INFORMATION ANALYSIS INC
Form 10-Q
November 14, 2018

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
September 30, 2018
or

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:
000-22405

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
(Address of principal executive offices, Zip Code)

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

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

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

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

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date:
11,201,760 shares of common stock, par value $0.01 per share, as of November 12, 2018.

INFORMATION ANALYSIS INCORPORATED
FORM 10-Q

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

INFORMATION ANALYSIS INCORPORATED
BALANCE SHEETS

	September 30, 2018	December 31, 2017
	(Unaudited)	(Note 1)
ASSETS		
Current assets		
Cash and cash equivalents	$2,053,691	$2,731,510
Accounts receivable, net	1,157,327	610,182
Prepaid expenses and other current assets	466,263	368,626
Contract assets	7,470	5,532
Notes receivable	-	1,719
Total current assets	3,684,751	3,717,569
Property and equipment, net of accumulated depreciation and amortization of $292,504 and $284,667	7,371	11,133
Other assets	6,281	6,281
Total assets	$3,698,403	$3,734,983
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$431,773	$47,658
Commissions payable	587,810	712,829
Contract liabilities	453,595	387,002
Accrued payroll and related liabilities	255,478	275,582
Other accrued liabilities	63,034	411,487
Franchise taxes payable	-	6,400
Total liabilities	1,791,690	1,840,958
Stockholders' equity		
Common stock, $0.01 par value, 30,000,000 shares authorized, 12,844,376 shares issued, 11,201,760 shares outstanding as of September 30, 2018, and December 31, 2017	128,443	128,443
Additional paid-in capital	14,670,288	14,646,406
Accumulated deficit	(11,961,807)	(11,950,613)

Treasury stock, 1,642,616 shares at cost at September 30, 2018 and December 31, 2017	(930,211)	(930,211)
Total stockholders' equity	1,906,713	1,894,025
Total liabilities and stockholders' equity	$3,698,403	$3,734,983

The accompanying notes are an integral part of the financial statements

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INFORMATION ANALYSIS INCORPORATED
STATEMENTS OF OPERATIONS
(Unaudited)

	For the three months ended September 30,	
	2018	2017
Revenues		
Professional fees	$1,111,358	$1,385,257
Software sales	1,307,319	1,346,537
Total revenues	2,418,677	2,731,794
Cost of revenues		
Cost of professional fees	575,200	776,404
Cost of software sales	1,274,371	1,319,499
Total cost of revenues	1,849,571	2,095,903
Gross profit	569,106	635,891
Selling, general and administrative expenses	409,761	386,929
Commissions expense	134,255	140,963
Income from operations	25,090	107,999
Other income	2,874	2,285
Income before provision for income taxes	27,964	110,284
Provision for income taxes	-	-
Net income	$27,964	$110,284
Net income per common share - basic	$-	$0.01
Net income per common share - diluted	$-	$0.01
Weighted average common shares outstanding		
Basic	11,201,760	11,201,760
Diluted	11,593,183	11,510,711

The accompanying notes are an integral part of the financial statements

INFORMATION ANALYSIS INCORPORATED
STATEMENTS OF OPERATIONS
(Unaudited)

	For the nine months ended September 30,	
	2018	2017
Revenues		
Professional fees	$3,429,153	$3,676,730
Software sales	4,091,819	4,592,828
Total revenues	7,520,972	8,269,558
Cost of revenues		
Cost of professional fees	1,828,542	1,990,383
Cost of software sales	4,017,549	4,506,099
Total cost of revenues	5,846,091	6,496,482
Gross profit	1,674,881	1,773,076
Selling, general and administrative expenses	1,319,790	1,231,863
Commissions expense	374,815	380,267
(Loss) income from operations	(19,724)	160,946
Other income	8,530	6,440
(Loss) income before provision for income taxes	(11,194)	167,386
Provision for income taxes	-	-
Net (loss) income	$(11,194)	$167,386
Net (loss) income per common share - basic	$-	$0.01
Net (loss) income per common share - diluted	$-	$0.01
Weighted average common shares outstanding		
Basic	11,201,760	11,201,760
Diluted	11,201,760	11,509,202

