

INFORMATION ANALYSIS INC  
Form 10-K  
March 29, 2013

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

Form 10-K

(Mark  
One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934  
For the fiscal year ended December 31, 2012

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  
(State or other jurisdiction of incorporation  
or organization)

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

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

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

Securities registered pursuant to Section 12(b) of the Act:

None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, par value \$0.01 per share  
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the

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Act. Yes  No

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 (the "Exchange Act") 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 | <input type="radio"/> | Accelerated filer         | <input type="radio"/>            |
| Non-accelerated filer   | <input type="radio"/> | Smaller reporting company | <input checked="" type="radio"/> |

(Do not check if a smaller reporting company)

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

The aggregate market value of the common stock held by non-affiliates of the registrant based on the closing price of the registrant's common stock on June 29, 2012, was approximately \$1,317,430. For purposes of this computation, all officers, directors and 10% beneficial owners of the registrant are deemed to be affiliates. Such determination should not be deemed to be an admission that such officers, directors or 10% beneficial owners are, in fact, affiliates of the registrant.

As of March 27, 2013, there were 11,201,760 outstanding shares of the registrant's common stock.

#### Documents Incorporated by Reference

Portions of the registrant's definitive proxy statement for the 2013 Annual Meeting of Stockholders, to be filed within 120 days after the end of the fiscal year covered by this Form 10-K, are incorporated by reference into Part III of this Form 10-K.

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### Cautionary Statement Regarding Forward-Looking Statements

This Form 10-K 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 here in our Form 10-K and in other filings with the Securities and Exchange Commission. These risks include, among others, the following:

- changes in the way the U.S. federal government contracts with businesses and changes in its budgetary priorities;
- 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 failure to adequately integrate businesses we may acquire; and
- fluctuations in our results of operations and its impact on our stock price.

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

## PART I

### ITEM 1. BUSINESS.

#### Overview of Market

Founded in 1979, Information Analysis Incorporated, to which we sometimes refer as IAI, is in the business of modernizing client information systems, developing and maintaining information technology systems, and performing consulting services to government and commercial organizations. Since its inception, we have performed software development and conversion projects for over 100 commercial and government customers including, but not limited to, Computer Sciences Corporation, IBM, Computer Associates, MCI, Sprint, Citibank, U.S. Department of Homeland Security, U.S. Treasury Department, U.S. Department of Agriculture, U.S. Department of Energy, U.S. Army, U.S. Air Force, U.S. Department of Veterans Affairs, and the Federal Deposit Insurance Corporation. At present, 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, including electronic forms conversions, for various agencies of the federal government.

The migration and modernization market is complex and diverse as to the multiple requirements clients possess to upgrade their older systems. Many large legacy systems remain in use because of the enormous cost to re-engineer these systems. Currently, the options available to modernize these systems are many. Performance and capacity of client-server systems, both UNIX and .NET, rival the traditional mainframe systems. There are many brands of

software that can interface with legacy systems via PC interfaces. New software development languages also allow users to warehouse and data-mine information from legacy databases. Finally, the evolution of the Internet and intranet technology offer a different approach for collecting and processing large volumes of user transactions, processes which are the forte of older legacy systems. All of these options are very expensive and time consuming because they require starting all over in defining requirements, designing structures, programming, and testing. Costs can range as high as \$10 or more per line of new code.

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Opportunities for our type of modernization may be expanding because of the recent large failures of large scale modernizations using redesign and off-the-shelf approaches. Most recently, the U.S. Air Force announced the failure of the ECSS modernization project which sought to modernize their systems using an off-the-shelf approach and cost over \$1 billion. There have also been failures wasting hundreds of millions of dollars at Veterans Affairs in recent years. As costs of maintaining these old systems on old hardware rises, there is more pressure to take an incremental approach that we can provide.

Companies are being driven for various reasons to address the upgrading of their legacy systems. One reason is the difficulty of finding and retaining staff with outdated technical skills, many of which are possessed only by senior programmers nearing retirement. Hardware platforms such as Unisys are reaching the horizon of their usefulness, and consequently, older programming and data base languages are generally poorly supported by their providers. Additionally, maintenance costs are materially increasing as vendors squeeze the most out of clients before the life-cycles of hardware and software expire. In addition, the Internet has added a new level of pressure to compete in the electronic marketplace with sector rivals. We expect that the next ten years should see an upsurge of movement and change as organizations revamp their older legacy systems.

A segment of mainframe users is interested in simply updating their legacy systems without drastic rewritings to these systems in newer languages or adapting expensive off-the-shelf products (such as SAP or Oracle) to their needs. These potential customers are looking for automated tools that can quickly and cost-effectively move applications onto cheaper computer platforms without the risk of failure. Tools such as those provided by Micro Focus can perform this function by preserving the business rules in COBOL but extending the screens to be accessed over the Internet and providing compilers and utilities that allow the application to work on PC and UNIX platforms. It is difficult to determine the exact size of this segment, but even a 5% share of this market would represent hundreds of prospective customers with meaningful opportunities.

Recently, in alliance with a company called Software Mining, IAI is pilot testing conversion software that can convert Cobol to Java or C#. Previously, the challenge was to create new code that is easily readable and maintainable. The tools Software Mining has developed address those issues exceptionally well, and combined with IAI's tools and experience, provide us a unique capability to deliver successful results. IAI has a number of potential clients exploring these options through pilot testing.

