INFORMATION ANALYSIS INC
Form 10-Q
August 14, 2012

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

Form 10-Q

(Mark One)

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2012

OR

o 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	54-1167364
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

11240 Waples Mill Road
Suite 201
Fairfax, Virginia 22030

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

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

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

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 þ No o

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	o	Accelerated filer	o
Non-accelerated filer (Do not check if a smaller reporting company)	o	Smaller reporting company	þ

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

As of August 4, 2012, 11,201,760 shares of common stock, par value $0.01 per share, of the registrant were outstanding.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

INFORMATION ANALYSIS INCORPORATED
BALANCE SHEETS
(Unaudited)

	June 30, 2012		December 31, 2011	
ASSETS				
Current assets:				
Cash and cash equivalents	$	2,269,024	$	1,280,926
Accounts receivable, net		1,057,125		2,889,658
Prepaid expenses		446,273		787,290
Notes receivable - employees, current		16,808		6,668
Total current assets		3,789,230		4,964,542
Fixed assets, net		39,037		40,440
Note receivable - employee, long-term		865		4,287
Other assets		6,281		6,281
Total assets	$	3,835,413	$	5,015,550
LIABILITIES & STOCKHOLDERS' EQUITY				
Current liabilities:				
Accounts payable	$	206,263	$	998,160
Commissions payable		782,424		679,498
Deferred revenue		442,899		939,783
Accrued payroll and related liabilities		274,584		247,885
Other accrued liabilities		56,447		107,235
Income taxes payable		--		2,800
Total current liabilities		1,762,617		2,975,361
Stockholders' equity:				
Common stock, par value $0.01, 30,000,000 shares authorized; 12,844,376 and 12,839,376 shares issued, 11,201,760 and 11,196,760 shares outstanding as of June 30, 2012 and December 31, 2011, respectively		128,443		128,393
Additional paid-in capital		14,577,791		14,574,128
Accumulated deficit		(11,703,227)		(11,732,121)
Treasury stock, 1,642,616 shares at cost		(930,211)		(930,211)
Total stockholders' equity		2,072,796		2,040,189
Total liabilities and stockholders' equity	$	3,835,413	$	5,015,550

The accompanying notes are an integral part of the financial statements

INFORMATION ANALYSIS INCORPORATED
STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
(Unaudited)

	For the three months ended June 30,	
	2012	2011
Sales		
Professional fees	$1,362,747	$1,147,873
Software sales	1,071,844	472,608
Total sales	2,434,591	1,620,481
Cost of sales		
Cost of professional fees	698,997	691,965
Cost of software sales	1,018,864	365,891
Total cost of sales	1,717,861	1,057,856
Gross profit	716,730	562,625
Selling, general and administrative expenses	464,333	376,257
Commissions on sales	202,520	141,060
Income from operations	49,877	45,308
Other income, net	1,567	1,974
Income before provision for income taxes	51,444	47,282
Provision for income taxes	--	--
Net income	$51,444	$47,282
Comprehensive income	$51,444	$47,282
Earnings per common share:		
Basic:	$0.00	$0.00
Diluted:	$0.00	$0.00
Weighted average common shares outstanding:		
Basic	11,199,782	11,196,760
Diluted	11,211,582	11,213,466

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 six months ended June 30,	
	2012	2011
Sales		
Professional fees	$2,527,996	$2,251,200
Software sales	1,420,585	793,018
Total sales	3,948,581	3,044,218
Cost of sales		
Cost of professional fees	1,375,630	1,284,981
Cost of software sales	1,323,533	642,174
Total cost of sales	2,699,163	1,927,155
Gross profit	1,249,418	1,117,063
Selling, general and administrative expenses	872,413	764,986
Commissions on sales	351,169	317,997
Income from operations	25,836	34,080
Other income, net	3,058	4,107
Income before provision for income taxes	28,894	38,187
Provision for income taxes	--	--
Net income	$28,894	$38,187
Comprehensive income	$28,894	$38,187
Earnings per common share:		
Basic:	$0.00	$0.00
Diluted:	$0.00	$0.00
Weighted average common shares outstanding:		
Basic	11,198,271	11,196,760
Diluted	11,215,117	11,209,229

