

INFORMATION ANALYSIS INC

Form 10-Q

August 14, 2009

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**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 June 30, 2009

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

Commission File Number 0-22405

**INFORMATION ANALYSIS INCORPORATED**

(Exact name of registrant as specified in its charter)

**Virginia**  
(State or other jurisdiction of

incorporation or organization)

**11240 Waples Mill Road, Suite 201, Fairfax, VA**  
(Address of principal executive offices)

**(703) 383-3000**

(Registrant's telephone number, including area code)

**54-1167364**  
(IRS Employer

Identification No.)

**22030**  
(Zip Code)

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

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

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

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

Smaller reporting company ☒

reporting company)

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

### APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY

### PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes ☐ No ☐

### APPLICABLE ONLY TO CORPORATE ISSUERS:

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 August 13, 2009

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**INFORMATION ANALYSIS INCORPORATED**

**FORM 10-Q**

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**INFORMATION ANALYSIS INCORPORATED****BALANCE SHEETS**

(Unaudited)

	June 30, 2009	December 31, 2008
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 957,547	\$ 1,549,335
Accounts receivable, net	1,001,628	1,121,709
Prepaid expenses	185,817	469,785
Other assets	2,174	1,028
Total current assets	2,147,166	3,141,857
Fixed assets, net	45,244	55,653
Other assets	6,281	6,281
Total assets	\$ 2,198,691	\$ 3,203,791
<b>LIABILITIES &amp; STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 102,526	\$ 801,782
Accrued payroll and related liabilities	255,200	213,830
Deferred revenue	217,514	602,713
Other accrued liabilities	125,575	32,292
Income taxes payable		1,971
Total current liabilities	700,815	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	14,552,102	14,550,067
Accumulated deficit	(12,252,408)	(12,196,046)
Treasury stock, 1,642,616 shares at cost	(930,211)	(930,211)
Total stockholders' equity	1,497,876	1,552,203
Total liabilities and stockholders' equity	\$ 2,198,691	\$ 3,203,791

*The accompanying notes are an integral part of the financial statements*

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**INFORMATION ANALYSIS INCORPORATED****STATEMENTS OF OPERATIONS****AND COMPREHENSIVE INCOME**

(Unaudited)

	<b>For the three months ended June 30,</b>	
	<b>2009</b>	<b>2008</b>
Sales		
Professional fees	\$ 1,198,233	\$ 1,345,180
Software sales	206,257	352,232
Total sales	1,404,490	1,697,412
Cost of sales		
Cost of professional fees	748,331	1,035,082
Cost of software sales	152,188	262,901
Total cost of sales	900,519	1,297,983
Gross profit	503,971	399,429
Selling, general and administrative expenses	500,354	483,559
Income (loss) from operations	3,617	(84,130)
Other income, net	2,365	4,323
Income (loss) before provision for income taxes	5,982	(79,807)
Provision for income taxes		
Net income (loss)	\$ 5,982	\$ (79,807)
Comprehensive income (loss)	\$ 5,982	\$ (79,807)
Earnings (loss) per common share:		
Basic:	\$ 0.00	(\$0.01)
Diluted:	\$ 0.00	(\$0.01)
Weighted average common shares outstanding:		
Basic	11,196,760	11,196,760
Diluted	11,207,620	11,196,760

*The accompanying notes are an integral part of the financial statements*

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**INFORMATION ANALYSIS INCORPORATED****STATEMENTS OF OPERATIONS****AND COMPREHENSIVE INCOME**

(Unaudited)

	<b>For the six months ended June 30,</b>	
	<b>2009</b>	<b>2008</b>
Sales		
Professional fees	\$ 2,299,236	\$ 2,832,024
Software sales	499,705	614,556
Total sales	2,798,941	3,446,580
Cost of sales		
Cost of professional fees	1,544,237	2,156,755
Cost of software sales	350,300	446,497
Total cost of sales	1,894,537	2,603,252
Gross profit	904,404	843,328
Selling, general and administrative expenses	967,381	1,051,075
Loss from operations	(62,977)	(207,747)
Other income, net	6,615	9,896
Loss before provision for income taxes	(56,362)	(197,851)
Provision for income taxes		
Net loss	\$ (56,362)	\$ (197,851)
Comprehensive loss	\$ (56,362)	\$ (197,851)
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	11,196,760	11,196,760

*The accompanying notes are an integral part of the financial statements*

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**INFORMATION ANALYSIS INCORPORATED****STATEMENTS OF CASH FLOWS**

(Unaudited)