The web solutions market continues to be one of the fastest growing segments of the information technology consulting business as individuals, small companies, large companies, and government agencies (state and federal) expand their presence on the Internet. The range of products and services involved in this sector is extensive and therefore, require some specialization for a small company such as IAI to make an impact. Most small web companies are involved in building websites and typically have many short duration projects. More complex web applications generally require knowledge of customers' back-end systems based on mainframe or mid-level computers. Few small companies have the expertise to develop these more sophisticated web applications. We distinguish ourselves among smaller companies by developing such expertise, typically associated with larger companies, both internally and through strategic business relationships with leading-edge software firms.

These types of applications, including innovative solutions in the Business Intelligence and Cybersecurity arenas, should become more prominent in the future as web-based solutions continue to evolve. The need for commercial and public sector managers to access and combine data from disparate sources (internally and externally) for timely decision-making is becoming ever more acute in our fast paced digitally driven environment. The volume of data available to companies and agencies is growing at an exponential rate, as well as the need to protect that data and the systems that house them. This convergence of the need for instantaneous reliable access to real-time data via the web,

combined with protecting such information from tampering and theft by unauthorized sources, should result in increased opportunities for IAI's evolving capability skill set.



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The commercial and government sectors of the software migration and modernization market can be quite different in their requirements for web-based applications. Many companies are generally interested in cataloging and selling items whereas government agencies wish to disseminate data to the citizenry. There is some overlap in common functionality when web applications are designed for procurement transactions or customer relations. What distinguishes the government requirements is that most government processes are based on forms. Many government agencies rely on thousands of internal and external forms to conduct their business. Any company that wishes to develop governmental web applications must address the forms issue. Adobe electronic forms products resold and supported by IAI are the predominant forms software in the federal government.

Over the last year there has been a pronounced emphasis within the U.S. federal government to employ form data entry and citizen communication using mobile devices such as iPhones, iPads, and mobile devices employing the Android operating system. Working with Adobe's latest version of LiveCycle, we have been able to build applications for several federal clients employing mobile devices, and currently are bidding to convert all existing electronic forms for a major government agency.

Description of Business and Strategy

Since the mid-1990's we have migrated customers from older computer languages generally associated with legacy computer systems to more modern languages used with current-day computer system platforms. Many organizations have become aware of the evolving obsolescence of these systems and are now beginning to fund their modernization. In addition, as part of this modernization, many organizations wish to extend these legacy systems to interface with web-based applications. Our strategy has been to develop and/or acquire tools that will facilitate the modernization process and differentiate our offerings in the marketplace.

In 2004, we aligned with Micro Focus, an established company in the legacy COBOL environment, to participate in an effort intended to promote, quickly and cost-effectively, the conversion of large legacy mainframe systems to PC and Unix server platforms. Micro Focus has developed a suite of products that simplify the conversion process and enable the entry screens to be Internet accessible. The convergence of these tools with the recent advancements in hardware performance of PC servers has finally permitted users to substantially reduce their annual mainframe hardware maintenance costs. As an authorized reseller and installer of the tools, our plan is to derive revenue from software sales and installation services as well as acquire supplementary programming services that typically occur with each engagement.

We have structured our company to address the wide range of requirements that we envision the market will demand. We believe that the Micro Focus tool suite and the use of our proprietary ICONS legacy conversion tools suite will give us a competitive edge in performing certain conversions and migrations faster and more economically than many other vendors. The diverse capabilities of our staff in mainframe technology and client-server implementations help to assure that our staff can analyze the original systems properly to conduct accurate and thorough conversions.

Our modernization methodology has developed over the past several years through the completion of successful conversion projects. Senior members of our professional staff can perform both technical and business requirements analyses, prepare general and detail design documentation and develop project plans including milestones, staffing, deliverables, and schedules. The actual work can be performed at customer sites or on our premises, which has mainframe and client-server facilities for the use of our personnel.

Some of our potential clients require that the Cobol code be converted to JAVA or C# and in those cases we have formed an alliance with a company called Software Mining that has developed tools that can be used successfully to

deliver readable and maintainable modern code. We are currently pilot testing this code for a number of potential customers and are hopeful that we can win some sizeable contracts this year.

Our strategy to exploit the conversion and modernization market is also based on forming alliances with large information technology consulting firms who currently maintain the legacy systems for large government agencies and Fortune 1000 companies. These firms have established relationships with such customers, who rely on their advice in selecting tools and services to modernize legacy systems. We have been successful in forming partnerships with firms such as Price Waterhouse, IBM, HP, Northrop Grumman, Unisys, Deloitte and Oracle. These alliances have resulted in significant contracts in the past and are important in procuring future business.

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In addition to gaining new business, we will focus on retaining and expanding existing contracts.

We are also using the experience we have acquired as an Adobe Lifecycle reseller to help secure engagements for web-based applications requiring forms. The Adobe products have evolved over the years into robust tools that can form the backbone of applications, especially those requiring forms and web content management. We have used this expertise to penetrate a number of federal government clients such as the Internal Revenue Service and Veterans Affairs and build sophisticated web applications at the Department of Homeland Security. Our knowledge of legacy system languages has been instrumental in connecting these web applications to legacy databases residing on mainframe computers. Our company has built a core group of professionals that can build this practice over the coming years.

Concentrating on the niche of electronic forms-related web applications through our relationship with Adobe products, we have developed a cadre of professionals that can quickly and efficiently develop web applications. We will focus on federal government clients during 2013 and beyond and leverage the company's reputation with existing federal customers to penetrate these agencies. We will be able to reference successful projects completed or in development for the Department of Homeland Security, the Department of Veterans Affairs, Federal Mediation and Conciliation Service, U.S. Department of Agriculture, General Services Administration, Army Reserve, and U.S. Air Force Logistics Command.

