

INFORMATION ANALYSIS INC
Form 10-Q
May 17, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2010

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

Commission File Number 0-22405

Information Analysis Incorporated

(Exact Name of Registrant as Specified in Its Charter)

Virginia
(State or other jurisdiction of
incorporation or organization)

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

11240 Waples Mill Road
Suite 201
Fairfax, Virginia 22030
(703) 383-3000

(Address including zip code, and telephone number, including area code, of principal executive offices)

Not applicable

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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 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. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of May 14, 2010, 11,196,760 shares of common stock, par value \$0.01 per share, of the registrant were outstanding.

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INFORMATION ANALYSIS INCORPORATED**BALANCE SHEETS**

(Unaudited)

| | March 31, 2010 | December 31, 2009 |
|--|-------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 1,378,659 | \$ 1,478,504 |
| Accounts receivable, net | 1,793,756 | 940,206 |
| Prepaid expenses | 939,362 | 688,914 |
| Total current assets | 4,111,777 | 3,107,624 |
| Fixed assets, net | 35,713 | 36,434 |
| Other assets | 6,281 | 6,281 |
| Total assets | \$ 4,153,771 | \$ 3,150,339 |
| LIABILITIES & STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 504,616 | \$ 89,560 |
| Deferred revenue | 1,114,369 | 779,367 |
| Other accrued liabilities | 447,392 | 306,910 |
| Accrued payroll and related liabilities | 257,162 | 254,918 |
| Total current liabilities | 2,323,539 | 1,430,755 |
| 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 | 14,560,267 | 14,553,386 |
| Accumulated deficit | (11,928,217) | (12,031,984) |
| Treasury stock, 1,642,616 shares at cost | (930,211) | (930,211) |
| Total stockholders' equity | 1,830,232 | 1,719,584, |
| Total liabilities and stockholders' equity | \$ 4,153,771 | \$ 3,150,339 |

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)

| | For the three months ended March 31, | |
|--|---|--------------------|
| | 2010 | 2009 |
| Sales | | |
| Professional fees | \$ 1,513,219 | \$ 1,101,003 |
| Software sales | 502,348 | 293,448 |
| Total sales | 2,015,567 | 1,394,451 |
| Cost of sales | | |
| Cost of professional fees | 790,521 | 795,906 |
| Cost of software sales | 421,853 | 198,113 |
| Total cost of sales | 1,212,374 | 994,019 |
| Gross profit | 803,193 | 400,432 |
| Selling, general and administrative expenses | 701,732 | 467,026 |
| Income (loss) from operations | 101,461 | (66,594) |
| Other income, net | 2,306 | 4,250 |
| Income (loss) before provision for income taxes | 103,767 | (62,344) |
| Provision for income taxes | | |
| Net income (loss) | \$ 103,767 | \$ (62,344) |
| 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 | 11,202,893 | 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)

| | For the three months ended March 31, | |
|--|---|---------------------|
| | 2010 | 2009 |
| Cash flows from operating activities: | | |
| Net income (loss) | \$ 103,767 | \$ (62,344) |
| Adjustments to reconcile net income (loss) to net cash used by operating activities: | | |
| Stock option compensation | 6,881 | 1,059 |
| Depreciation and amortization | 6,198 | 8,430 |
| Changes in operating assets and liabilities | | |
| Accounts receivable | (853,550) | 239,891 |
| Other assets and prepaid expenses | (250,448) | 112,476 |
| Accounts payable and accrued expenses | 557,782 | (531,735) |
| Deferred revenue | 335,002 | (177,093) |
| Net cash used in operating activities | (94,368) | (409,316) |
| Cash flows from investing activities: | | |
| Acquisition of furniture and equipment | (5,477) | (3,061) |
| Net cash used in investing activities | (5,477) | (3,061) |
| Net decrease in cash and cash equivalents | (99,845) | (412,377) |
| Cash and cash equivalents, beginning of the period | 1,478,504 | 1,549,335 |
| Cash and cash equivalents, end of the period | \$ 1,378,659 | \$ 1,136,958 |
| 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

First Quarter 2010 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 and not misleading presentation of the results of the interim periods presented. These unaudited financial statements should be read in conjunction with our audited financial statements for the year ended December 31, 2009 included in the Annual Report on Form 10-K filed by the Company with the Securities and Exchange Commission on March 31, 2010. The results of operations for any interim period are not necessarily indicative of the results of operations for any other interim period or for a full fiscal year.

