INFORMATION ANALYSIS INC
Form 10-Q
November 15, 2016

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, 2016

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 ofincorporation or organization)	(I.R.S. EmployerIdentification 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 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

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

As of November 10, 2016, 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

	September 30, 2016	December 31, 2015
	(Unaudited)	(see Note 1)
ASSETS		
Current assets:		
Cash and cash equivalents	$2,797,537	$2,167,928
Accounts receivable, net	1,293,513	1,298,029
Prepaid expenses and other current assets	497,565	603,340
Notes receivable, current	3,589	-
Total current assets	4,592,204	4,069,297
Property and equipment, net	31,576	42,039
Other assets	6,281	6,281
Total assets	$4,630,061	$4,117,617
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$1,136,306	$64,599
Commissions payable	907,524	959,052
Deferred revenue	463,854	581,102
Accrued payroll and related liabilities	218,366	261,202
Other accrued liabilities	131,757	74,472
Total liabilities	2,857,807	1,940,427
Stockholders' equity:		
Common stock, par value $0.01, 30,000,000 shares authorized; 12,844,376 shares issued, 11,201,760 shares outstanding as of September 30, 2016 and December 31, 2015	128,443	128,443
Additional paid-in capital	14,630,681	14,622,352

Accumulated deficit	(12,056,659)	(11,643,394)
Treasury stock, 1,642,616 shares at cost	(930,211)	(930,211)
Total stockholders' equity	1,772,254	2,177,190
Total liabilities and stockholders' equity	$4,630,061	$4,117,617

The accompanying notes are an integral part of the financial statements

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

	For the three months ended September 30,	
	2016	2015
Revenues:		
Professional fees	$885,505	$1,217,234
Software sales	1,146,048	241,655
Total revenues	2,031,553	1,458,889
Cost of revenues:		
Cost of professional fees	468,556	788,066
Cost of software sales	1,006,912	226,566
Total cost of revenues	1,475,468	1,014,632
Gross profit	556,085	444,257
Selling, general and administrative expenses	428,852	434,954
Commissions expense	187,030	109,630
Loss from operations	(59,797)	(100,327)
Other income	2,559	2,585
Loss before provision for income taxes	(57,238)	(97,742)
Provision for income taxes	-	-
Net loss	$(57,238)	$(97,742)
Comprehensive loss	$(57,238)	$(97,742)
Net loss per common share:		
Basic	$(0.01)	$(0.01)
Diluted	$(0.01)	$(0.01)

Weighted average common shares outstanding:		
Basic	11,201,760	11,201,760
Diluted	11,201,760	11,201,760

The accompanying notes are an integral part of the financial statements

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

	For the nine months ended September 30,	
	2016	2015
Revenues:		
Professional fees	$2,655,006	$3,329,766
Software sales	2,667,567	915,119
Total revenues	5,322,573	4,244,885
Cost of revenues:		
Cost of professional fees	1,509,281	2,023,609
Cost of software sales	2,373,788	856,561
Total cost of revenues	3,883,069	2,880,170
Gross profit	1,439,504	1,364,715
Selling, general and administrative expenses	1,451,423	1,301,322
Commissions expense	408,695	349,295
Loss from operations	(420,614)	(285,902)
Other income	7,349	7,680
Loss before provision for income taxes	(413,265)	(278,222)
Provision for income taxes	-	-
Net loss	$(413,265)	$(278,222)
Comprehensive loss	$(413,265)	$(278,222)
Net loss per common share:		
Basic	$(0.04)	$(0.02)
Diluted	$(0.04)	$(0.02)
Weighted average common shares outstanding:		
Basic	11,201,760	11,201,760
Diluted	11,201,760	11,201,760

The accompanying notes are an integral part of the financial statements

INFORMATION ANALYSIS INCORPORATED

STATEMENTS OF CASH FLOWS

(Unaudited)

	For the nine months ended September 30,	
	2016	2015
Cash flows from operating activities:		
Net loss	$(413,265)	$(278,222)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	22,044	22,475
Stock-based compensation	8,329	7,826
Bad debt expense	13,781	107
Forgiveness of notes receivable	-	7,863
Changes in operating assets and liabilities:		
Accounts receivable	(9,265)	(18,680)
Prepaid expenses and other current assets	105,775	454,737
Accounts payable, accrued payroll and related liabilities, and other accrued liabilities	1,086,156	306,420
Commissions payable	(51,528)	(110,481)
Deferred revenue	(117,248)	(457,133)
Net cash provided by (used in) operating activities	644,779	(65,088)
Cash flows from investing activities:		
Acquisition of property and equipment	(11,581)	(10,727)
Increase in notes receivable - employees	(5,768)	-
Payments received on notes receivable - employees	2,179	1,135
Net cash used in investing activities	(15,170)	(9,592)