	<b>For the six months ended June 30,</b>	
	<b>2009</b>	<b>2008</b>
Cash flows from operating activities:		
Net loss	\$ (56,362)	\$ (197,851)
Adjustments to reconcile net loss to net cash (used) provided by operating activities:		
Depreciation and amortization	16,740	18,005
Stock compensation	2,035	2,387
Changes in operating assets and liabilities		
Accounts receivable	120,081	92,361
Other receivables and prepaid expenses	282,822	84,251
Accounts payable and accrued expenses	(563,603)	(241,460)
Deferred revenue	(385,199)	87,720
Income taxes payable	(1,971)	
Net cash used by operating activities	(585,457)	(154,587)
Cash flows from investing activities:		
Purchases of fixed assets	(6,331)	(6,671)
Net cash used by investing activities	(6,331)	(6,671)
Cash flows from financing activities:		
Net cash provided by financing activities		
Net (decrease) increase in cash and cash equivalents	(591,788)	161,258
Cash and cash equivalents at beginning of the period	1,549,335	1,222,742
Cash and cash equivalents at end of the period	\$ 957,547	\$ 1,061,484
Supplemental cash flow Information		
Interest paid	\$	\$

*The accompanying notes are an integral part of the financial statements*

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**Information Analysis Incorporated**  
**PART I**

Second Quarter 2009 Report on Form 10-Q

### **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 May 2009, the FASB issued SFAS No. 165, *Subsequent Events* ( SFAS No. 165 ). SFAS No. 165 establishes general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Although there is new terminology, the standard is based on the same principles as those that currently exist in the auditing standards. SFAS No. 165, which includes a new required disclosure of the date through which an entity has evaluated subsequent events, is effective for the Company during the interim period ended June 30, 2009.

On July 1, 2009, the *FASB Accounting Standards Codification* ( Codification ) was launched as the single source of authoritative U.S. GAAP applicable to all non-governmental entities. The Codification will supersede all existing FASB, AICPA, and Emerging Issue Task Force (EITF) pronouncements and related literature. The Codification will also include relevant portions of authoritative SEC content relating to matters within the basic financial statements, which are considered as sources of authoritative GAAP for SEC registrants. The Codification is not intended to change current U.S. GAAP, but is intended to simplify user access to all authoritative U.S. GAAP pronouncements by providing all the authoritative literature related to a particular topic in one place. The Codification is effective for the Company for interim and annual periods after September 15, 2009 and is not expected to have an impact on the Company's financial condition or results of operations. The Company is currently evaluating the impact to its financial reporting process of providing Codification references in its public filings.

###### **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.



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

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

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.

### **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 \$39,882 and \$0 as of June 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 \$9,229 at June 30, 2009, and at December 31, 2008.

### **Fixed Assets**

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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.

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

#### **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 June 30, 2009, the Company had the stock-based compensation plans described in Note 3 below. Total compensation expense related to these plans was \$976 and \$1,100 for the three months ended June 30, 2009 and 2008, respectively, of which \$90 and \$0, respectively, related to options awarded to non-employees. Total compensation expense related to these plans was \$2,035 and \$2,387 for the six months ended June 30, 2009 and 2008, respectively, of which \$90 and \$0, respectively, 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.

### **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.

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 June 30, 2009, the Company granted options to certain employees to purchase an aggregate of 20,000 shares of the Company's common stock, with a per share weighted average fair value of \$0.05 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 three months ended June 30, 2008, the Company granted options to certain employees to purchase an aggregate of 27,500 shares of the Company's common stock, with a per share weighted average fair value of \$0.14, and did not grant options to non-employee consultants.

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### 3. Stock Options and Warrants (continued)

During the six months ended June 30, 2009, the Company granted options to certain employees to purchase an aggregate of 32,500 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 six months ended June 30, 2008, the Company granted options to certain employees to purchase an aggregate of 31,500 shares of the Company's common stock, with a per share weighted average fair value of \$0.15, and did not grant options to non-employee consultants.