We recognize the need to enhance our service and product capabilities as a means of expanding our business base and maintaining growth in the future. To that end, beginning in late 2010 and continuing in 2013, we have aggressively pursued strategic business relationships with certain leading-edge technology firms in our local area that have developed unique and innovative software-based products and services. These new business areas include, but are not limited to, cybersecurity, real-time business intelligence, mobile applications and SharePoint developments. Where appropriate, we have entered into teaming arrangements or product reseller agreements with certain of these firms. These products and services are synergistic to our present business strategy and also allow us to expand into new business areas, both within the federal government and commercial sectors, without the expenditure of significant technical development dollars. Our partners benefit by our potential to leverage their new technology developments into our existing client base, as well as utilize our expertise and credibility in developing applications around their inventive products.

Our management will continue to explore ways to expand our current market spaces and develop new ones that may offer more opportunity. This may take the shape of organic growth or through acquisition of other companies. In any event, IAI will be more aggressive than in the past and will take more risks in terms of investment in business development, exploring the potential of diversified business opportunities, and seeking targets of acquisition. We expect to see the results of these efforts during 2013 and beyond.

Backlog

As of December 31, 2012, we estimated our backlog at approximately \$11.9 million over the next three years, of which \$2.7 million was funded. This backlog consists of outstanding contracts and general commitments from current clients. We regularly provide services to certain clients on an as-needed basis without regard to a specific contract. General commitments represent those services which we anticipate providing to such clients during a twelve-month period.

Competition

The competition in the conversion and modernization market is very strong. Many software professional services companies have had some involvement in this area and profess proficiency in performing these projects. We also face competition from other companies that purport to substantially automate the process through software tools including Blue Phoenix Solutions, Fujitsu, and IBM. “Off-the-shelf” software for enterprise resource planning, such as SAP and Oracle, provides an additional source of competition, although to date, the cost and lengthy installation time for enterprise resource planning software has slowed its implementation in the market place. No matter what type of solution is offered, many of our competitors have greater name recognition than our company, a larger, more established customer base, and significantly greater financial and market resources.

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In the electronic forms arena there are multiple forms vendors such as IBM (Pure Edge), Microsoft, and FormNet. These are formidable competitors who are constantly trying to gain a share of the Adobe market penetration. In the federal marketplace, the cost of switching from Adobe and losing the sizeable investments in forms already developed gives Adobe an advantage in retaining and extending its client base. Also, the prevalence of Adobe's PDF standard format for presenting images in the electronic world is a difficult obstacle for its competitors to overcome.

There are hundreds of firms performing traditional information technology services, business intelligence and cybersecurity, and general consulting for the federal government. A great number of them are much larger than IAI, and are more established in the marketplace, and have more resources to pursue individual prospects.

Government Regulations

We supply our products and services to the United States federal government pursuant to its General Services Administration Information Technology contract, its General Services Administration Mission Oriented Business Integrated Services contract, and through contracts resulting from competitive bidding processes. We are bound by various rules and regulations promulgated by agencies of the federal government. We have not experienced undue expense beyond those expenses normally incurred in our ordinary course of business in adhering to such rules and regulations.

Intellectual Property

We depend upon a combination of trade secret and copyright laws, nondisclosure and other contractual provisions and technical measures to protect our proprietary rights in our methodologies, databases and software. We have not filed any patent applications covering our methodologies and software. In addition, we attempt to protect the secrecy of our proprietary databases and other trade secrets and proprietary information through agreements with employees and consultants.

We also seek to protect the source code of our proprietary ICONS legacy code conversion tools suite as trade secrets and under copyright law. The copyright protection accorded to databases, however, is fairly limited. While the arrangement and selection of data can be protected, the actual data is not, and others are free to create software performing the same function. We believe, however, that the creation of competing databases would be very time consuming and costly.

Employees

As of December 31, 2012, we employed 25 full-time and 7 part-time individuals. In addition, we maintained subcontractor relationships with companies and individuals that add 11 individuals for professional information technology services. Approximately 95% of our professional employees have at least four years of related experience. For computer related services, we believe that the diverse professional opportunities and interaction among our employees contribute to maintaining a stable professional staff with limited turnover.

We have no collective bargaining agreements or other such labor contracts with our employees and believe that our employee relationships are satisfactory. In the long-term, management will likely hire additional staff to meet its anticipated growth requirements. We do not anticipate encountering material problems in our ability to hire individuals with the requisite employee skill sets, despite a competitive market for our requisite technical skill sets and government clearances, when required. We utilize fee-based recruiting firms when it is necessary to speed up the process of locating and hiring employees with specialized skill sets and clearances.



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Available Information

We make available free of charge on or through our website our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission, or SEC. Our website address is [www.infoa.com](http://www.infoa.com).

ITEM 1A. RISK FACTORS.

We operate in a rapidly changing environment that involves a number of risks, some of which are beyond our control. This discussion 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.

Changes in the funding priorities of the U.S. federal government, and changes in the way the U.S. federal government contracts with businesses, may materially and adversely affect our revenue and earnings.

Since the U.S. federal government is our largest customer, both directly and with us as a subcontractor, changes in the funding priorities of the U.S. federal government may materially and adversely affect us if funding is cut or shifted away from the information technology services that we are equipped to provide. Additionally, changes in the way the government awards contracts may create a disadvantage for us to compete in certain markets.

U.S. federal government contracts are generally subject to terms more favorable to the customer than commercial contracts.