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 six months ended June 30, 2012	2011
Cash flows from operating activities:		
Net income	$28,894	$38,187
Adjustments to reconcile net income to		
net cash provided by operating activities:		
Depreciation and amortization	13,021	9,338
Stock option compensation	3,363	4,846
Bad debt expense	1,020	1,138
Changes in operating assets and liabilities		
Accounts receivable	1,831,513	(137,968)
Other receivables and prepaid expenses	341,017	270,480
Accounts payable and accrued expenses	(815,986)	26,463
Commissions payable	102,926	69,125
Deferred revenue	(496,884)	(276,445)
Income taxes payable	(2,800)	--
Net cash provided by operating activities	1,006,084	5,164
Cash flows from investing activities:		
Payments received on notes receivable - employees	3,305	3,191
Increase in notes receivable - employees	(10,023)	--
Acquisition of furniture and equipment	(11,618)	(6,189)
Net cash used in investing activities	(18,336)	(2,998)
Cash flows from financing activities:		
Proceeds from exercise of stock options	350	--
Net cash provided by financing activities	350	--
Net increase in cash and cash equivalents	988,098	2,166
Cash and cash equivalents, beginning of the period	1,280,926	1,968,077
Cash and cash equivalents, end of the period	$2,269,024	$1,970,243
Supplemental cash flow information		
Interest paid	$--	$--
Income taxes paid	$2,800	$--

The accompanying notes are an integral part of the financial statements

INFORMATION ANALYSIS INCORPORATED

NOTES TO FINANCIAL STATEMENTS

1. Basis of Presentation

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

2. Summary of Significant Accounting Policies

Operations

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

Revenue Recognition

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

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

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

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

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

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

2. Summary of Significant Accounting Policies (continued)

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

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

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

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

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

Government Contracts

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

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 $90,582 at June 30, 2012 and $141,721 at December 31, 2011.

Notes Receivable - employees

Notes receivable - employees consists of two notes issued to non-officer employees of the Company which were outstanding as of June 30, 2012 and one note issued to a non-officer employee of the Company which was outstanding as of December 30, 2011. The note that was outstanding at both periods reported bears interest compounded at 3.5%, requires equal semi-monthly payments, and will mature on August 10, 2013. The other note, which was only outstanding as of June 30, 2012, bears simple interest of 3.5%, and requires a lump-sum payment on October 7, 2012.

2. Summary of Significant Accounting Policies (continued)

Stock-Based Compensation

Total compensation expense was $1,787 and $1,462 for the quarters ended June 30, 2012 and 2011, respectively, of which $0 related to options awarded to non-employees. For the six months ended June 30, 2012 and 2011, total compensation expense was $3,363 and $4,846, respectively, of which $550 and $0, respectively, related to options awarded to non-employees. The Company estimates the fair value of options granted using a Black-Scholes valuation model to establish the expense. When stock-based compensation is awarded to employees, the expense is recognized ratably over the vesting period. When stock-based compensation is awarded to non-employees, the expense is recognized immediately.

Earnings Per Share

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

Reclassifications

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

Subsequent Events

The Company has evaluated the period from June 30, 2012, the date of the financial statements, through the date of the issuance and filing of the financial statements, and has determined that no material subsequent events have occurred that would affect the information presented in these financial statements or require additional disclosure.

