

INFORMATION ANALYSIS INC  
Form 10QSB  
August 09, 2006

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-QSB**

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(Mark One)

**QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2006

**TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-22405

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**INFORMATION ANALYSIS INCORPORATED**

(Exact name of small business issuer as specified in its charter)

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**Virginia**  
(State or other jurisdiction of

incorporation or organization)

11240 Waples Mill Road, Suite 201, Fairfax, VA 22030

(Address of principal executive offices)

(703) 383-3000

(Issuer's telephone number)

**54-1167364**  
(IRS Employer

Identification No.)

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

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Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

**APPLICABLE ONLY TO CORPORATE ISSUERS**

State 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, 11,137,371 shares as of July 31, 2006

Transitional Small Business Disclosure Format (Check one): Yes  No

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## INFORMATION ANALYSIS INCORPORATED

## FORM 10-QSB

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## INFORMATION ANALYSIS INCORPORATED

## BALANCE SHEETS

	June 30, 2006 Unaudited	December 31, 2005
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 667,997	\$ 451,777
Accounts receivable, net	2,232,937	1,994,010
Prepaid expenses	324,084	183,282
Notes receivable	105,050	85,000
Other assets	11,782	
Other receivables	4,397	15,326
<b>Total current assets</b>	<b>3,346,247</b>	<b>2,729,395</b>
Fixed assets, net	57,583	56,825
Other assets	2,500	8,782
<b>Total assets</b>	<b>\$ 3,406,330</b>	<b>\$ 2,795,002</b>
<b>LIABILITIES &amp; STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 1,137,065	\$ 1,174,677
Deferred revenue	440,316	213,876
Accrued payroll and related liabilities	327,471	321,209
Other accrued liabilities	129,871	125,048
Income taxes payable		4,500
<b>Total current liabilities</b>	<b>2,034,723</b>	<b>1,839,310</b>
Stockholders equity:		
Common stock, par value \$0.01, 30,000,000 shares authorized; 12,779,987 shares issued, 11,137,371 outstanding at June 30, 2006, and 12,127,626 shares issued, 10,623,015 outstanding at December 31, 2005	127,799	121,276
Additional paid in capital	14,458,048	14,212,165
Accumulated deficit	(12,272,029)	(12,511,436)
Accumulated other comprehensive loss	(12,000)	(12,000)
Treasury stock, 1,642,616 shares at June 30, 2006, and 1,504,611 shares at December 31, 2005, at cost	(930,211)	(854,313)
<b>Total stockholders equity</b>	<b>1,371,607</b>	<b>955,692</b>
<b>Total liabilities and stockholders equity</b>	<b>\$ 3,406,330</b>	<b>\$ 2,795,002</b>

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



## INFORMATION ANALYSIS INCORPORATED

## STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

	For the three months ended June 30,	
	2006 Unaudited	2005 Unaudited
Sales		
Professional fees	\$ 2,298,862	\$ 2,371,384
Software sales	269,948	634,397
Total sales	2,568,810	3,005,781
Cost of sales		
Cost of professional fees	1,703,225	1,837,147
Cost of software sales	225,050	563,858
Total cost of sales	1,928,275	2,401,005
Gross profit	640,535	604,776
Selling, general and administrative expenses	488,817	451,993
Income from operations	151,718	152,783
Other income (expenses), net	1,957	(4,589)
Income before provision for income taxes	153,675	148,194
Provision for income taxes		
Net income	\$ 153,675	\$ 148,194
Comprehensive income	\$ 153,675	\$ 148,194
Earnings per common share:		
Basic:	\$ 0.01	\$ 0.01
Diluted:	\$ 0.01	\$ 0.01
Weighted average common shares outstanding:		
Basic	11,035,507	10,296,527
Diluted	11,504,714	11,292,107

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

## INFORMATION ANALYSIS INCORPORATED

## STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

	For the six months ended	
	June 30,	
	2006	2005
	Unaudited	Unaudited
Sales		
Professional fees	\$ 4,494,890	\$ 4,486,479
Software sales	388,431	706,545
Total sales	4,883,321	5,193,024
Cost of sales		
Cost of professional fees	3,454,001	3,519,037
Cost of software sales	295,397	604,931
Total cost of sales	3,749,398	4,123,968
Gross profit	1,133,923	1,069,056
Selling, general and administrative expenses	897,541	840,379
Income from operations	236,382	228,677
Other income (expenses), net	3,025	(8,180)
Income before provision for income taxes	239,407	220,497
Provision for income taxes		
Net income	\$ 239,407	\$ 220,497
Comprehensive income	\$ 239,407	\$ 220,497
Earnings per common share:		
Basic:	\$ 0.02	\$ 0.02
Diluted:	\$ 0.02	\$ 0.02
Weighted average common shares outstanding:		
Basic	10,890,164	10,290,057
Diluted	11,399,119	11,151,036