Net increase (decrease) in cash and cash equivalents	629,609	(74,680)
Cash and cash equivalents, beginning of the period	2,167,928	2,450,006
Cash and cash equivalents, end of the period	$2,797,537	$2,375,326
Supplemental cash flow information		
Interest paid	$-	$-
Income taxes paid	$-	$-

The accompanying notes are an integral part of the financial statements

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INFORMATION ANALYSIS INCORPORATED
NOTES TO FINANCIAL STATEMENTS

1.
Basis of Presentation

Organization and Business

Founded in 1979, Information Analysis Incorporated (“We”, the “Company”), 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, 2015 included in the Annual Report on Form 10-K filed by the Company with the SEC on March 29, 2016 (the “Annual Report”). The accompanying December 31, 2015 balance sheet and financial information 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, 2016 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, 2015 that was filed with the SEC on March 29, 2016.

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, 2016, there have been no material changes to the Company’s uncertain tax position disclosures as provided in Note 7 of the Annual Report. The Company does not anticipate that total unrecognized tax benefits will significantly change prior to September 30, 2017.

2.
Recent Accounting Pronouncements

From time to time, new accounting pronouncements are issued by the Financial Accounting Standards Board ("FASB"), or other standard setting bodies that the Company adopts as of the specified effective date.

In May 2014, the FASB issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" (“ASU 2014-09”). This new standard will supercede nearly all existing revenue recognition guidance in U.S. GAAP. The core principle of the ASU is that an entity should recognize revenue for the transfer of goods or services equal to the amount it expects to receive for those goods and services. The standard defines a five step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than are required under existing U.S. GAAP, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. The standard allows entities to apply either of two adoption methods: (a) retrospective application to each prior reporting period presented with the option to elect certain practical expedients as defined within ASU 2014-09; or (b) retrospective application with the cumulative effect of initially applying the standard recognized at the date of initial application and providing certain additional disclosures as defined per ASU 2014-09. In August 2015, the FASB issued ASU 2015-14, “Revenue from Contracts with Customers: Topic 606” ("ASU 2015-14"), which defers the effective date for ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. The Company is evaluating the impact of adopting this new standard on its financial statements and the method of adoption.

There have been three new ASUs issued amending certain aspects of ASU 2014-09. ASU 2016-08, "Principal versus Agent Considerations (Reporting Revenue Gross Versus Net)," was issued in March 2016 to clarify certain aspects of the principal versus agent guidance in ASU 2014-09. In addition, ASU 2016-10, "Identifying Performance Obligations and Licensing" issued in April 2016, amends other sections of ASU 2014-09 including clarifying guidance related to identifying performance obligations and licensing implementation. Finally, ASU 2016-12, "Revenue from Contracts with Customers - Narrow Scope Improvements and Practical Expedients" provides amendments and practical expedients to the guidance in ASU 2014-09 in the areas of assessing collectability, presentation of sales taxes received from customers, noncash consideration, contract modification and clarification of using the full retrospective approach to adopt ASU 2014-09. With its evaluation of the impact of ASU 2014-09, the Company will also consider the impact related to the updated guidance provided by these three new ASUs.

In February 2016, the FASB issued ASU 2016-02, “Leases: Topic 842,” which provided updated guidance on lease accounting. ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that annual period, with early adoption permitted. The Company is evaluating the impact of adopting this new standard on its financial statements.

In March 2016, the FASB issued ASU 2016-09, “Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting” (“ASU 2016-09”), which simplifies several aspects of the accounting for employee share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The update is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years, with early adoption permitted. An entity that elects early adoption must adopt all of the amendments in the same period. Amendments related to the timing of when excess tax benefits are recognized, minimum statutory withholding requirements, forfeitures, and intrinsic value should be applied using a modified retrospective transition method by means of a cumulative-effect adjustment to equity as of the beginning of the period in which the guidance is adopted. Amendments related to the presentation of employee taxes paid on the statement of cash flows when an employer withholds shares to meet the minimum statutory withholding requirement should be applied retrospectively. Amendments requiring recognition of excess tax benefits and tax deficiencies in the income statement and the practical expedient for estimating expected term should be applied prospectively. An entity may elect to apply the amendments related to the presentation of excess tax benefits on the statement of cash flows using either a prospective transition method or a retrospective transition method. The Company is required to adopt ASU 2016-09 in the first quarter of 2017, and is currently assessing the impact of this pronouncement on its financial statements.