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

	Three Months		Six Months	
	2009	2008	2009	2008
Risk free interest rate	1.86	3.72%	3.15	3.49%
Dividend yield	0%	0%	0%	0%
Expected term	5-10 years	5 years	5-10 years	5 years
Expected volatility	60.1	105.6%	61.2	61.3%
	59.1	105.6%	61.2	64.4%

The Company had a stock option plan, which became effective June 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 June 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 six months ended June 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 June 30, 2009, and changes during the three months ended June 30, 2009 and 2008, were as follows:

	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
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**3. Stock Options and Warrants (continued)**

	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

The following table summarizes information about options at June 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
1,018,500	\$ 0.33	5.3	\$ 625	959,250	\$ 0.34	5.0	\$ 0

Nonvested stock options as of June 30, 2009, and changes during the three months ended June 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

Nonvested  
Number of  
shares  
Weighted  
average  
grant

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		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

As of June 30, 2009, unrecognized compensation cost associated with non-vested share based employee compensation approximated \$2,310, which is expected to be recognized over a weighted average period of 7 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 June 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.



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**4. 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.

	<b>Net Income</b>	<b>Shares</b>	<b>Per Share Amount</b>
Basic net loss per common share for the three months ended June 30, 2009:			
Income available to common stockholders	\$ 5,982	11,196,760	\$ 0.00
Effect of dilutive stock options		3	
Effect of dilutive stock warrants		10,857	
Diluted net loss per common share for the three months ended June 30, 2009:	\$ 5,982	11,207,620	\$ 0.00
Basic net loss per common share for the three months ended June 30, 2008:			
Income available to common stockholders	(\$79,807)	11,196,760	(\$0.01)
Effect of dilutive stock options and warrants			
Diluted net income per common share for the three months ended June 30, 2008:	(\$79,807)	11,196,760	(\$0.01)
Basic net loss per common share for the six months ended June 30, 2009:			
Income available to common stockholders	(\$56,362)	11,196,760	(\$0.01)
Effect of dilutive stock options and warrants			
Diluted net loss per common share for the six months ended June 30, 2009:	(\$56,362)	11,196,760	(\$0.01)
Basic net loss per common share for the six months ended June 30, 2008:			
Income available to common stockholders	(\$197,851)	11,196,760	(\$0.02)
Effect of dilutive stock options and warrants			
Diluted net income per common share for the six months ended June 30, 2008:	(\$197,851)	11,196,760	(\$0.02)

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**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

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incurring losses could affect our ability to finance our operations.

### **Additional Risk Factor**

*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.

### **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.

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### **Information Analysis Incorporated Three Months Ended June 30, 2009 versus Three Months Ended June 30, 2008**

Second Quarter 2009 Report on Form 10-Q

#### *Revenue*

Our revenues in the second quarter of 2009 were \$1,404,490, compared to \$1,697,412 in 2008, a decrease of 17.3%. Professional services revenue was \$1,198,233 versus \$1,345,180, a decrease of 10.9%, and software product revenue was \$206,257 versus \$352,232, an increase of 41.4%. 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 decrease 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 \$503,971, or 35.9% of sales, in the second quarter of 2009 versus \$399,429, or 23.5% of sales, in the second quarter of 2008. Of the \$503,971 in 2009, \$449,902, or 37.5%, was attributable to professional services and \$54,069, or 26.2%, was attributable to software sales. In the same quarter in 2008, we reported gross margins of \$310,098, or 23.1% of sales for professional services and \$89,331, or 25.4% of sales for software sales. Professional services gross margin and gross margin as a percentage of sales increased due to the combination of the expiration of lower-margin contracts and the addition or expansion of contracts with more desirable margins. Our decrease in the dollar value of gross margin on software sales is due to a decrease in initial sales of software products, which is subject to considerable fluctuation. The increase in gross margin as a percentage of software sales is due to the decrease in initial software product sales, which frequently have smaller gross margins than the continuing maintenance on those software products. 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 \$500,354, or 35.6% of revenues, in the second quarter of 2009 versus \$483,559, or 28.5% of revenues, in the second quarter of 2008. This increase is primarily due to an increase in incentives earned by our marketing personnel, offset by a decrease in overhead salaries, general and administrative salaries, fees paid to marketing consultants, and recruiting expenses.

#### *Profits*

Net income for the three months ended June 30, 2009, was \$5,982, or 0.4% of revenue, versus a net loss of \$78,485, or 4.6% 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, as well as reducing non revenue-producing salary and consulting expenses while paying incentives based on profitability of contracts.