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 nine months ended September 30,	
	2018	2017
Cash flows from operating activities:		
Net (loss) income	$(11,194)	$167,386
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:		
Depreciation and amortization	7,837	13,670
Stock option compensation	23,882	6,618
Changes in operating assets and liabilities:		
Accounts receivable and contract assets	(549,083)	(651,813)
Prepaid expenses and other current assets	(97,637)	170,033
Accounts payable	384,115	909,315
Accrued payroll and related liabilities and other accrued liabilities	(374,957)	301,234
Commissions payable	(125,019)	(95,668)
Contract liabilities	66,593	(165,569)
Net cash (used in) provided by operating activities	(675,463)	655,206
Cash flows from investing activities		
Acquisition of property and equipment	(4,075)	-
Payments received on notes receivable	1,719	2,641
Increase in notes receivable	-	(2,500)
Net cash (used in) provided by investing activities	(2,356)	141
Net (decrease) increase in cash and cash equivalents	(677,819)	655,347
Cash and cash equivalents, beginning of the period	2,731,510	1,895,372
Cash and cash equivalents, end of the period	$2,053,691	$2,550,719
Supplemental cash flow Information		
Interest paid	$-	$-
Income taxes paid	$-	$-

The accompanying notes are an integral part of the financial statements

INFORMATION ANALYSIS INCORPORATED
NOTES TO FINANCIAL STATEMENTS

1.
Summary of Significant Accounting Policies

Organization and Business

Founded in 1979, Information Analysis Incorporated (the “Company”, “we”), to which we sometimes refer as IAI, is in the business of developing and maintaining information technology (IT) systems, modernizing client information systems, and performing professional services to government and commercial organizations. We presently concentrate our technology, services and experience to developing web-based and mobile device solutions (including electronic forms conversions), data analytics, cyber security applications, and legacy software migration and modernization for various agencies of the federal government. We provide software and services to government and commercial customers throughout the United States, with a concentration in the Washington, D.C. metropolitan area.

Unaudited Interim Financial Statements

The accompanying unaudited financial statements have been prepared in conformity with U.S. 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 and Exchange Commission (“SEC”). 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, 2017 included in the Annual Report on Form 10-K filed by the Company with the SEC on April 2, 2018 (the “Annual Report”). The accompanying December 31, 2017 balance sheet was derived from our audited financial statements included in the Annual Report. The results of operations for any interim periods are not necessarily indicative of the results of operations for any other interim period or for a full fiscal year.

There have been no changes in the Company’s significant accounting policies as of September 30, 2018 as compared to the significant accounting policies disclosed in Note 1, "Summary of Significant Accounting Policies" in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017, that was filed with the SEC on April 2, 2018, except as described in Note 2 herein.

Use of Estimates and Assumptions

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect certain reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results can, and in many cases will, differ from those estimates.

Income Taxes

As of September 30, 2018, there have been no material changes to the Company’s uncertain tax position disclosures as provided in Note 7 of the Annual Report. Through the filing of its 2017 federal income tax return, the Company has net operating loss carryforwards in the amount of $14,959,541, of which $7,750,305 will expire, if unused, on

December 31, 2018.

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ASC 606 Impact to Previously Reported Results

On January 1, 2018, we adopted the FASB-issued ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASC 606”) by applying the modified retrospective transition method to all of our contracts. Comparative information has not been restated and continues to be reported under the accounting standards in effect for the periods presented. Based on the results of our evaluation, the adoption of ASC 606 did not have a material impact on our revenue recognition policies. In addition, the adoption of ASC 606 did not have a material impact on our financial statements for the nine months ended September 30, 2018 and 2017. Additionally, the cumulative effect to the opening balance sheet on January 1, 2018, from the adoption of ASC 606 was not material.

Reclassification of Financial Statement Line Items

Certain financial statement line items presented in prior periods have been reclassified for consistency between the periods presented. Contract assets in the form of unbilled receivables have been disaggregated from accounts receivable, net, and deferred revenue has been reclassified as contract liabilities.

2.
Revenue from Contracts with Customers

Revenue is recognized when all of the following steps have been taken and criteria met for each contract:

Identification of the contract, or contracts, with a customer - A contract with a customer exists when (i) we enter into an enforceable contract with a customer that defines each party’s rights regarding the goods or services to be transferred and identifies the payment terms related to these goods or services, (ii) the contract has commercial substance and the parties are committed to perform and, (iii) we determine that collection of substantially all consideration to which we will be entitled in exchange for goods or services that will be transferred is probable based on the customer’s intent and ability to pay the promised consideration.

Identification of the performance obligations in the contract - Performance obligations promised in a contract are identified based on the goods or services that will be transferred to the customer that are both capable of being distinct, whereby the customer can benefit from the goods or service either on its own or together with other resources that are readily available from third parties or from us, and are distinct in the context of the contract, whereby the transfer of the goods or services is separately identifiable from other promises in the contract. To the extent a contract includes multiple promised goods or services, we apply judgment to determine whether promised goods or services are capable of being distinct and distinct in the context of the contract. If these criteria are not met the promised goods or services are accounted for as a combined performance obligation.