3. Stock Options

There were 42,500 option awards granted to employees and no option awards granted to non-employees in the three months ended June 30, 2012 and there were 35,500 option awards granted to employees and no option awards granted to non-employees in the three months ended June 30, 2011. There were 102,500 option awards granted to employees and 5,000 option awards granted to non-employees in the six months ended June 30, 2012 and there were 10,000 option awards granted to employees and no option awards granted to non-employees in the six months ended June 30, 2011. The fair values of option awards granted in the six months ended June 30, 2012 and 2011, were estimated using a Black-Scholes option pricing model using the following assumptions:

	Three Months ended June 30,		Six Months ended June 30,	
	2012	2011	2012	2011
Risk free interest rate	0.75 – 1.10 %	1.65 – 1.72 %	0.75 – 2.31 %	1.65 - 2.30 %
Dividend yield	0 %	0 %	0 %	0 %

Expected term	5 years	5 years	5-10 years	5 years
Expected volatility	62.8 %	61.7 %	62.8 - 67.9 %	61.7 – 61.9 %

3. Stock Options (continued)

The status of the options issued as of June 30, 2012, and changes during the six months ended June 30, 2012 and 2011, were as follows:

	Options outstanding	
	Number of shares	Weighted average price per share
Balance at December 31, 2011	1,003,000	$ 0.31
Options granted	65,000	0.15
Options exercised, expired or forfeited	28,000	0.36
Balance at March 31, 2012	1,040,000	$ 0.30
Options granted	42,500	0.15
Options exercised	5,000	0.07
Options expired or forfeited	20,000	0.20
Balance at June 30, 2012	1,057,500	$ 0.29

	Options outstanding	
	Number of shares	Weighted average price per share
Balance at December 31, 2010	1,119,000	$ 0.30
Options granted	10,000	0.16
Options exercised, expired or forfeited	4,500	0.27
Balance at March 31, 2011	1,124,500	$ 0.30
Options granted	35,500	0.17
Options exercised, expired or forfeited	--	--
Balance at June 30, 2011	1,160,000	$ 0.29

The following table summarizes information about options at June 30, 2012:

Options outstanding				Options exercisable			
Total shares	Weighted average exercise price	Weighted average remaining contractual life in years	Aggregate intrinsic value	Total shares	Weighted average exercise price	Weighted average remaining contractual life in years	Aggregate intrinsic value
1,057,500	$ 0.29	4.69	$ 1,770	947,250	$ 0.31	4.12	$ 1,770

Nonvested stock awards as of June 30, 2012 and changes during the six months ended June 30, 2012, were as follows:

Nonvested

	Number of shares	Weighted average grant date fair value
Balance at December 31, 2011	60,000	$ 0.09
Granted	65,000	0.08
Vested	18,500	0.11
Expired before vesting	6,000	0.09
Balance at March 31, 2012	100,500	$ 0.08
Granted	42,500	0.08
Vested	22,750	0.09
Expired before vesting	10,000	0.08
Balance at June 30, 2012	110,250	$ 0.08

3. Stock Options (continued)

As of June 30, 2012 and 2011, unrecognized compensation cost associated with non-vested share-based employee and non-employee compensation totaled $6,598 and $4,085, respectively, which are expected to be recognized over weighted average periods of 7 months and 9 months, respectively.

4. Earnings Per Share

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

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

	Net Income	Shares	Per Share Amount
Basic net income per common share for the three months ended June 30, 2012:			
Income available to common stockholders	$51,444	11,199,782	$0.00
Effect of dilutive stock options	-	11,800	-
Diluted net income per common share for the three months ended June 30, 2012:	$51,444	11,211,582	$0.00
Basic net income per common share for the six months ended June 30, 2012:			
Income available to common stockholders	$28,894	11,198,271	$0.00
Effect of dilutive stock options	-	16,846	-
Diluted net income per common share for the six months ended June 30, 2012:	$28,894	11,215,117	$0.00
Basic net income per common share for the three months ended June 30, 2011:			
Income available to common stockholders	$47,282	11,196,760	$0.00
Effect of dilutive stock options	-	16,706	-
Diluted net income per common share for the three months ended June 30, 2011:	$47,282	11,213,466	$0.00
Basic net income per common share for the six months ended June 30, 2011:			
Income available to common stockholders	$38,187	11,196,760	$0.00
Effect of dilutive stock options	-	26,103	-
Diluted net income per common share for the six months ended June 30, 2011:	$38,187	11,222,863	$0.00

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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, 2011 and in other filings with the Securities and Exchange Commission.