U.S. federal government contracts generally contain provisions and are subject to laws and regulations that give the federal government rights and remedies not typically found in commercial contracts, including provisions permitting the federal government to:

- terminate our existing contracts;
- reduce potential future income from our existing contracts;
- modify some of the terms and conditions in our existing contracts;
- suspend or permanently prohibit us from doing business with the federal government or with any specific government agency;
- impose fines and penalties;
- subject the award of some contracts to protest or challenge by competitors, which may require the contracting federal agency or department to suspend our performance pending the outcome of the protest or challenge and which may also require the government to solicit new proposals for the contract or result in the termination, reduction or modification of the awarded contract;
- suspend work under existing multiple year contracts and related task orders if the necessary funds are not appropriated by Congress;
- decline to exercise an option to extend an existing multiple year contract; and
- claim rights in technologies and systems invented, developed or produced by us.

The U.S. federal government may terminate a contract either “for convenience” (for instance, due to a change in its perceived needs or its desire to consolidate work under another contract) or if a default occurs by failing to perform under the contract. If the federal government terminates a contract for convenience, we generally would be entitled to recover only our incurred or committed costs, settlement expenses and profit on the work completed prior to termination. If the federal government terminates a contract based upon a default, we generally would be denied any recovery for undelivered work, and instead may be liable for excess costs incurred by the federal government in procuring undelivered items from an alternative source and other damages as authorized by law.



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Failure to keep pace with a changing technological environment could negatively impact our business.

The computer industry in general, and the market for our application software offerings and services, is characterized by rapidly changing technology, frequent new technology introductions, and significant competition. In order to keep pace with this rapidly changing market environment, we must continually develop and incorporate into our services new technological advances and features desired by the marketplace at acceptable prices. The successful development and commercialization of new services and technology involves many risks, including the identification of new opportunities, timely completion of the development process, the control and recovery of development and production costs and acceptance by customers of our products and services. If we are unsuccessful in identifying, developing and marketing our services and technology or adapting our business to rapid technological change, it will have a material negative impact on our results of operations.

We are subject to intense competition from other companies engaged in software development and computer related services.

The market for our products and services is competitive, rapidly evolving, and can be affected by new product introductions and other market activities of industry participants. Some of these companies have longer operating histories, greater financial, marketing and other resources, greater name recognition in other markets and a larger base of customers than IAI. In addition, some companies have well-established relationships with our current and prospective customers. As a result, these competitors may be able to devote greater resources to the development, promotion and sale of their products and services than we can. Should we not be able to maintain our competitive advantages in light of these factors, it could have a material negative impact on our results of operations.

If we are unable to accurately estimate the cost of services and the timeline for completion of contracts, the profitability of our contracts may be materially and adversely affected.

Our commercial and federal government contracts are typically awarded on a competitive basis. Our bids are based upon, among other items, the cost to provide the services. To generate an acceptable return on our investment in these contracts we must be able to accurately estimate our costs to provide the services required by the contract and be able to complete the contracts in a timely manner. If we fail to accurately estimate our costs or the time required to complete a contract the profitability of our contracts may be materially and adversely affected.

Contracts on which we utilize subcontractors or suppliers may be adversely affected if our subcontractors or suppliers fail to perform required obligations under the contract.

We frequently utilize subcontract labor on contracts where we bid as partners, we lack a specific type of expertise, or where the subcontractor has brought the opportunity to us. If our subcontractors or suppliers fail to perform as specified, it may adversely affect our contracts and subject us to loss of the contracts, unintended expenses, and/or the inability to secure future contracts due to our nonperformance.

Our federal government contracts typically have terms of one or more base years and one or more option years. Federal governmental agencies generally have the right not to exercise options to extend a contract. A decision to terminate or not to exercise options to extend our existing contracts could have a material adverse effect on our business, prospects, financial condition and results of operations.

We are dependent on key personnel to maintain our profitability and grow our business.

Our future success depends, to a significant extent, on the continued services of our key personnel. A loss of certain key personnel, both managerial and technical, would most likely have an adverse effect on our business. In addition, competition for qualified technical personnel throughout the industry is significant and we may be unable to retain our current personnel or attract, integrate or retain other highly qualified personnel in the future. If we do not succeed in retaining our current personnel or in attracting and motivating new personnel, our business could be adversely affected.

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We are dependent upon third-party software and software maintenance suppliers, making us vulnerable to supply shortages and lapses in support.

We obtain software licenses and related software maintenance contracts for resale from third-party suppliers. Any delay in our suppliers' fulfillment of our orders could impair our ability to deliver products and maintenance to customers and, accordingly, could have a material adverse effect on business, results of operations, financial condition, and reputation.

Failure to adequately integrate prospective new businesses or acquisitions could materially impact and disrupt our business.

We are seeking to expand our business and may acquire or make investments in companies or businesses offering complementary products, services and technologies in the future. Acquisitions and investments typically involve numerous risks including, but not limited to difficulties in integrating operations, technologies, services and personnel and diversion of financial and managerial resources from existing operations. To manage this prospective growth effectively, we may need to implement additional management information systems capabilities, further develop our operating, administrative, financial and accounting systems and controls, improve coordination among accounting, finance, marketing and operations and hire and train additional personnel. Should these prospective integrations prove more difficult and time consuming than anticipated, it could negatively impact our results of operations.

Fluctuations in our results of operations from period to period may cause fluctuations in our stock price.