3.
Stock-Based Compensation

During the nine months ended September 30, 2016, the Company had three stock-based compensation plans. The 1996 Stock Option Plan was adopted in 1996 (“1996 Plan”) and had options granted under it through May 29, 2006. The last of the options granted under the 1996 Plan expired on May 18, 2016. 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.

Total compensation expense related to these plans was $2,857 and $2,112 for the quarters ended September 30, 2016 and 2015, respectively, none of which related to options awarded to non-employees. Total compensation expense related to these plans was $8,329 and $7,826 for the nine months ended September 30, 2016 and 2015, respectively, none of which 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 over the period of performance.

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The fair values of option awards granted in the three months and nine months ended September 30, 2016 and 2015, were estimated using the Black-Scholes option pricing model using the following assumptions:

	Three Months ended September 30,		Nine Months ended September 30,	
	2016	2015	2016	2015
Risk free interest rate	n/a	n/a	0.70% - 1.73%	1.61% - 1.97%
Dividend yield	n/a	n/a	0%	0%
Expected term	n/a	n/a	2-10 years	5-10 years
Expected volatility	n/a	n/a	34.9% - 50.4%	41.2% - 54.2%

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, 2016, there were no options yet issued under the 2016 Plan.

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. The maximum number of shares for which equity awards could be granted under the 2006 Plan was 1,950,000. Options under the 2006 Plan expire no later than ten years from the date of grant or when employment ceases, whichever comes first, and vest over periods determined by the Board of Directors. There were 1,193,500 and 992,500 unexpired exercisable options remaining from the 2006 Plan at September 30, 2016 and 2015, respectively.

1996 Stock Option Plan

The 1996 Plan provided for the granting of options to purchase shares of our common stock to key employees, including officers and directors. The maximum number of shares for which options could be granted under the 1996 Plan was 3,075,000. Options expired no later than ten years from the date of grant or when employment ceases, whichever came first, and vested over periods determined by the Board of Directors. There were zero and 98,000 unexpired exercisable options remaining from the 1996 Plan at September 30, 2016 and 2015, respectively.

The status of the options issued as of September 30, 2016 and changes during the nine months ended September 30, 2016 and 2015 were as follows:

Options outstanding

	Number of shares	Weighted average exercise price per share
Balance at December 31, 2015	1,193,000	$0.24
Options granted	50,000	0.14
Options exercised	-	-
Options expired or forfeited	(3,000)	0.70
Balance at March 31, 2016	1,240,000	$0.24
Options granted	235,000	0.26
Options exercised	-	-
Options expired or forfeited	(145,000)	0.45
Balance at June 30, 2016	1,330,000	$0.22
Options granted	-	-
Options exercised	-	-
Options expired or forfeited	(17,000)	0.18
Balance at September 30, 2016	1,313,000	$0.22

	Options outstanding	
	Number of shares	Weighted average exercise price per share
Balance at December 31, 2014	1,264,000	$0.26
Options granted	20,000	0.20
Options exercised	-	-
Options expired or forfeited	(1,000)	0.24
Balance at March 31, 2015	1,283,000	$0.26
Options granted	-	-
Options exercised	-	-
Options expired or forfeited	(5,000)	0.52
Balance at June 30, 2015	1,278,000	$0.25
Options granted	-	-
Options exercised	-	-
Options expired or forfeited	(10,000)	0.38
Balance at September 30, 2015	1,268,000	$0.25

The following tables summarize information about options at September 30, 2016:

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
1,313,000	$0.22	5.45	$3,305	1,193,500	$0.23	5.07	$2,455

Nonvested option awards as of September 30, 2016 and changes during the nine months ended September 30, 2016 were as follows:

	Nonvested	
	Number of shares	Weighted average grant date fair value
Balance at December 31, 2015	49,500	$0.07
Granted	50,000	0.04

Vested	(5,000)	0.08
Expired before vesting	-	-
Balance at March 31, 2016	94,500	$0.05
Granted	235,000	0.03
Vested	(165,000)	0.08
Expired before vesting	(35,000)	0.15
Balance at June 30, 2016	129,500	$0.06
Granted	-	-
Vested	(10,000)	0.07
Expired before vesting	-	-
Balance at September 30, 2016	119,500	$0.06

As of September 30, 2016 and 2015, unrecognized compensation cost associated with non-vested share-based compensation totaled $1,378 and $1,846, respectively, which are expected to be recognized over weighted average periods of four months and five months, respectively.