2. Summary of Significant Accounting Policies

Operations

Information Analysis Incorporated (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.

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

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

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2. Summary of Significant Accounting Policies (continued)

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.

Segment Reporting

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

Cash and Cash Equivalents

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

Accounts Receivable

Accounts receivable consist of trade accounts receivable and do not bear interest. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company reviews its allowance for doubtful accounts monthly. Accounts with receivable balances past due over 90 days are reviewed individually for collectability. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The Company does not have any off-balance sheet credit exposure related to its customers. The Company has recorded an allowance for doubtful accounts of \$29,918 at March 31, 2009 and December 31, 2009.

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

At March 31, 2010, the Company had the stock-based compensation plans described in Note 3 below. Total compensation expense related to these plans was \$6,881 and \$1,059 for the quarters ended March 31, 2010 and 2009, respectively, of which \$5,250 and \$0, respectively, related to options awarded to non-employees. The Company estimates the fair value of options granted to establish the expense using the Black-Scholes valuation model.

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.

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2. Summary of Significant Accounting Policies (continued)**Recent Accounting Pronouncements adopted**

In May 2009, the FASB issued guidance regarding subsequent events, which was subsequently updated in February 2010. This guidance established 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. In particular, this guidance sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. This guidance was effective for financial statements issued for fiscal years and interim periods ending after June 15, 2009, and was therefore adopted by the Company for the quarter ended September 30, 2009. The adoption did not have a significant impact on the subsequent events that the Company reports, either through recognition or disclosure, in the financial statements. In February 2010, the FASB amended its guidance on subsequent events to remove the requirement to disclose the date through which an entity has evaluated subsequent events, alleviating conflicts with current SEC guidance. This amendment was effective immediately and therefore the Company did not include the disclosure in this Form 10-Q

Recent Accounting Pronouncements not yet adopted

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. The Company is currently evaluating the impact the adoption of this update might have on its 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

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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. The Company is currently evaluating the impact the adoption of this update might have on its results of operations and financial condition.

Income Taxes

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

Fair Market Value of Financial Instruments

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

3. Stock Options and Warrants

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

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

The Company recognizes compensation costs only for those shares expected to vest on a straight-line basis over the requisite service period of the awards, generally, the option vesting term of six months to two years. The fair values of option awards granted in the three months ending March 31, 2010 and 2009 were estimated using the Black-Sholes option pricing model under the following assumptions:

| | Three Months ended March 31, 2010 | | Three months ended March 31, 2009 | |
|----------------------------------|--|-------|--|-------|
| Risk free interest rate | 2.42% | 3.66% | 1.60% | 1.87% |
| Dividend yield | 0% | | 0% | |
| Expected term | 5-10 years | | 5 years | |
| Expected volatility | 63.3% | 97.6% | 59.1% | 59.4% |
| <i>2006 Stock Incentive Plan</i> | | | | |

The Company has a stock incentive plan, which became effective May 18, 2006, and expires May 17, 2016 (the 2006 Plan). The 2006 Plan provides for the granting of equity awards to key employees, including officers and directors. The maximum number of shares for which equity awards may be granted under the 2006 Plan is 950,000. Options under the 2006 Plan expire no later than ten years from the date of grant or when employment ceases, whichever comes first, and vest over periods determined by the Board of Directors. The average vesting periods for options granted to employees under the 2006 Plan in the three months ended March 31, 2010 and 2009, were fourteen months and eighteen months, respectively. The exercise price of each option equals the quoted market price of the Company's stock on the date of grant.