Determination of the transaction price - The transaction price is determined based on the consideration to which we will be entitled in exchange for transferring goods or services to the customer adjusted for estimated variable consideration, if any. We typically estimate the transaction price impact of discounts offered to the customers for early payments on receivables or rebates based on sales target achievements. Constraints are applied when estimating variable considerations based on historical experience where applicable.

Allocation of the transaction price to the performance obligations in the contract - If the contract contains a single performance obligation, the entire transaction price is allocated to the single performance obligation. Contracts that contain multiple performance obligations require an allocation of the transaction price to each performance obligation based on a relative standalone selling price basis. Determination of the standalone selling price requires judgement. We determine standalone selling price taking into account available information such as historical selling prices of the performance obligation, geographic location, overall strategic pricing objective, market conditions and internally approved pricing guidelines related to the performance obligations.

Recognition of revenue when, or as, we satisfy performance obligations - We satisfy performance obligations either over time or at a point in time as discussed in further detail below. Revenue is recognized at or over the time the related performance obligation is satisfied by transferring a promised good or service to a customer.

Nature of products and services

We generate revenue from the sales of information technology professional services, sales of third-party software licenses and implementation and training services, sales of third-party support and maintenance contracts based on those software products, and incentive payments received from third-party software suppliers for facilitating sales directly between that supplier and a customer introduced by us. We sell through our direct relationships with end customers and under subcontractor arrangements. We account for our performance obligations in accordance with ASC 606, and all related interpretations.

Professional services are offered through several arrangements – through time and materials arrangements, fixed-price-per-unit arrangements, fixed-price arrangements, or combinations of these arrangements within individual contracts. Revenue under time and materials arrangements is recognized over time in the period the hours are worked or the expenses are incurred, as control of the benefits of the work is deemed to have passed to the customer as the work is performed. Revenue under fixed-price-per-unit arrangements is recognized at a point in time when delivery of units have occurred and units are accepted by the customer or are reasonably expected to be accepted. Generally, revenue under fixed-price arrangements and mixed arrangements is recognized either over time or at a point in time based on the allocation of transaction pricing to each identified performance obligation as control of each is transferred to the customer. For fixed-price arrangements for which we are paid a fixed fee to make ourselves available to support a customer, with no predetermined deliverables to which transaction prices can be estimated or allocated, revenue is recognized ratably over time.

Third-party software licenses are classified as enterprise server-based software licenses or desktop software licenses, and desktop licenses are further classified by the type of customer and whether the licenses are bulk licenses or individual licenses. Our obligations as the seller for each class differ based on our reseller agreements and whether our customers are government or non-government customers. Revenue from enterprise server-based sales to either government or non-government customers is usually recognized in full at a point in time based on when the customer gains use of the full benefit of the licenses, after the licenses are implemented. If the transaction prices of the performance obligations related to implementation and customer support for the individual contract is material, these obligations are recognized separately over time, as performed. Revenue for desktop software licenses for government customers is usually recognized in full at a point in time, based on when the customer's administrative contact gains training in and beneficial use of the administrative portal. If the transaction prices of the performance obligations related to implementing the government administrator's use of the administrative portal and administrator support for the individual contract are material (rare), these obligations are recognized separately over time, as performed. Revenue for bulk desktop software licenses for non-government customers is usually recognized in full at a point in time, based on when the customer's administrative contact gains training in and beneficial use of the administrative portal. For desktop software licenses sold on an individual license basis to non-government customers, where we have no obligation to the customer after the third-party makes delivery of the licenses, we have determined we are acting as an agent, and we recognize revenue upon delivery of the licenses only for the net of the selling price and our contract costs.

Third-party support and maintenance contracts for enterprise server-based software include a performance obligation under our reseller agreements for us to be the first line of support (direct support) and second line of support (intermediary between customer and manufacturer) to the customer. Because of the support performance obligations, and because the amount of support is not estimable, we recognize revenue ratably over time as we make ourselves available to provide the support.

Incentive payments are received under reseller agreements with software manufacturers and suppliers where we introduce and court a customer, but the sale occurs directly between the customer and the supplier or between the

customer and the manufacturer. Since the transfer of control of the licenses cannot be measured from outside of these transactions, revenue is recognized when payment from the manufacturer or supplier is received.