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

## INFORMATION ANALYSIS INCORPORATED

## STATEMENTS OF CASH FLOWS

	For the six months ended June 30,	
	2006 Unaudited	2005 Unaudited
Cash flows from operating activities:		
Net income	\$ 239,407	\$ 220,497
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	15,075	10,967
Stock options compensation	4,158	
Reduction of accounts payable through issuance of equity		4,500
Changes in operating assets and liabilities		
Accounts receivable	(238,927)	(336,737)
Other receivables and prepaid expenses	(155,423)	(117,627)
Accounts payable and accrued expenses	(31,027)	301,506
Deferred revenue	226,440	85,129
Net cash provided by operating activities	59,703	168,235
Cash flows from investing activities:		
Purchases of fixed assets	(15,833)	(22,007)
Net cash used by investing activities	(15,833)	(22,007)
Cash flows from financing activities:		
Proceeds from exercise of stock options	172,350	4,450
Net payments under revolving line of credit		(185,681)
Net cash provided (used) by financing activities	172,350	(181,231)
Net increase (decrease) in cash and cash equivalents	216,220	(35,003)
Cash and cash equivalents at beginning of the period	451,777	115,917
Cash and cash equivalents at end of the period	\$ 667,997	\$ 80,914
Supplemental cash flow Information		
Interest paid	\$ 608	\$ 11,088

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



**PART I****Item 1. Financial Statements.****INFORMATION ANALYSIS INCORPORATED****NOTES TO FINANCIAL STATEMENTS****1. Basis of Presentation**

The accompanying financial statements have been prepared by Information Analysis Incorporated ( "IAI" or the "Company" ) pursuant to the rules and regulations of the Securities and Exchange Commission. Financial information included herein is unaudited; however, in the opinion of management, all adjustments (which include normal recurring adjustments) considered necessary for a fair presentation have been made. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted pursuant to such rules and regulations, but the Company believes that the disclosures made are adequate to make the information presented not misleading. For more complete financial information, these financial statements should be read in conjunction with the audited financial statements and notes thereto for the year ended December 31, 2005 included in the Company's annual report on Form 10-KSB. Results for interim periods are not necessarily indicative of the results for any other interim period or for the full fiscal year.

**2. Summary of Significant Accounting Policies****Operations**

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 provides services under various pricing arrangements. Revenue from cost-plus-fixed-fee contracts is recognized on the basis of reimbursable contract costs incurred during the period, plus a percentage of the fixed fee. Revenue from firm-fixed-price contracts is recognized as work is performed, with costs and estimated profits recorded on the basis of direct and indirect costs incurred. Revenue from time and material contracts is recognized on the basis of hours utilized, plus other reimbursable contract costs incurred during the period. Contract losses, if any, are accrued when their occurrence becomes known and the amount of the loss is reasonably determinable. Changes in job performance, job conditions and estimated profitability, including final contract settlements, may result in revisions to costs and income and are recognized in the period in which the revisions are determined.

Revenue from software sales is recognized upon delivery, when collection of the receivable is probable. Maintenance revenue is recognized ratably over the maintenance period.

**2. Summary of Significant Accounting Policies (cont.)****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. Audits by DCAA were completed through the year ended December 31, 1997. No amounts were changed as a result of the audits. Since the Company has entered into no cost plus fixed fee contracts since 1997, management is of the opinion that any disallowance of costs for subsequent fiscal years by government auditors, other than amounts already provided, will not materially affect the Company's 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. 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 \$0 and \$129,617 at June 30, 2006 and 2005, respectively.

**Fixed Assets**

Fixed assets are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized over the term of the lease or the estimated life of the improvement, whichever is shorter. Maintenance and minor repairs are charged to operations as incurred. Gains and losses on dispositions are recorded in current operations.

**Stock-Based Compensation**

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

At June 30, 2006, the Company had the stock-based compensation plans described below. Total compensation expense related to these plans was \$4,158 and \$6,198 for the six months ended June 30, 2006 and 2005, respectively, of which \$520 and \$228, respectively, related to options awarded to non-employees. Total compensation expense related to these plans was \$3,354 and \$2,916 for the three months ended June 30, 2006 and 2005, respectively, of which \$0 and \$114, respectively, related to options awarded to non-employees.

**2. Summary of Significant Accounting Policies (cont.)**

Prior to January 1, 2006, the Company accounted for employee stock-based compensation in accordance with Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, (APB 25), under which no expense was recognized for options issued to employees where the exercise price is equal to or greater than the market value of the underlying security. Expense was recognized in the financial statements for options issued to employees where the option price is below the fair value of the underlying security, for options issued to non-employees, and for options and warrants issued in connection with financing and equity transactions (collectively referred to as compensatory options). Expense recognized for non-employee options is measured based on management's estimate of grant date fair value using the Black-Scholes model as service performance is completed. Any resulting compensation expense was recognized ratably over the related service period.

Prior to January 1, 2006, the Company provided pro forma disclosure of compensation amounts in accordance with Statement of Financial Accounting Standard No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure* (SFAS 148), as if the fair value method defined by SFAS 123 had been applied to its stock-based compensation to employees. The pro forma table below reflects net loss and basic and diluted net loss per share for the six months and three months ended June 30, 2005, as though the Company had adopted the fair value recognition provision of SFAS 123, as follows:

	<b>Six months</b>	<b>Three months</b>
Net income, as reported	\$ 220,497	\$ 148,194
Stock-based employee compensation cost that would have been included in the determination of net income if the fair-value method had been applied to all awards	(6,198)	(2,916)
Pro forma net income	\$ 214,299	\$ 145,278