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3. Stock Options and Warrants (continued)*1996 Stock Option Plan*

The 1996 Plan provided for the granting of options to purchase shares of our common stock to key employees, including officers and directors. The maximum number of shares for which options could be granted under the 1996 Plan was 3,075,000. Options expire no later than ten years from the date of grant or when employment ceases, whichever comes first, and vest over periods determined by the Board of Directors. There were 618,500 and 622,000 unexpired exercisable options remaining from the 1996 Plan at March 31, 2010 and December 31, 2009, respectively.

The status of the options issued under the foregoing option plans as of March 31, 2010, and changes during the quarters ended March 31, 2010 and 2009, were as follows:

| | Options outstanding | Weighted |
|---|---------------------|---------------|
| | Number of | average price |
| | shares | per share |
| Balance at December 31, 2009 | 1,019,000 | \$ 0.33 |
| Options granted | 98,000 | 0.18 |
| Options exercised, expired or forfeited | 4,250 | 0.53 |
| Balance at March 31, 2010 | 1,112,750 | \$ 0.31 |
| 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 |

The following table summarizes information about options at March 31, 2010:

| Total shares | Options outstanding | | | Total shares | Options exercisable | | |
|--------------|---------------------------------|--|---------------------------|--------------|---------------------------------|--|---------------------------|
| | Weighted average exercise price | Weighted average remaining contractual life in years | Aggregate intrinsic value | | Weighted average exercise price | Weighted average remaining contractual life in years | Aggregate intrinsic value |
| 1,112,750 | \$ 0.31 | 5.00 | \$ 5,338 | 967,500 | \$ 0.33 | 4.33 | \$ 1,718 |

Nonvested stock awards as of March 31, 2010 and changes during the quarter ended March 31, 2010, were as follows:

| | Nonvested | Weighted |
|------------------------------|-----------|-----------------|
| | Number of | average grant |
| | shares | date fair value |
| Balance at December 31, 2009 | 56,250 | \$ 0.08 |
| Granted | 98,000 | 0.12 |
| Vested | 8,250 | 0.07 |

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| | | |
|---------------------------|---------|------|
| Expired before vesting | 750 | 0.04 |
| Balance at March 31, 2010 | 145,250 | 0.11 |

As of March 31, 2010 and 2009, unrecognized compensation cost associated with non-vested share-based employee and non-employee compensation totaled \$6,070 and \$2,296, respectively, which are expected to be recognized over weighted average periods of 6 months and 7 months, respectively.

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

The Board of Directors may also grant warrants to directors, employees and others. There were no warrants issued or exercised in the three months ended March 31, 2010 and in fiscal years 2009 or 2008. There were no warrants exercised in 2009 or in 2008. As of March 31, 2010 and 2009, outstanding warrants were 0 and 12,000, respectively. The purchase price for shares issued upon exercise of these warrants was \$0.01 per share. These warrants were immediately exercisable.

4. Earnings Per Share

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

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

| | Net Income | Shares | Per Share Amount |
|---|-----------------------|---------------|---------------------------------|
| Basic net income per common share for the three months ended March 31, 2010: | | | |
| Income available to common stockholders | \$ 103,767 | 11,196,760 | \$ 0.01 |
| Effect of dilutive stock options | | 6,133 | |
| Diluted net income per common share for the three months ended March 31, 2010: | \$ 103,767 | 11,202,893 | \$ 0.01 |
| Basic net loss per common share for the three months ended March 31, 2009: | | | |
| Income available to common stockholders | (\$ 62,344) | 11,196,760 | (\$ 0.01) |
| Effect of dilutive stock options and warrants | | | |
| Diluted net loss per common share for the three months ended March 31, 2009: | (\$ 62,344) | 11,196,760 | (\$ 0.01) |

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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, 2009 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; and

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

Our Business

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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.