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Disaggregation of Revenue from Contracts with Customers

Contract	Three months ended 9/30/2018		Three months ended 9/30/2017	
Type	Amount	Percentage	Amount	Percentage
Professional Services	$1,111,358	45.9%	$1,385,257	50.7%
Third-Party Software	1,153,091	47.7%	531,505	19.4%
Support & Maintenance	146,532	6.1%	807,535	29.6%
Incentive Payments	7,696	0.3%	7,497	0.3%
Total Revenue	$2,418,677		$2,731,794	

Contract	Nine months ended 9/30/2018		Nine months ended 9/30/2017	
Type	Amount	Percentage	Amount	Percentage
Professional Services	$3,429,153	45.6%	$3,676,730	44.5%
Third-Party Software	3,636,225	48.3%	2,645,082	32.0%
Support & Maintenance	440,544	5.9%	1,928,134	23.3%
Incentive Payments	15,050	0.2%	19,612	0.2%
Total Revenue	$7,520,972		$8,269,558	

Revenue	Three months ended 9/30/2018		Three months ended 9/30/2017	
Recognition Type	Amount	Percentage	Amount	Percentage

Time & Materials	$694,524	28.7%	$913,432	33.4%
Fixed-Price Ratably over Time	541,057	22.4%	561,337	20.5%
Fixed-Price per Unit	1,122,960	46.4%	1,127,107	41.3%
Mixed	52,440	2.2%	122,421	4.5%
Incentive Payments	7,696	0.3%	7,497	0.3%
Total Revenue	$2,418,677		$2,731,794	

Revenue	Nine months ended 9/30/2018		Nine months ended 9/30/2017	
Recognition Type	Amount	Percentage	Amount	Percentage
Time & Materials	$2,223,949	29.6%	$2,374,280	28.7%
Fixed-Price Ratably over Time	2,098,920	27.9%	1,733,911	21.0%
Fixed-Price per Unit	3,009,290	40.0%	3,867,576	46.8%
Mixed	173,763	2.3%	274,179	3.3%
Incentive Payments	15,050	0.2%	19,612	0.2%
Total Revenue	$7,520,972		$8,269,558	

Contract Balances

Accounts Receivable

Trade accounts receivable are recorded at the billable amount where we have the unconditional right to bill, net of allowances for doubtful accounts. The allowance for doubtful accounts is based on our assessment of the collectability of accounts. Management regularly reviews the adequacy of the allowance for doubtful accounts by considering the age of each outstanding invoice, each customer's expected ability to pay and collection history, when applicable, to determine whether a specific allowance is appropriate. Accounts receivable deemed uncollectible are charged against the allowance for doubtful accounts when identified.

Contract Assets

Contract assets consist of assets typically resulting when revenue recognized exceeds the amount billed or billable to the customer due to allocation of transaction price. Contract assets balances were $7,470 and $5,532 as of September 30, 2018, and December 31, 2017, respectively. The increase in contract assets from December 31, 2017, to September 30, 2018, is due primarily to one contract for which the invoice is a fixed monthly amount but for which the quantity of performance obligations satisfied varies each month.

Contract Liabilities

Contract liabilities, to which we formerly referred as deferred revenue, consist of amounts that have been invoiced and for which the Company has the right to bill, but that have not been recognized as revenue because the related goods or services have not been transferred. Contract liabilities balances were $453,595 and $387,002 at September 30, 2018, and December 31, 2017, respectively. The increase in contract liabilities from December 31, 2017, to September 30, 2018, is due primarily to the differences in the timing of the cycles of recognition of revenue from third-party support and maintenance contracts for enterprise server-based software sales.

Costs to Obtain or Fulfill a Contract

When applicable, we recognize an asset related to the costs incurred to obtain a contract only if we expect to recover those costs and we would not have incurred those costs if the contract had not been obtained. We recognize an asset from the costs incurred to fulfill a contract if the costs (i) are specifically identifiable to a contract, (ii) enhance resources that will be used in satisfying performance obligations in future and (iii) are expected to be recovered. There were $4,640 and $3,480 of such assets at September 30, 2018 and December 31, 2017, respectively.

Financing Components

In instances where the timing of revenue recognition differs from the timing of invoicing, we have determined our contracts do not include a significant financing component. The primary purpose of our invoicing terms is to provide customers with simplified and predictable ways of purchasing our products and services, not to receive financing from our customers or to provide customers with financing. Examples include invoicing at the beginning of a software support and maintenance term with revenue recognized ratably over the contract period.

Deferred Costs of Revenue

Deferred costs of revenue consist of the costs of third-party support and maintenance contracts for enterprise server-based software. These costs are reported under the prepaid expenses caption on our balance sheet. We

recognize these direct costs ratably over time as we make ourselves available to provide our performance obligation for software support, commensurate with our recognition of revenue. Deferred costs of revenue balances included in prepaid expenses were $404,243 and $300,558 at September 30, 2018, and December 31, 2017, respectively.