Our financial results vary from quarter to quarter based on certain factors such as the timing of significant orders, contract funding approvals and contract completions, some of which are beyond our control. As a consequence, our quarterly and annual revenue and operating results may fluctuate from period to period, and period comparisons may therefore not be meaningful. Such fluctuations in the future could contribute to corresponding fluctuations in our stock price and in certain cases cause the trading price of our stock to decline.

The exercise of outstanding options to purchase our common stock could substantially dilute shareholders' investments.

Under the terms of outstanding options to acquire our common stock issued to employees and others, the holders thereof are given an opportunity to profit from a rise in the market price of our common stock that, upon the exercise of such options, could result in dilution in the interests of our other shareholders.

Our business potential could be impacted by our failure to adequately protect our intellectual property.

Our success depends in part on our ability to obtain and maintain proprietary protection for our technologies, products, and processes, and our ability to operate without infringing the proprietary rights of other parties. We may not be able to obtain copyright, patent or other protection for our proprietary technologies or for certain processes developed by our employees. Legal standards relating to intellectual property rights in computer software are still developing and this area of the law is evolving with new technologies. Any copyrights, patents or other registrations may not sufficiently protect us against competitors with similar technology. In addition, our intellectual property rights may be challenged, narrowed, invalidated or circumvented. Our intellectual property rights do not guarantee any competitive advantage. Because our success in part relies upon our technologies, if proper protection is not available or can be circumvented, our business may be negatively impacted.

There is a limited public market for our common stock.

Our common stock is presently quoted on the OTC Bulletin Board under the symbol "IAIC", and the securities are traded through broker-dealers. Because our stock trades on the OTC Bulletin Board rather than on a national securities exchange, a shareholder may find it difficult to either dispose of or obtain quotations as to the price of our common stock. There has historically been a low trading volume of our shares which may have an adverse impact on a shareholder's ability to execute transactions of our shares.

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

Our actual financial results likely will be different from those projected due to the inherent nature of projections and may be better or worse than projected. Given these uncertainties, you should not rely on forward-looking statements. The forward-looking statements contained in this Form 10-K speak only as of the date of this Form 10-K. We expressly disclaim a duty to provide updates to forward-looking statements after the date of this Form 10-K to reflect the occurrence of subsequent events, changed circumstances, changes in our expectations, or the estimates and assumptions associated with them. The forward-looking statements in this Form 10-K are intended to be subject to the safe harbor protection provided by the federal securities laws.

ITEM 2. PROPERTIES.

Our offices are located at 11240 Waples Mill Road, Fairfax, VA 22030. We hold a lease for 4,434 square feet. This lease expires on May 31, 2017. We believe that our current facility is suitable and adequate to meet our current needs, and that suitable additional or substitute space will be available as needed to accommodate expansion of our operations.

ITEM 3. LEGAL PROCEEDINGS.

There are presently no pending legal proceedings to which we are a party or to which any of our property is subject and, to the best of our knowledge, no such actions against us are contemplated or threatened.

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## PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

## Market Information

Our Common Stock trades on the Over-the-Counter Bulletin Board under the symbol IAIC. The following table sets forth, for the fiscal periods indicated, the high and low bid prices of the Common Stock, as reported by Yahoo Finance:

|      | Fiscal Year Ended December 31, 2012 |         |         |          | Fiscal Year Ended December 31, 2011 |         |         |          |
|------|-------------------------------------|---------|---------|----------|-------------------------------------|---------|---------|----------|
|      | Quarter Ended:                      |         |         |          | Quarter Ended:                      |         |         |          |
|      | 3/31/12                             | 6/30/12 | 9/30/12 | 12/31/12 | 3/31/11                             | 6/30/11 | 9/30/11 | 12/31/11 |
| High | \$0.19                              | \$0.15  | \$0.18  | \$0.17   | \$0.19                              | \$0.20  | \$0.22  | \$0.24   |
| Low  | \$0.15                              | \$0.15  | \$0.13  | \$0.10   | \$0.15                              | \$0.15  | \$0.17  | \$0.13   |

The quotations on which the above data are based reflect inter-dealer prices without adjustment for retail mark-up, mark-down or commission, and may not necessarily represent actual transactions.

Because our stock trades on the OTC Bulletin Board rather than on a national securities exchange, a shareholder may find it difficult to either dispose of or obtain quotations as to the price of our common stock. There has historically been a low trading volume of our shares which may have an adverse impact on a shareholder's ability to execute transactions of our shares.

## Holders

As of December 31, 2012, we had 111 holders of record of our Common Stock.

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## Dividends

We have never paid any cash dividends on our common stock and do not anticipate paying cash dividends within the foreseeable future. Our management anticipates that all earnings, if any, will be retained for development of our business. Any future dividends will be subject to the discretion of the board of directors and will depend on, among other things, future earnings, our operating and financial condition, our capital requirements and general business conditions.

## Securities Authorized for Issuance under Equity Compensation Plans

The following table contains information regarding securities authorized and available for issuance under our equity compensation plans for certain employees, directors, and consultants.

## Equity Compensation Plan Information

| Plan Category   | Number of securities to be issued upon exercise of outstanding options, warrants, and rights<br>(a) | Weighted-average exercise price of outstanding options, warrants, and rights<br>(b) | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))<br>(c) |
|---|---|---|--|
| Equity compensation plans approved by security holders <sup>1,2</sup> | 1,032,500   | \$ 0.29   | 1,272,500  |
| Equity compensation plans not approved by security holders            | -   | -   | -  |
| <b>Total</b>  | <b>1,032,500</b>  | <b>\$ 0.29</b>  | <b>1,272,500</b>   |

<sup>1</sup> The Company has a stock incentive plan, which became effective May 18, 2006, and expires May 17, 2016 (the “2006 Plan”). The 2006 Plan provides for the granting of equity awards to employees and directors. The maximum number of shares for which equity awards may be granted under the 2006 Plan is 1,950,000. Options under the 2006 Plan expire no later than ten years from the date of grant or 90 days after employment ceases, whichever comes first, and vest over periods determined by the Board of Directors.