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

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

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

Our Business

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

Three of our customers, one of which is a U.S. government agency with which we contract directly and two of which are companies with which we contract for services to U.S. government agencies represent material portions of our revenue. These customers accounted for 31.6% (direct) and 20.8%, and 20.0% (under subcontract) of revenue in the first six months of 2012.

Three Months Ended June 30, 2012 versus Three Months Ended June 30, 2011

Revenue

Our revenues in the second quarter of 2012 were $2,434,591, compared to $1,620,481 in 2011, an increase of 50.2%. Professional services revenue was $1,362,747 versus $1,147,873, an increase of 18.7%, and software product and maintenance revenue was $1,071,844 versus $472,608, an increase of 126.8%. The increase in professional services revenue was due to new contracts and to increases in activity in some of our existing contracts in excess of the contracts that expired, were completed, and that decreased activity since June 30, 2011. The increase in our software product and maintenance revenue was primarily due to two new product and maintenance orders that were received in the second quarter of 2012 and a maintenance order that was received in December 2011. Software product sales and associated margins are subject to considerable fluctuation from period to period, based on the product mix sold.

Gross Margins

Gross margin was $716,730, or 29.4% of sales, in the second quarter of 2012 versus $562,625, or 34.7% of sales, in the second quarter of 2011. For the quarter ended June 30, 2012, $663,750 of the gross margin was attributable to professional services at a gross margin percentage of 48.7%, and $52,980 of the gross margin was attributable to software sales at a gross margin percentage of 4.9%. In the same quarter in 2011, we reported gross margins of $455,908, or 39.7% of sales for professional services and $106,717, or 22.6% of sales for software sales. Gross margin on professional services increased in terms of both dollars and as a percentage of sales due to the addition of or increased activity of some more profitable services contracts and cost containment on fixed price contracts. Gross margin on software sales decreased in terms of both dollars and as a percentage of sales despite increases in revenue due to significantly narrower margins on existing product lines. Software product sales and associated margins are subject to considerable fluctuation from period to period, based on the product mix sold.

Selling, General and Administrative

Selling, general and administrative expenses, exclusive of sales commissions, were $464,333, or 19.1% of revenues, in the second quarter of 2012 versus $376,257, or 23.2% of revenues, in the second quarter of 2011. These expenses increased $88,076, or 23.4%, due largely to increases in overhead labor and fringe benefits applied to overhead labor.

Commission expense was $202,520, or 8.3% of revenues, in the second quarter of 2012 versus $141,060, or 8.7% of revenues, in the second quarter of 2011. This increase of $61,460, or 43.6%, is due to the increase in incentives earned by our sales and marketing personnel, which fluctuate with gross margins and operating income at varying rates for each salesperson.

Net Income

Net income for the three months ended June 30, 2012, was $51,444, or 2.1% of revenue, versus net income of $47,282, or 2.9 % of revenue, for the same period in 2011. The increase in net income is due to new business in professional services, while the decrease in net income as a percentage of revenue is due to the increase in software product and maintenance sales with significantly lesser margins relative to professional services.

Six Months Ended June 30, 2012 versus Six Months Ended June 30, 2011

Revenue

Our revenues in the first six months of 2012 were $3,948,581, compared to $3,044,218 in 2011, an increase of 29.7%. Professional services revenue was $2,527,996 versus $2,251,200, an increase of 12.3%, and software product and maintenance revenue was $1,420,585 versus $793,018, an increase of 79.1%. The increase in professional services revenue was due to new contracts and to increases in activity in some of our existing contracts in excess of the contracts that expired, were completed, and that decreased activity since June 30, 2011. The increase in our software product and maintenance revenue was primarily due to two new product and maintenance orders that were received in the second quarter of 2012 and a maintenance order that was received in December 2011. Software product sales and associated margins are subject to considerable fluctuation from period to period, based on the product mix sold.