3.
Recent Accounting Pronouncements

From time to time, new accounting pronouncements are issued by the FASB, or other standard setting bodies, that the Company adopts as of the specified effective date.

In February 2016, the FASB issued ASU 2016-02, “Leases: Topic 842,” and followed it up with ASU 2018-10, “Codification Improvements to Topic 842, Leases” and ASU 2018-11, “Leases (Topic 842: Targeted Improvements” (collectively “Topic 842”)), which provided updated guidance on lease accounting. Topic 842 is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that annual period, with early adoption permitted. The Company does not expect the adoption of this new standard will have a material impact on its financial statements. When adopted, the Company’s operating lease for office space will be presented as a right-of-use asset and as an offsetting liability for the present value of the contractual cash flows. The Company does not currently have any other material lease obligations.

In June 2018, the FASB issued ASU 2018-07, “Compensation – Stock Compensation” (“ASU 2018-07”), which provided updated guidance on nonemployee share-based payment awards. ASU 2018-07 is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that annual period, with early adoption permitted. The Company does not expect the adoption of this new standard will have a material impact on its financial statements.

4.
Stock-Based Compensation

The Company has two shareholder–approved stock-based compensation plans. The 2006 Stock Incentive Plan was adopted in 2006 (“2006 Plan”) and had options granted under it through April 12, 2016. On June 1, 2016, the shareholders ratified the IAI 2016 Stock Incentive Plan (“2016 Plan”), which had been approved by the Board of Directors on April 4, 2016.

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 such options vest over periods of nine months to two years. The fair values of option awards granted in the three months and nine months ended September 30, 2018 and 2017, were estimated using the Black-Sholes option pricing model under the following assumptions:

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Risk-free interest rate	2.75%	1.87%	2.65% - 2.92%	1.87%
Dividend yield	0%	0%	0%	0%
Expected term	5 years	5 years	5 years	5 years
Expected volatility	53.4%	44.6%	49.0%-53.4%	44.6%

2016 Stock Incentive Plan

The 2016 Plan became effective June 1, 2016, and expires April 4, 2026. The 2016 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 2016 Plan is 1,000,000. Options under the 2016 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 minimum exercise price of each option is the quoted market price of the Company's stock on the date of grant. At September 30, 2018, there were unexpired options for 385,000 shares issued under the 2016 Plan, of which 217,000 were exercisable.

2006 Stock Incentive Plan

The 2006 Plan became effective May 18, 2006, and expired April 12, 2016. The 2006 Plan provides for the granting of equity awards to key employees, including officers and directors. Options under the 2006 Plan were generally granted at-the-money or above, expire no later than ten years from the date of grant or within three months of when employment ceases, whichever comes first, and vest over periods determined by the Board of Directors. The number of shares subject to options available for issuance under the 2006 Plan could not exceed 1,950,000. There were 1,003,500 unexpired options remaining from the 2006 Plan at September 30, 2018, of which 1,003,500 were exercisable.

The status of the options issued under the foregoing option plans as of September 30, 2018, and changes during the nine months ended September 30, 2018, were as follows:

	Options outstanding		
Incentive Options	Shares	Weighted average exercise price per share	Weighted average remaining contractual term
Outstanding at January 1, 2018	1,288,000	$0.21	
Options granted	163,000	0.45	
Options exercised	-	-	
Options expired	(62,500)	0.31	
Options forfeited	-	-	
Outstanding at September 30, 2018	1,388,500	$0.23	5 years
Exercisable at September 30, 2018	1,220,500	$0.21	4 years, 6 months

There were 3,000 options granted during the three months ended September 30, 2018, of which none were granted to non-employees, and 163,000 options granted during the nine months ended September 30, 2018, of which 5,000 options were granted to non-employees. There were 217,000 options granted during both the three months and nine months ended September 30, 2017, of which none were granted to non-employees. The weighted-average grant date fair values of options granted during the three months and nine months ended September 30, 2018, were $0.12 and $0.20, respectively, and the weighted-average grant date fair value of options granted during both the three months and nine months ended September 30, 2017, was $0.10. There were no options exercised during the nine months ended September 30, 2018 and 2017. As of September 30, 2018, there was $15,981 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the stock incentive plans; that cost is expected to be recognized over a weighted-average period of five months.

Total compensation expense related to these plans was $8,226 and $6,908 for the three months ended September 30, 2018 and 2017, respectively, of which $426 and $0 related to options awarded to non-employees, respectively. Total compensation expense related to these plans was $23,882 and $7,230 for the nine months ended September 30, 2018 and 2017, respectively, of which $644 and $0 related to options awarded to non-employees, respectively.