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### **Information Analysis Incorporated**

Second Quarter 2009 Report on Form 10-Q

**Six months Ended June 30, 2009 versus Six months Ended June 30, 2008**

#### *Revenue*

Our revenues in the first six months of 2009 were \$2,798,941, compared to \$3,446,580 in 2008, a decrease of 18.8%. Professional services revenue was \$2,299,236 versus \$2,832,024, a decrease of 18.8%, and software product revenue was \$499,705 versus \$614,556, a decrease of 18.7%. 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 \$904,404, or 32.3% of sales, in the first six months of 2009 versus \$843,328, or 24.5% of sales, in the first six months of 2008. Of the \$904,404 in 2009, \$754,999 was attributable to professional services and \$149,405 was attributable to software sales. Our gross margin percentage was 32.8% for professional services and 29.9% for software sales for the six months ended June 30, 2009. In the same six months in 2008, we recorded gross margins of \$675,269, or 23.8% of sales for professional services and \$168,059, or 27.3% of sales for software sales. Professional services gross margin and gross margin as a percentage of sales increased due to the combination of the expiration of lower-margin contracts and the addition or expansion of contracts with more desirable margins. Our decrease in gross margin on software sales is due to a decrease in initial sales of software products, which is subject to considerable fluctuation. Our increase in gross margin as a percentage of software sales is due to a one-time rebate on the cost of a fourth quarter 2008 product sale, offset by decreases in margins on software product and maintenance sales. 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 \$967,381, or 34.6% of revenues, in the first six months of 2009 versus \$1,051,075, or 30.5% of revenues, in the first six months of 2008. This decrease is due to a decrease in overhead salaries, general and administrative salaries, fees paid to marketing consultants, and recruiting expenses, offset by increases in sales incentives.

#### *Profits*

Net loss for the six months ended June 30, 2009, was \$56,362, or 2.0% of revenue, versus a net loss of \$197,851, or 5.7% of revenue, for the same period in 2008. The decrease in net loss is due to replacing expiring lower-margin professional services contracts with higher-margin contracts, as well as reducing non revenue-producing salary and consulting expenses.

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### **Information Analysis Incorporated Liquidity and Capital Resources**

Second Quarter 2009 Report on Form 10-Q

Throughout 2008, and for the first quarter of 2009, we experienced operating and net losses. In the second quarter of 2009, we had operating income of \$3,617 and net income of \$5,982. 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 second quarter was \$179,411, which when subtracted from a beginning balance of \$1,136,958 at March 31, 2009, yielded cash and cash equivalents of \$957,547 at June 30, 2009. Our accounts receivable balances increased \$119,810 in the second quarter, due to the combination of new contracts and an increase in the scale of an existing contract. Our accounts payable balances fell \$123,147 due largely to the expiration of a contract under which we used a substantial amount of subcontractor labor. Our deferred revenue balance decreased \$208,106 due to the regular recognition of revenue on software maintenance contracts ratably over the life of the contracts, and our prepaid expenses decreased \$170,431 due largely to the recognition of expenses for the same software maintenance 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 October 1, 2009. As of June 30, 2009, no amounts were outstanding under this line of credit. At June 30, 2009, our allowable borrowings were limited to \$769,000 based on our outstanding accounts receivable.

Although the bank has extended our line of credit from August 1 to October 1, 2009, it has not formally waived our covenant not to incur an annual net loss, on which we defaulted 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 find ourselves needing to borrow. At this time, we do not anticipate needing to borrow 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 4. 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 June 30, 2009 that have materially affected, or are reasonably likely to affect, our internal control over financial reporting.

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PART II - OTHER INFORMATION**

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

On June 11, 2009, we held our annual meeting of stockholders.

The vote for the election of Directors was as follows:

(i)	Charles A. May, Jr. -	9,391,783 FOR,	265,267	WITHHELD
(ii)	Sandor Rosenberg -	9,568,383 FOR,	88,667	WITHHELD
(iii)	Bonnie K. Wachtel -	8,507,130 FOR,	1,149,920	WITHHELD
(iv)	James D. Wester -	9,370,183 FOR,	286,867	WITHHELD

All directors were incumbents, and all will serve terms which expire at the next annual meeting of stockholders.

The vote for ratification of the selection of Reznick Group, P.C., as our Independent Public Accountants for 2009 was as follows:

9,502,925 FOR,	139,457 AGAINST,	14,668 ABSTAIN,	0 BROKER NON-VOTE
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**Item 6. Exhibits**

(a) Exhibits: See Exhibit Index on page 17.

**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: August 14, 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

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**Information Analysis Incorporated**  
**Exhibit Index**

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<b>Exhibit No.</b>	<b>Description</b>	<b>Location</b>
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