Three of our customers, two of which are government agencies with which we contract directly and one of which is a company with which we contract for services to government agencies, represent material portions of our revenue. These customers accounted for 29.3%, 19.4% and 14.5% of revenue in the first quarter, respectively.

Three Months Ended March 31, 2010 versus Three Months Ended March 31, 2009

Revenue

Our revenues in the first quarter of 2010 were \$2,015,567, compared to \$1,394,451 in 2009, an increase of 44.5%. Professional services revenue was \$1,513,219 versus \$1,101,003, an increase of 37.4%, and software product and maintenance revenue was \$502,348 versus \$293,448, an increase of 71.2%. The increase in professional services revenue is due an increase in our electronic forms-related services. The increase in software product and maintenance revenue is primarily due to a few substantial software maintenance 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 \$803,193, or 39.8% of sales, in the first quarter of 2010 versus \$400,432, or 28.7% of sales, in the first quarter of 2009. \$722,698 of the gross margin was attributable to professional services at a gross margin percentage of 47.8%, and \$80,495 of the gross margin was attributable to software sales at a gross margin percentage of 16.0%. In the same quarter in 2009, we reported gross margins of \$305,097, or 27.7% of sales for professional services and \$95,335, or 32.5% of sales for software sales. Professional services gross margin and gross margin as a percentage of sales increased due

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mainly to the addition of new forms services contracts, some of which are shorter-term contracts. Forms services contracts generally include fixed price elements whose margins increase when we establish operating efficiencies with individual customers. We expect to continue to add contracts with better margins, though we have several contracts with more limited margins that have rights to exercise option years with only limited incremental increases in the prices of deliverables. Our decrease in the dollar value of gross margin on software sales - despite an increase in revenue on software sales - is due to increasing prices from third party software suppliers in conjunction with the need to discount prices to win contracts over competitors. 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 \$701,732, or 34.8% of revenues, in the first quarter of 2010 versus \$467,026, or 33.5% of revenues, in the first quarter of 2009. This increase of \$234,706, or 50.3%, is due almost entirely to the increase in incentives earned by our marketing personnel as a result of our increases in both revenue and gross margin on services.

Net income (loss)

Net income for the three months ended March 31, 2010, was \$103,767, or 5.1% of revenue, versus a net loss of (\$62,344), or (4.5%) of revenue, for the same period in 2009. The increase in profitability is due to the addition or expansion of forms services contracts, which generally include fixed price elements, and the operating efficiencies we establish on these fixed-price forms-related contracts.

Liquidity and Capital Resources

In the third and fourth quarters of 2009 and the first quarter of 2010, we had operating income of \$120,756, \$96,386 and \$101,461, respectively, and net income of \$122,109, \$98,314 and \$103,767, respectively. Our December 31, 2009 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 and investing activities in the first quarter was \$99,845, which when subtracted from a beginning balance of \$1,478,504 at December 31, 2009, yielded cash and cash equivalents of \$1,378,659 at March 31, 2010. Our accounts receivable balances increased \$853,550 in the first 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 \$557,782, due largely to the cost side of the new software product sales contracts. Our prepaid expenses and deferred revenue balances increased \$250,448 and \$335,002, respectively, due to the sales of software maintenance contracts for which we recognize revenue 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, 2005, and expires on December 1, 2010. As of March 31, 2010, no amounts were outstanding under this line of credit. At March 31, 2010, our allowable borrowings were the maximum of \$1,000,000 based on our outstanding accounts receivable.

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

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. (Removed and Reserved)**Item 4T. Controls and Procedures***Evaluation of Disclosure Controls and Procedures*

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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

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Information Analysis Incorporated

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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 March 31, 2010 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, 2009 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, 2009. 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, 2009.

Item 6. Exhibits

(a) Exhibits: See Exhibit Index on page 14.

SIGNATURES

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

Information Analysis Incorporated

(Registrant)

Date: May 17, 2010

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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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 |