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4.
Loss Per Share

Basic 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 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 Loss	Shares	Per Share Amount
Basic net loss per common share for the three months ended September 30, 2016:			
Loss available to common stockholders	$(57,238)	11,201,760	$(0.01)
Effect of dilutive stock options	-	-	-
Diluted net loss per common share for the three months ended September 30, 2016	$(57,238)	11,201,760	$(0.01)
Basic net loss per common share for the three months ended September 30, 2015:			
Loss available to common stockholders	$(97,742)	11,201,760	$(0.01)
Effect of dilutive stock options	-	-	-
Diluted net loss per common share for the three months ended September 30, 2015	$(97,742)	11,201,760	$(0.01)

	Net Loss	Shares	Per Share Amount
Basic net loss per common share for the nine months ended September 30, 2016:			
Loss available to common stockholders	$(413,265)	11,201,760	$(0.04)
Effect of dilutive stock options	-	-	-
Diluted net loss per common share for the nine months ended September 30, 2016	$(413,265)	11,201,760	$(0.04)
Basic net loss per common share for the			

nine months ended September 30, 2015:			
Loss available to common stockholders	$(278,222)	11,201,760	$(0.02)
Effect of dilutive stock options	-	-	-
Diluted net loss per common share for the nine months ended September 30, 2015	$(278,222)	11,201,760	$(0.02)

5.
Financial Instruments

Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or be paid to transfer a liability in the principal or most advantageous market in an orderly transaction. To increase consistency and comparability in fair value measurements, the FASB established a three-level hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The three levels of fair value measurements are:

Level 1—Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2—Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.

Level 3—Unobservable inputs that are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

The inputs used in measuring the fair value of cash and cash equivalents are considered to be Level 1 in accordance with the three-tier fair value hierarchy. The fair market values are based on period-end statements supplied by the various banks and brokers that held the majority of the Company's funds. The fair value of short-term financial instruments (primarily cash and cash equivalents, accounts receivable, accounts payable, and other current assets and liabilities) approximate their carrying values because of their short-term nature.

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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 Annual Report on Form 10-K for the fiscal year ended December 31, 2015 (“2015 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;

our failure to adequately integrate businesses we may acquire;

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

the limited public market for our common stock;

changes in the economic health of our non U.S. federal government customers; 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 2015 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, developing electronic forms, 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 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. 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.

Over the last eighteen months, to improve our prospects for growth, we have added two members to our board of directors, William Pickle and Mark Krial, and the Neo4j graph database software to our General Services Administration Schedule 70 contract.

In the three months ended September 30, 2016, our prime contracts with U.S. government agencies generated 77.2% of our revenue, subcontracts under federal procurements generated 9.2% of our revenue and 13.6% of our revenue came from commercial contracts. The terms of these contracts and subcontracts vary from single transactions to five years. Within the group of prime contracts with U.S. government agencies, three individual contracts generated 16.2%, 10.4% and 9.3% of our total revenue, respectively.

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In the same period in 2015, our prime contracts with U.S. government agencies generated 66.6% of our revenue, subcontracts under federal procurements generated 21.2% of our revenue, 11.7% of our revenue came from commercial contracts, and 0.5% of our revenue came from state and local government contracts. The terms of these contracts and subcontracts varied from single transactions to five years. Within the group of prime contracts with U.S. government agencies, two individual contracts generated 24.8% and 20.7% of our revenue, respectively. One customer under which we subcontract for multiple U.S. government agencies accounted for 12.6% of our revenue. One commercial customer generated 11.2% of our revenue.

In the nine months ended September 30, 2016, our prime contracts with U.S. government agencies generated 73.7% of our revenue, subcontracts under federal procurements generated 12.6% of our revenue, and 13.7% 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, two individual contracts generated 18.5% and 11.4% of our revenue, respectively. One commercial customer generated 9.0% of our revenue.