Compensation expense relating to prior periods in the amount of $612 was reversed in the nine months ended September 30, 2017, from options that were forfeited prior to vesting.

Nonvested option awards as of September 30, 2018 and changes during the nine months ended September 30, 2018 were as follows:

	Nonvested	
		Weighted average grant date
	Shares	fair value
Nonvested at January 1, 2018	232,000	$0.10
Granted	163,000	0.20
Vested	(227,000)	0.10
Forfeited	-	-
Nonvested at September 30, 2018	168,000	$0.20

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5.
Revolving Line of Credit

The Company has a revolving line of credit with a bank providing for demand or short-term borrowings of up to $1,000,000. The line expires on May 31, 2020. As of September 30, 2018, no amounts were outstanding under this line of credit. The Company did not borrow against this line of credit in the last twelve months.

6.
Earnings (Loss) Per Share

Basic earnings (loss) per share excludes dilution and is computed by dividing loss available to common shareholders by the weighted-average number of shares outstanding for the period. Diluted (loss) 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 antidilutive effect of 511,118 shares from stock options were excluded from diluted shares for the nine months ended September 30, 2018.

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

	Net income (loss)	Shares	Per share amount
Basic net income per common share for the three months ended September 30, 2018:			
Income available to common shareholders	$27,964	11,201,760	$-
Effect of dilutive stock options	-	391,423	-
Diluted net income per common share for the three months ended September 30, 2018	$27,964	11,593,183	$-
Basic net income per common share for the three months ended September 30, 2017:			
Income available to common shareholders	$110,284	11,201,760	$0.01
Effect of dilutive stock options	-	308,951	-
Diluted net income per common share for the three months ended September 30, 2017	$110,284	11,510,711	$0.01
Basic net loss per common share for the nine months ended September 30, 2018:			
Loss available to common shareholders	$(11,194)	11,201,760	$-
Effect of dilutive stock options	-	-	-

Diluted net loss per common share for the nine months ended September 30, 2018	$(11,194)	11,201,760	$-
Basic net income per common share for the nine months ended September 30, 2017:			
Income available to common shareholders	$167,386	11,201,760	$0.01
Effect of dilutive stock options	-	307,442	-
Diluted net income per common share for the nine months ended September 30, 2017	$167,386	11,509,202	$0.01

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 Annual Report on Form 10-K for the fiscal year ended December 31, 2017 (“2017 10-K”) 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 third-party software and software maintenance suppliers;

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

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 of our 2017 10-K. 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 programs, developing Section 508-compliant electronic forms and smart forms, and performing consulting services to government and commercial organizations. We have performed software modernization and electronic forms conversion projects for over 100 commercial and government customers, including, but not limited to, 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 Education, U.S. Department of Energy, U.S. Army, U.S. Air Force, U.S. Department of Veterans Affairs, and the Federal Deposit Insurance Corporation, and the U.S. Small Business Administration. 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. IAI also provides services through its GSA IT Schedule 70 contracts (47QTCA18D0080) and maintains Reseller and/or Solution Partner relationships with firms such as Adobe Systems, Micro Focus, and Heirloom Computing (additional information on IAI may be viewed at its website located at www.infoa.com).

IAI has earned an ISO 9001:2015 Management System certificate for the provisioning and management of certain services and product delivery to its customers. Many government agencies are now requiring this certification as a basis for participating in designated contract solicitations. ISO 9001:2015 is a process-based certification recognizing organizations that can link business objectives with operating effectiveness and institutionalize continual improvement in its operations. In order to achieve and maintain certification, IAI is required to demonstrate through external audit our ability to consistently provide products and services that meet customer and applicable statutory and regulatory requirements set forth in the referenced ISO 9001:2015 standard. Companies that achieve such certification have demonstrated effective implementation of documentation and records management, top management's commitment to their customers, establishment of clear policy, good planning and implementation, good resource management, efficient process control, as well as measurement and analysis.

In the three months ended September 30, 2018, our prime contracts with U.S. government agencies generated 71.3% of our revenue, subcontracts under federal procurements generated 24.7% of our revenue, and 4.0% of our revenue came from commercial contracts. The terms of these contracts and subcontracts vary from single transactions to five years. Within this group of prime contracts with U.S. government agencies, one software sale generated 15.5% of our revenue and one other contract generated 13.6% of our revenue. One subcontract generated 20.4% of our revenue.

In the three months ended September 30, 2017, our prime contracts with U.S. government agencies generated 67.4% of our revenue, subcontracts under federal procurements generated 27.7% of our revenue, and 4.9% of our revenue came from commercial contracts. The terms of these contracts and subcontracts varied from single transactions to five years. Within this group of prime contracts with U.S. government agencies, one software sale generated 23.9% of our revenue and one other contract generated 12.0% of our revenue. One subcontract generated 22.0% of our revenue.