<sup>2</sup>The Company had a stock option plan, which became effective June 25, 1996, and expired May 29, 2006 (the “1996 Plan”). The 1996 Plan provided for the granting of stock options to employees and directors. The maximum number of shares for which options could be granted under the 1996 Plan was 3,075,000. Options expire no later than ten years from the date of grant or 90 days after employment ceases, whichever comes first, and vest over periods determined by the Board of Directors.

## Recent Sales of Unregistered Securities

We had no sales of unregistered securities during 2012 that have not been previously disclosed in a Current Report on Form 8-K or Quarterly Reports on Form 10-Q.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

We did repurchase any of our equity securities during 2012.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following discussion should be read in conjunction with the attached financial statements and notes thereto. Reference is made to "Cautionary Statement Regarding Forward-Looking Statements" on page 1 hereof, which describes important factors that could cause actual results to differ from expectations and non-historical information contained herein.



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## Overview

During 2012 our sales and marketing efforts were focused to capitalize on our expertise in these areas – electronic forms software, conversion, modernization, accessibility, web-enablement, services and tools to address the legacy modernization/conversion market, including third party tools, legacy and post-conversion database support, development and support of database-backed web portals, other web-based solutions, and management consulting services.

In 2012 we had net income of \$100,423. Our stockholders' equity was \$2,148,009 at December 31, 2012. Our gross margins decreased by \$31,272 on a decrease in revenue of \$763,222. The revenue decrease is due to decreases in sales of third-party software products and related maintenance contracts. Gross margins as a percentage of sales were consistent with 2011 for professional services and decreased from 14.6% to 14.0% for software sales. Our expenses related to selling, general and administrative infrastructure increased 7.7% in 2012, and increased from 20.0% to 23.9% as a percentage of sales. Commission expense decreased 13.4% due primarily to the decrease in software sales.

Cash and cash equivalents increased \$1,342,090, primarily due to one large product-related receivable outstanding at December 31, 2011 and collected in 2012. We were able to maintain and to grow our investment in interest bearing accounts, and we were able to operate throughout 2012 without borrowing against our line of credit.

## Results of Operations

The following table sets forth, for the periods indicated, selected information from our Statements of Operations, expressed as a percentage of revenue:

|                                     | Years Ended             |    |                         |    |
|-------------------------------------|-------------------------|----|-------------------------|----|
|                                     | December<br>31,<br>2012 |    | December<br>31,<br>2011 |    |
| Revenue                             | 100.0                   | %  | 100.0                   | %  |
| Cost of revenues                    | 65.8                    | %  | 68.8                    | %  |
| Gross profit                        | 34.2                    | %  | 31.2                    | %  |
| Operating expenses                  |                         |    |                         |    |
| Selling, general and administrative | (23.9                   | %) | (20.0                   | %) |
| Commissions expense                 | (9.0                    | %) | (9.3                    | %) |
| Income from operations              | 1.3                     | %  | 1.9                     | %  |
| Other income                        | 0.1                     | %  | 0.1                     | %  |
| Income before income taxes          | 1.4                     | %  | 2.0                     | %  |
| Provision for income taxes          | ( 0.0                   | %) | ( 0.0                   | %) |
| Net income                          | 1.4                     | %  | 2.0                     | %  |

## 2012 Compared to 2011

Revenue. Total revenue for 2012 decreased \$763,000, or 9.8%, to \$7.06 million from \$7.82 million in 2011. Revenue from professional services fees increased \$326,000, or 6.9%, to \$5.03 million in 2012 from \$4.70 million in 2011. Revenue from software sales decreased \$1.09 million, or 34.9%, to \$2.03 million in 2012 from \$3.12 million in 2011. Revenue from software sales comprised 28.8% of total sales in 2012, compared to 39.9% of total sales in 2011. Our

software sales decreases were due to contract expirations and decreases in customer maintenance renewals due to competition and enterprise-wide consolidations of licenses and maintenance agreements.

**Gross Profit.** Gross profit decreased \$31,000, or 1.3% in 2012 versus 2011. Gross profit as a percentage of revenue increased to 34.2% of revenue in 2012 from 31.2% of revenue in 2011. The increase in gross profit as a percentage of revenue is due to the increase in the ratio of professional fees revenue to software sales revenue. Gross profit from professional fees was 42.3% in 2012 on 71.2% of total revenues while gross profit from software sales was 14.0% on 28.8% of total sales. In 2011, gross profit from professional fees was 42.3% on 60.1% of total revenues while gross profit from software sales was 14.6% on 39.9% of total sales. Professional services gross margin was \$2.13 million in 2012, compared to \$1.99 million in 2011. Software sales gross margin decreased from \$456,000 in 2011 to \$284,000 in 2012. Gross margin for software sales decreased due to decreases in new product and maintenance sales and maintenance renewals.

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**Selling, General and Administrative.** Selling, general and administrative expense for 2012 increased \$121,000 to \$1.69 million, or 23.9% of revenue, from \$1.56 million, or 20.0% of revenue, in 2011. The increase is primarily due to increases in non-revenue-producing labor costs. These consisted of an increase in overhead labor related to periods of U.S. federal government customer budget uncertainties and to a short-term business development project that did not yield anticipated results.

