increase in the dollar value of gross margin on software sales is due to an increase in initial sales of software products, which is subject to considerable fluctuation. The decrease in gross margin as a percentage of software sales is due to the increase in initial software product sales, which frequently have smaller gross margins than the continuing maintenance on those software products, as well as a decrease in margins on continuing maintenance contracts. Software product sales and associated margins are subject to considerable fluctuation from period to period, based on the product mix sold.

Selling, General and Administrative

Selling, general and administrative expenses were $535,944, or 27.0% of revenues, in the third quarter of 2009 versus $567,384, or 35.6% of revenues, in the third quarter of 2008. This decrease is due to the aggregate of an increase in incentives earned by our marketing personnel and an increase in the fringe benefits allocated to overhead and administrative personnel, offset by a decrease in overhead salaries, general and administrative salaries, marketing expenses, and recruiting expenses.

Profits

Net income for the three months ended September 30, 2009, was $122,109, or 6.1% of revenue, versus a net loss of ($71,061), or (4.5%) of revenue, for the same period in 2008. The increase in profitability is due to replacing expiring lower-margin professional services contracts with higher-margin contracts and the increase in the sales of software products, as well as reducing non revenue-producing salary expenditures while paying incentives based on profitability of contracts.

Nine months Ended September 30, 2009 versus Nine months Ended September 30, 2008

Revenue

Our revenues in the first nine months of 2009 were $4,787,347, compared to $5,042,473 in 2008, a decrease of 5.1%. Professional services revenue was $3,601,267 versus $4,093,179, a decrease of 12.0%, and software product revenue was $1,186,080 versus $949,294, an increase of 24.9%. The decrease in professional services revenue is primarily due to the expiration of contracts. Our new and continuing contracts did not produce sufficient levels of activity and revenue to offset the reductions of the levels of activity and the revenues from our expired contracts. The increase in software product revenue is due to normal fluctuations in sales of Micro Focus and Adobe products and related software maintenance contracts. Software product sales are subject to considerable fluctuation from period to period, based on the aggregate of demand, customer funding, and customer lead time.

Gross Margins

Gross margin was $1,561,104, or 32.6% of sales, in the first nine months of 2009 versus $1,333,991, or 26.5% of sales, in the first nine months of 2008. Of the 2009 gross margin, $1,305,735 was attributable to professional services and $255,369 was attributable to software sales. Our gross margin percentage was 36.3% for professional services and 21.5% for software sales for the nine months ended September 30, 2009. In the same nine months in 2008, we recorded gross margins of $1,065,886, or 26.0% of sales for professional services and $268,105, or 28.2% of sales for software sales. Professional services gross margin and gross margin as a percentage of sales increased due to the combination of the addition or expansion of contracts with more desirable margins and the expiration of lower-margin contracts. Our decrease in the dollar value of gross margin on software sales and gross margin as a percentage of software sales is due to a shift in the software sales product mix from ongoing maintenance to initial software product sales, which frequently have smaller gross margins than the continuing maintenance on those software products, as well as a decrease in margins on continuing maintenance contracts. Software product sales and associated margins are subject to considerable fluctuation from period to period, based on the product mix sold.

Selling, General and Administrative

Selling, general and administrative expenses were $1,503,324, or 31.4% of revenues, in the first nine months of 2009 versus $1,618,459, or 32.1% of revenues, in the first nine months of 2008. This decrease is due to the aggregate of an increase in incentives earned by our marketing personnel, offset by a decrease in the fringe benefits allocated to overhead and administrative personnel, overhead salaries, general and administrative salaries, marketing expenses, marketing consultants, and recruiting expenses.

Profits

Net income for the nine months ended September 30, 2009, was $65,748, or 1.4% of revenue, versus a net loss of ($268,912), or (5.3%) of revenue, for the same period in 2008. The increase in profitability is due to replacing expiring lower-margin professional services contracts with higher-margin contracts and the increase in the sales of software products, as well as reducing non revenue-producing salary expenditures while paying incentives based on profitability of contracts.

Liquidity and Capital Resources

Throughout 2008, and for the first quarter of 2009, we experienced operating and net losses. In the second and third quarters of 2009, we had operating income of $3,617 and $120,756, respectively, and net income of $5,982 and $122,109, respectively. Our beginning cash and cash equivalents balance, when combined with our cash flow from operations, were sufficient to provide financing for our operations. Net cash used by operating, investing and financing activities in the third quarter was $15,598, which when subtracted from a beginning balance of $957,547 at June 30, 2009, yielded cash and cash equivalents of $941,949 at September 30, 2009. Our accounts receivable balances increased $603,215 in the third quarter, due to the combination of new software products sales contracts and an increase in the activity on existing contracts. Our accounts payable balances increased $362,524 due largely to the cost side of the new software product sales contracts. Our deferred revenue balance decreased $17,607 due to the regular recognition of revenue on software maintenance contracts ratably over the life of the contracts.

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, 2006, and expires on December 1, 2009. As of September 30, 2009, no amounts were outstanding under this line of credit. At September 30, 2009, our allowable borrowings were the maximum of $1,000,000 based on our outstanding accounts receivable.

Although the bank has extended our line of credit from August 1 to December 1, 2009, it has not formally waived the default of our covenant not to incur an annual net loss for the year ended December 31, 2008. In the absence of a formal waiver of the defaulted covenant, the bank could exercise its right not to advance us funds under the line of credit, should we need to borrow funds. At this time, we do not anticipate borrowing funds under our line of credit within the next year.

Irrespective of whether the bank renews our line of credit or formally waives the defaulted covenant, we anticipate that we will be able to meet our cash requirements for at least twelve months, based on our current operating plan, without reliance on the line of credit.

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.

Item 4T. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, and people performing similar functions, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act), as of the end of the period reported in this quarterly report (the Evaluation Date). Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the Evaluation Date, our disclosure controls and procedures 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 Controls

There were no changes in our internal controls over financial reporting during the quarter ended September 30, 2009 that have materially affected, or are reasonably likely to affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1A. Risk Factors

Item 1A. Risk Factors of our annual report on Form 10-K for the year ended December 31, 2008 includes a discussion of our risk factors. The information presented below updates, and should be read in conjunction with, the risk factors and information disclosed in our annual report on Form 10-K for the year ended December 31, 2008. Except as presented below, there have been no material changes from the risk factors described in our annual report on Form 10-K for the year ended December 31, 2008.

Our default on a covenant of our current line of credit could affect our ability to finance our operations.

If we are unable to secure a formal waiver of the defaulted covenant on our line of credit (covenant not to record an annual loss), or if the bank should fail to renew our line of credit, our operations could be negatively affected in that we could find ourselves unable to bid on or to proceed with a contract with high upfront costs, or unable to finance our continuing operations, should we use our cash reserves due to prolonged losses or difficulty collecting on our customer invoices.

Item 6. Exhibits

(a) Exhibits: See Exhibit Index on page 18.

SIGNATURES

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

Information Analysis Incorporated

(Registrant)

Date: November 16, 2009

By: /S/ Sandor Rosenberg
Sandor Rosenberg, Chairman of the Board,

Chief Executive Officer, and President

By: /S/ Richard S. DeRose
Richard S. DeRose, Executive Vice President,

Treasurer, and Chief Financial Officer

Exhibit Index

Exhibit No.	Description	Location
31.1	Certification by Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002	Filed with this Form 10-Q
31.2	Certification by Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002	Filed with this Form 10-Q
32.1	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-Q
32.2	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-Q