In the nine months ended September 30, 2018, our prime contracts with U.S. government agencies generated 72.0% of our revenue, subcontracts under federal procurements generated 24.3% of our revenue, and 3.7% of our revenue came from commercial contracts. The terms of these contracts and subcontracts vary from single transactions to five years. Within this group of prime contracts with U.S. government agencies, one software sale generated 24.3% of our revenue and one other contract generated 13.1% of our revenue. One subcontract generated 20.2% of our revenue.

In the nine months ended September 30, 2017, our prime contracts with U.S. government agencies generated 72.2% of our revenue, subcontracts under federal procurements generated 22.1% of our revenue, and 5.7% of our revenue came from commercial contracts. The terms of these contracts and subcontracts varied from single transactions to five years. Within this group of prime contracts with U.S. government agencies, two software sales contracts generated 20.4% and 10.2% of our revenue, respectively, and one professional fees contract generated 12.0% of our revenue. One subcontract generated 16.6% of our revenue.

At September 30, 2018, balances related to one subcontract under a federal procurement represented 42.5% of our outstanding accounts receivable, and balances related to two prime contracts represented 11.9% and 10.6% of our outstanding accounts receivable, respectively.

At September 30, 2017, balances related to that same subcontract under a federal procurement represented 22.8% of our outstanding accounts receivable, and balances related to two prime contracts represented 33.3% and 12.2% of our outstanding accounts receivable, respectively.

We sold third-party software and maintenance contracts under agreements with one major supplier. These sales accounted for 51.1% of total revenue in the third quarter of 2018 and 49.3% of revenue in the third quarter of 2017, and 53.5% of total revenue in the first nine months of 2018 and 55.5% of revenue in the first nine months of 2017.

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Three Months Ended September 30, 2018 versus Three Months Ended September 30, 2017

Revenue
Our revenues in the third quarter of 2018 were $2,418,677 compared to $2,731,794 in the corresponding quarter in 2017, a decrease of $313,117, or (11.5%). Professional fee revenue was $1,111,358 in the third quarter of 2018 versus $1,385,257 in the corresponding quarter in 2017, a decrease of $273,899, or (19.8%), and software revenue was $1,307,319 in the third quarter of 2018 versus $1,346,537 in the third quarter of 2017, a decrease of $39,218, or (2.9%). Revenue from professional fees decreased due primarily to the completion or expirations of certain contracts since the third quarter of 2017, as well as variations in the levels of activity on several other continuing contracts. The decrease in our software revenue in 2018 versus the same period in 2017 is due to the non-recurring nature of many of our software sales transactions. Software sales and associated margins are subject to considerable fluctuation from period to period, based on the product mix sold and referral fees earned.

Gross Profit
Gross profit was $569,106, or 23.5% of revenue in the third quarter of 2018 versus $635,891, or 23.3% of revenue in the third quarter of 2017. For the quarter ended September 30, 2018, $536,158 of the gross profit was attributable to professional fees at a gross profit percentage of 48.2%, and $32,948 of the gross profit was attributable to software sales at a gross profit percentage of 2.5%. In the same quarter in 2017, we reported gross profit for professional fees of $608,853, or 44.0%, of professional fee revenue, and gross profit of $27,038, or 2.0% of software sales. Gross profit from professional fees decreased primarily due to the completion or expirations of certain contracts, and fluctuations in activity on continuing contracts, since the third quarter of 2017. Gross profit on software sales increased due to fluctuations in the mix of products sold. Software product sales and associated margins are subject to considerable fluctuation from period to period, based on the product mix sold and referral fees earned.

Selling, General and Administrative Expenses
Selling, general and administrative expenses, exclusive of sales commissions, were $409,761, or 16.9% of revenues, in the third quarter of 2018 versus $386,929, or 14.2% of revenues, in the third quarter of 2017. These expenses increased $22,832, or 5.9%, from the third quarter of 2017. These increases are from increases in the costs of non-billable labor and the fringe benefits associated with that labor.

Commissions expense was $134,255, or 5.6% of revenues, in the third quarter of 2018 versus $140,963, or 5.2% of revenues, in the third quarter of 2017. Commissions are driven by varying factors and are earned at varying rates for each salesperson.

Net income
Net income for the three months ended September 30, 2018, was $27,964, or 1.2% of revenue, versus net income of $110,284, or 4.0% of revenue, for the same period in 2017.