**Commission Expense.** Commission expense in 2012 was \$632,000, or 9.0% of revenue, versus \$729,000, or 9.3% in 2011. Commission expenses vary with income generated from contracts sold by our commission-based sales associates.

### Recent Accounting Pronouncements

From time to time, new accounting pronouncements are issued by the Financial Accounting Standards Board (the "FASB"), or other standard setting bodies that the Company adopts as of the specified effective date. The Company does not believe that the impact of recently issued accounting standards that are not yet effective will have a material effect on its financial position or results of operations upon adoption.

### Liquidity and Capital Resources

Our beginning cash and cash equivalents balance, when combined with our cash flow from operations, were sufficient to provide financing for our operations. For 2012, net cash provided by operating, investing and financing activities was \$1,342,090. Our net cash provided of \$1,342,090, when added to a beginning balance of \$1,280,926, yielded cash and cash equivalents of \$2,623,016 at December 31, 2012. Our accounts receivable balances decreased \$2,151,614, and our accounts payable balances decreased \$886,575, primarily due to outstanding product-related invoices at the 2011 year end. We had no non-current liabilities at December 31, 2012.

We have a revolving line of credit with a bank providing for demand or short-term borrowings of up to \$1,000,000. The line became effective December 20, 2005, and expires on December 1, 2013. As of December 31, 2012, no amounts were outstanding under this line of credit. We did not borrow against this line of credit in 2012.

Based on our current cash position and operating plan, we anticipate that we will be able to meet our cash requirements beyond 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.

### Off-Balance Sheet Arrangements

We do not have any off balance sheet arrangements that have or are likely to have a material current or future effect on our financial condition, or changes in financial condition, liquidity or capital resources or expenditures.

### Critical Accounting Policies and Estimates

Our significant accounting policies are described in Note 1 to our accompanying financial statements. We consider the accounting policies related to revenue recognition to be critical to the understanding of our results of operations. Our critical accounting policies also include the areas where we have made what we consider to be particularly difficult, subjective or complex judgments in making estimates, and where these estimates can significantly impact our financial results under different assumptions and conditions. We prepare our financial statements in conformity with accounting principles generally accepted in the United States. As such, we are required to make certain estimates, judgments and assumptions that we believe are reasonable based upon the information available. These estimates, judgments and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the periods presented. Actual results could be different from these estimates.

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Revenue Recognition

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

We recognize revenue on time and materials contracts based on direct labor hours expended at contract billing rates and adding other billable direct costs.

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

For fixed-price contracts in which we are paid a specific amount to be available to provide a particular service for a stated period of time, we recognize revenue ratably over the service period. We apply this method of revenue recognition to renewals of maintenance contracts on third-party software sales from prior years and to separable maintenance elements of sales of third-party software that include fixed terms of maintenance, such as Adobe and Micro Focus software, for which we are responsible for “first line support” to the customer and for serving as a liaison between the customer and the third-party maintenance provider for issues we are unable to resolve.

We report revenue on both gross and net bases on a transaction by transaction analysis using authoritative guidance issued by the FASB. We consider the following factors to determine the gross versus net presentation: if we (i) act as principal in the transaction; (ii) take title to the products; (iii) have risks and rewards of ownership, such as the risk of loss for collection, delivery or return; and (iv) act as an agent or broker (including performing services, in substance, as an agent or broker) with compensation on a commission or fee basis. Generally, sales of third-party software products such as Adobe and Micro Focus products are reported on a gross basis, with our company acting as the principal in these arrangements. This determination is based on the following: 1) we have inventory risk as suppliers are not obligated to accept returns, 2) we have reasonable latitude, within economic constraints, in establishing price, 3) in our marketing efforts, we frequently aid the customer in determining product specifications, 4) we have physical loss and inventory risk as title transfers at the shipping point, 5) we bear full credit risk, and 6) the amount we earn in the transaction is neither a fixed dollar amount nor a fixed percentage. Generally, revenue derived for facilitating a sales transaction of Adobe products in which a customer introduced by us makes a purchase directly from our supplier or another designated reseller is recognized net when the commission payment is received, since we are merely acting as an agent in these arrangements. Since we are not a direct party in the sales transaction, payment by the supplier is our confirmation that the sale occurred.

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

We determine VSOE for each element based on historical stand-alone sales to third parties or from the stated renewal rate for the elements contained in the initial arrangement. We have established VSOE for our third-party software maintenance and support services.

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

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

Effects of Inflation

In the opinion of management, inflation has not had a material effect on our operations.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

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| <u>Report of Independent Registered Public Accounting Firm</u>  | 18 |
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and  
Stockholders of Information Analysis Incorporated

We have audited the accompanying balance sheet of Information Analysis Incorporated as of December 31, 2012, and the related statements of operations, changes in stockholders' equity and cash flows for the year ended December 31, 2012. Information Analysis Incorporated's management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Information Analysis Incorporated as of December 31, 2012, and the results of its operations and its cash flows for the year ended December 31, 2012 in conformity with accounting principles generally accepted in the United States of America.

/s/ CohnReznick LLP

Vienna, Virginia  
March 29, 2013



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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders  
Information Analysis Incorporated

We have audited the accompanying balance sheet of Information Analysis Incorporated as of December 31, 2011, and the related statements of operations, changes in stockholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company has determined that it is not required to have, nor were we engaged to perform, an audit of its internal controls over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Information Analysis Incorporated as of December 31, 2011, and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ Reznick Group, P.C.