Gross Margins

Gross margin was $1,249,418, or 31.6% of sales, in the first six months of 2012 versus $1,117,063, or 36.7% of sales, in the first six months of 2011. For the six months ended June 30, 2012, $1,152,366 of the gross margin was attributable to professional services at a gross margin percentage of 45.6%, and $97,052 of the gross margin was attributable to software sales at a gross margin percentage of 6.8%. In the same period in 2011, we reported gross margins of $966,219, or 42.9% of sales for professional services and $150,844, or 19.0% of sales for software sales. Gross margin on professional services increased in terms of both dollars and as a percentage of sales due to the addition of or increased activity of some more profitable services contracts and cost containment on fixed price contracts. Gross margin on software sales decreased in terms of both dollars and as a percentage of sales despite increases in revenue due to significantly narrower margins on existing product lines. Software product sales and associated margins are subject to considerable fluctuation from period to period, based on the product mix sold.

Selling, General and Administrative

Selling, general and administrative expenses, exclusive of sales commissions, were $872,413, or 22.1% of revenues, in the first six months of 2012 versus $764,986, or 25.1% of revenues, in the first six months of 2011. These expenses increased $107,427, or 14.0%, due largely to increases in overhead labor and fringe benefits applied to overhead labor.

Commission expense was $351,169, or 8.9% of revenues, in the first six months of 2012 versus $317,997, or 10.4% of revenues, in the first six months of 2011. This increase of $33,172, or 10.4%, is due to the increase in incentives earned by our sales and marketing personnel, which fluctuate with gross margins and operating income at varying rates for each salesperson.

Net Income

Net income for the six months ended June 30, 2012, was $28,894, or 0.7% of revenue, versus net income of $38,187, or 1.3 % of revenue, for the same period in 2011. The decrease in net income is due to decreases in margins on product and maintenance sales, for which sales increased while gross margins decreased.

Liquidity and Capital Resources

Our cash and cash equivalents balance, when combined with our cash flow from operations during the first six months of 2012, were sufficient to provide financing for our operations. Our net cash provided by combining our operating, investing, and financing activities in the first six months of 2012 was $988,098. Our net cash provided, when added to a beginning balance of $1,280,926 yielded cash and cash equivalents of $2,269,024 as of June 30, 2012. Our accounts receivable balances decreased $1,831,513 and our accounts payable balances decreased $815,986, primarily due to product-related invoices that were outstanding at the prior year end. We had no non-current liabilities as of June 30, 2012.

We have a revolving line of credit with a bank providing for demand or short-term borrowings of up to $1,000,000. The line became effective December 20, 2005, and expires on December 1, 2012. As of June 30, 2012, no amounts were outstanding under this line of credit. At June 30, 2012, $838,000 was available under this line of credit based on our outstanding accounts receivable.

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

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

We have no material commitments for capital expenditures.

We have no off-balance sheet arrangements.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

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

Changes in Internal Controls over Financial Reporting

There were no changes in the Company's internal control over financial reporting during the quarter ended June 30, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

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

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 1A. RISK FACTORS

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

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

31.1	Certification of Chief Executive Officer Pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934
31.2	Certification of Chief Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

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

	Information Analysis Incorporated (Registrant)
Date: August 15, 2012	By: /s/ Sandor Rosenberg Sandor Rosenberg, Chairman of the Board, Chief Executive Officer, and President
Date: August 15, 2012	By: /s/ Richard S. DeRose Richard S. DeRose, Executive Vice President, Treasurer, and Chief Financial Officer