Nine months Ended September 30, 2018 versus Nine months Ended September 30, 2017

Revenue
Our revenues in the first nine months of 2018 were $7,520,972 compared to $8,269,558 in the corresponding quarter in 2017, a decrease of $748,586, or (9.1%). Professional fee revenue was $3,429,153 in the first nine months of 2018 versus $3,676,730 in the corresponding period in 2017, a decrease of $247,577, or (6.7%), and software revenue was $4,091,819 in the first nine months of 2018 versus $4,592,828 in the first nine months of 2017, a decrease of $501,009, or (10.9%). Revenue from professional fees decreased due primarily to the completion or expirations of certain contracts since the third quarter of 2017, as well as variations in the levels of activity on several other continuing contracts. The decrease in our software revenue in 2018 versus the same period in 2017 is due to the

non-recurring nature of many of our software sales transactions. Software sales and associated margins are subject to considerable fluctuation from period to period, based on the product mix sold and referral fees earned.

Gross Profit

Gross profit was $1,674,881, or 22.3% of revenue in the first nine months of 2018 versus $1,773,076, or 21.4% of revenue in the first nine months of 2017. For the nine months ended September 30, 2018, $1,600,611 of the gross profit was attributable to professional fees at a gross profit percentage of 46.7%, and $74,270 of the gross profit was attributable to software sales at a gross profit percentage of 1.8%. In the same period in 2017, we reported gross profit for professional fees of $1,686,347, or 45.9%, of professional fee revenue, and gross profit of $86,729, or 1.9% of software sales. Gross profit from professional fees decreased primarily due to the completion or expirations of certain contracts since the third quarter of 2017. Gross profit on software sales decreased due to the non-recurring nature of many of our software sales transactions and to decreases in referral fees earned. Software product sales and associated margins are subject to considerable fluctuation from period to period, based on the product mix sold and referral fees earned.

Selling, General and Administrative Expenses

Selling, general and administrative expenses, exclusive of sales commissions, were $1,319,790, or 17.5% of revenues, in the first nine months of 2018 versus $1,231,863, or 14.9% of revenues, in the first nine months of 2017. These expenses increased $87,927, or 7.1%, from the first nine months of 2017. These increases are from increases in non-billable labor and the fringe benefits associated with that labor, costs of issuing incentive stock options to certain key employees, the cost of maintaining our ISO 9001 certification, costs associated with bids and proposals, and severance payments for former employees.

Commissions expense was $374,815, or 5.0% of revenues, in the first nine months of 2018 versus $380,267, or 4.6% of revenues, in the first nine months of 2017. Commissions are driven by varying factors and are earned at varying rates for each salesperson.

Net (loss) income

Net loss for the nine months ended September 30, 2018, was ($11,194), or (0.1%) of revenue, versus net income of $167,386, or 2.0% of revenue, for the same period in 2017.

Liquidity and Capital Resources

Our cash and cash equivalents balance, when combined with our cash flow from operations during the first nine months of 2018, were sufficient to provide financing for our operations. Our net cash used in the combination of our operating and investing activities in the first nine months of 2018 was $677,819. This net cash, when subtracted from a beginning balance of $2,731,510, yielded cash and cash equivalents of $2,053,691 as of September 30, 2018. Accounts receivable and contract assets increased $549,083. Prepaid expenses and other current assets increased $97,637 due primarily to unrecognized expenses related to maintenance contracts on software sales, which are recognized over the terms of the maintenance contracts. Commissions payable decreased $125,019 due to payouts of existing commissions payable balances occurring faster than new commissions were earned.

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 expires on May 31, 2020. As of September 30, 2018, no amounts were outstanding under this line of credit. We did not borrow against this line of credit in the last twelve months.

Given our current cash position and operating plan, we anticipate that we will be able to meet our cash requirements for at least twelve months from the date of filing of this Form 10-Q.

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 September 30, 2018 (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 September 30, 2018, 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, 2017 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, 2017.

Item 2.
Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3.
Defaults Upon Senior Securities

None.

Item 4.
Mine Safety Disclosures

Not applicable.

Item 5.
Other Information

None.

Item 6.
Exhibits

10.16	Eighth Amendment to Loan Agreement regarding Line of Credit Agreement with TD Bank, N.A., successor to Commerce Bank, N.A., dated May 28, 2017
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

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SIGNATURES

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

Information Analysis Incorporated
(Registrant)

Date: November 14, 2018 By: /s/ Sandor Rosenberg
Sandor Rosenberg, Chairman of the
Board, Chief Executive Officer,
and President

Date: November 14, 2018 By: /s/ Richard S. DeRose
Richard S. DeRose, Executive Vice
President, Treasurer, and Chief Financial Officer