In the same nine month period in 2015, our prime contracts with U.S. government agencies generated 61.6% of our revenue, subcontracts under federal procurements generated 25.8% of our revenue, 12.3% of our revenue came from commercial contracts, and 0.3% of our revenue came from state and local government 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 contracts generated 21.3% and 17.5% of our revenue, respectively. One customer under which we subcontract for multiple U.S. government agencies accounted for 13.4% of our revenue. One commercial customer accounted for 11.6% of our revenue.

Three Months Ended September 30, 2016 versus Three Months Ended September 30, 2015

Revenue
Our revenues in the third quarter of 2016 were $2,031,553 compared to $1,458,889 in the corresponding quarter in 2015, an increase of $572,664, or 39.3%. Professional fees revenue was $885,505 versus $1,217,234, a decrease of 27.3%, and software revenue was $1,146,048 versus $241,655, an increase of 374.2%. There were several offsetting increases and decreases in activity under continuing professional fees contracts, as well as new and expiring prime contracts and subcontracts. The decrease in our professional fees revenue is primarily due to the completion of projects prior to third quarter 2016 under two contracts. The increase in our software revenue in 2016 versus the same period in 2015 is due to several U.S. federal government agency orders for Adobe and Micro Focus licenses and an increase in referral fees earned for facilitating sales directly from our suppliers to customers we introduced. Software sales and associated margins are subject to considerable fluctuation from period to period, based on the product mix sold and referral fees earned. Over the last four years, we have experienced an increase in the quantity of software product orders in the third quarter as the U.S. federal government fiscal year comes to a close.

Gross Profit
Gross profit was $556,085, or 27.4% of revenue in the third quarter of 2016 versus $444,257, or 30.5% of revenue in the third quarter of 2015. For the quarter ended September 30, 2016, $416,949 of the gross profit was attributable to professional fees at a gross profit percentage of 47.1%, and $139,136 of the gross profit was attributable to software sales at a gross profit percentage of 12.1%. In the same quarter in 2015, we reported gross profit for professional fees of $429,168, or 35.3%, of professional fee revenue, and gross profit of $15,089, or 6.2% of software sales. Gross profit from professional fees decreased with the decrease in revenue, yet gross profit as a percentage of revenue increased due to the timing of revenue recognition of certain fixed price contracts. In the third quarter of 2015 we had a fixed price contract that was affected negatively by timing, accumulating direct costs without certainty of achieving billable deliverables. That revenue was ultimately recognized in the fourth quarter of 2015. Gross profit on software

sales increased in terms of dollars due to the increase in sales and to an increase in the third quarter of 2016 over the third quarter of 2015 in referral fees for facilitating third-party sales, for which there were no direct costs incurred by us. The increase in gross profit percentage is due exclusively to the increase in referral fees. 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 $428,852, or 21.1% of revenues, in the third quarter of 2016 versus $434,954, or 29.8% of revenues, in the third quarter of 2015. These expenses decreased $6,102, or 1.4%, from the third quarter of 2015.

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Commission expense was $187,030, or 9.2% of revenues, in the third quarter of 2016 versus $109,630, or 7.5% of revenues, in the third quarter of 2015. This increase of $77,400, or 70.6%, is due to increases in gross profits on commissionable professional services contracts, which drive commission earned at varying rates for each salesperson, and an increase in referral fees earned for facilitating sales directly from our suppliers to customers we introduced, for which there are little to no direct costs.

Net loss
Net loss for the three months ended September 30, 2016, was $57,238, or 2.8% of revenue, versus net loss of $97,742, or 6.7% of revenue, for the same period in 2015.

Nine months Ended September 30, 2016 versus Nine months Ended September 30, 2015

Revenue
Our revenues in the first nine months of 2016 were $5,322,573 compared to $4,244,885 in 2015, an increase of $1,077,688, or 25.4%. Professional fees revenue was $2,655,006 versus $3,329,766, a decrease of 20.3%, and software revenue was $2,667,567 versus $915,119, an increase of 191.5%. The decrease in our professional fees revenue is primarily due to the expiration of two U.S. federal government prime short-term contracts and several subcontracts that were active in the first nine months of 2015. In addition, there were several offsetting increases and decreases in activity under continuing contracts. The increase in our software revenue in 2016 versus the same period in 2015 is primarily due to a few larger U.S. federal government agency orders for Adobe and Micro Focus licenses and software maintenance, and an increase in referral fees earned for facilitating sales directly from our suppliers to customers we introduced. 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 $1,439,504, or 27.0% of revenue in the first nine months of 2016 versus $1,364,715, or 32.1% of revenue in the first nine months of 2015. For the nine months ended September 30, 2016, $1,145,725 of the gross profit was attributable to professional fees at a gross profit percentage of 43.2%, and $293,779 of the gross profit was attributable to software sales at a gross profit percentage of 11.0%. In the same period in 2015, we reported gross profit for professional fees of $1,306,157, or 39.2% of professional fees revenue and $58,558, for software sales, or 6.4% of software sales. Gross profit from professional fees decreased with the decrease in revenue, yet gross profit as a percentage of revenue increased due to the timing of revenue recognition of certain fixed price contracts. In 2015 we had a fixed price contract that was affected negatively by timing, accumulating direct costs without certainty of achieving billable deliverables. That revenue was ultimately recognized in the fourth quarter of 2015. Gross profit on software sales increased in terms of dollars due to the increase in sales and to an increase in the first nine months of 2016 over the first nine months of 2015 in referral fees for facilitating third-party sales, for which there were no direct costs incurred by us. The increase in gross profit percentage is due exclusively to the increase in referral fees. There has been considerable downward pressure on margins for software sales over the last few years due to the use by U.S. federal government agencies of new bidding processes such as reverse auctions. 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 $1,451,423, or 27.3% of revenues, in the first nine months of 2016 versus $1,301,322, or 30.7% of revenues, in the first nine months of 2015. These expenses increased $150,101, or 11.5%. Since the first nine months of 2015, we have added an additional member of our sales staff, experienced increases in the costs of providing health insurance and other fringe benefits to our

employees, incurred expenses for training our staff in programming and on the latest developments in supporting the third party software we sell, experienced increases in legal expenses with regard to contracts, utilized more labor in developing our bids and proposals for new contracts, and have increased certain aspects of our business insurance coverage.

Commission expense was $408,695, or 7.7% of revenues, in the first nine months of 2016 versus $349,295, or 8.2% of revenues, in the first nine months of 2015. This increase of $59,400, or 17.0%, is due to increases in gross profits on commissionable professional services contracts, which drive commission earned at varying rates for each salesperson, and an increase in referral fees earned for facilitating sales directly from our suppliers to customers we introduced, for which there are little to no direct costs.

Net loss

Net loss for the nine months ended September 30, 2016, was $413,265, or 7.8% of revenue, versus net loss of $278,222, or 6.6% of revenue, for the same period in 2015.

Liquidity and Capital Resources

Our cash and cash equivalents balance, when combined with our cash flow from operations during the first nine months of 2016, were sufficient to provide financing for our operations. Our net cash provided by the combination of our operating and investing activities in the first nine months of 2016 was $629,609. This net cash provided, when added to a beginning balance of $2,167,928, yielded cash and cash equivalents of $2,797,537 as of September 30, 2016. Prepaid expenses and other current assets decreased $105,775 due to the allocation over time of prepaid expenses associated with the maintenance contracts on software sales. Deferred revenue decreased $117,248 due to the recognition of revenue over time from maintenance contracts on software sales. Accounts payable, accrued payroll and accrued expenses increased $1,086,156 due to the timing of product and maintenance orders placed by our U.S. federal government customers immediately before their fiscal year end of September 30, and commissions payable decreased $51,528. We had no non-current liabilities as of September 30, 2016.

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 May 31, 2017. As of September 30, 2016, no amounts were outstanding under this line of credit.

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.

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, 2016 (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, 2016 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.

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Information Analysis Incorporated Form 10-Q Third Quarter 2016

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, 2015 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, 2015.

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

10.14	Modification Agreement regarding Line of Credit Agreement with TD Bank, N.A., successor to Commerce Bank, N.A., dated May 25, 2016
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, 2016 By: /s/ Sandor Rosenberg
Sandor Rosenberg, Chairman of the Board, Chief Executive Officer, and President

Date: November 14, 2016 By: /s/ Richard S. DeRose
Richard S. DeRose, Executive Vice President, Treasurer, and Chief Financial Officer