Vienna, Virginia  
March 30, 2012

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INFORMATION ANALYSIS INCORPORATED  
BALANCE SHEETS

|   | December<br>31,<br>2012 | December<br>31,<br>2011 |
|---|-------------------------|-------------------------|
| <b>ASSETS</b>   |                         |                         |
| Current assets  |                         |                         |
| Cash and cash equivalents   | \$2,623,016             | \$1,280,926             |
| Accounts receivable, net  | 738,044                 | 2,889,658               |
| Prepaid expenses and other current assets   | 191,406                 | 787,290                 |
| Note receivable, current  | 2,410                   | 6,668                   |
| Total current assets  | 3,554,876               | 4,964,542               |
| Property and equipment, net of accumulated depreciation<br>and amortization of \$292,301 and \$264,837  | 39,226                  | 40,440                  |
| Note receivable, long-term  | 3,885                   | 4,287                   |
| Other assets  | 6,281                   | 6,281                   |
| Total assets  | \$3,604,268             | \$5,015,550             |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                         |                         |
| Current liabilities   |                         |                         |
| Accounts payable  | \$111,585               | \$998,160               |
| Commissions payable   | 806,133                 | 679,498                 |
| Accrued payroll and related liabilities   | 269,716                 | 247,885                 |
| Deferred revenue  | 220,424                 | 939,783                 |
| Other accrued liabilities   | 48,401                  | 107,235                 |
| Income taxes payable  | -                       | 2,800                   |
| Total current liabilities   | 1,456,259               | 2,975,361               |
| Stockholders' equity  |                         |                         |
| Common stock, \$0.01 par value, 30,000,000 shares authorized, 12,844,376 and<br>12,839,376 shares issued, 11,201,760 and 11,196,760 shares outstanding as of<br>December 31, 2012 and December 31, 2011, respectively | 128,443                 | 128,393                 |
| Additional paid-in capital  | 14,581,475              | 14,574,128              |
| Accumulated deficit   | (11,631,698)            | (11,732,121)            |
| Treasury stock, 1,642,616 shares at cost at December 31, 2012 and 2011  | (930,211 )              | (930,211 )              |
| Total stockholders' equity  | 2,148,009               | 2,040,189               |
| Total liabilities and stockholders' equity  | \$3,604,268             | \$5,015,550             |

The accompanying notes are an integral part of the financial statements



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INFORMATION ANALYSIS INCORPORATED  
STATEMENTS OF OPERATIONS AND  
COMPREHENSIVE INCOME

|  | For the years ended<br>December 31, |             |
|--|-------------------------------------|-------------|
|  | 2012                                | 2011        |
| Revenues                                     |                                     |             |
| Professional fees                            | \$5,026,676                         | \$4,700,679 |
| Software sales                               | 2,030,877                           | 3,120,096   |
| Total revenues                               | 7,057,553                           | 7,820,775   |
| Cost of revenues                             |                                     |             |
| Cost of professional fees                    | 2,899,297                           | 2,714,118   |
| Cost of software sales                       | 1,747,274                           | 2,664,403   |
| Total cost of revenues                       | 4,646,571                           | 5,378,521   |
| Gross profit                                 | 2,410,982                           | 2,442,254   |
| Selling, general and administrative expenses | 1,685,156                           | 1,564,370   |
| Commissions expense                          | 631,698                             | 729,075     |
| Income from operations                       | 94,128                              | 148,809     |
| Other income                                 | 6,295                               | 7,392       |
| Income before provision for income taxes     | 100,423                             | 156,201     |
| Provision for income taxes                   | -                                   | 2,800       |
| Net income                                   | \$100,423                           | \$153,401   |
| Comprehensive income                         | \$100,423                           | \$153,401   |
| Net Income per common share – basic          | \$0.01                              | \$0.01      |
| Net Income per common share – diluted        | \$0.01                              | \$0.01      |
| Weighted average common shares outstanding   |                                     |             |
| Basic  | 11,200,025                          | 11,196,760  |
| Diluted                                      | 11,210,939                          | 11,224,410  |

The accompanying notes are an integral part of the financial statements

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INFORMATION ANALYSIS INCORPORATED  
STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

|                             | Shares of<br>Common<br>Stock<br>Issued | Common<br>Stock | Additional<br>Paid-in<br>Capital | Accumulated<br>Deficit | Treasury<br>Stock | Total       |
|-----------------------------|--|-----------------|----------------------------------|------------------------|-------------------|-------------|
| Balances, December 31, 2010 | 12,839,376                             | \$128,393       | \$14,567,422                     | \$(11,885,522)         | \$(930,211 )      | \$1,880,082 |
| Net Income                  | -                                      | -               | -                                | 153,401                | -                 | 153,401     |
| Stock option compensation   | -                                      | -               | 6,706                            | -                      | -                 | 6,706       |
| Balances, December 31, 2011 | 12,839,376                             | \$128,393       | \$14,574,128                     | \$(11,732,121)         | \$(930,211 )      | \$2,040,189 |
| Net Income                  | -                                      | -               | -                                | 100,423                | -                 | 100,423     |
| Stock option compensation   | -                                      | -               | 7,047                            | -                      | -                 | 7,047       |
| Stock option exercise       | 5,000                                  | 50              | 300                              | -                      | -                 | 350         |
| Balances, December 31, 2012 | 12,844,376                             | \$128,443       | \$14,581,475                     | \$(11,631,698)         | \$(930,211 )      | \$2,148,009 |

The accompanying notes are an integral part of the financial statements

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INFORMATION ANALYSIS INCORPORATED  
STATEMENTS OF CASH FLOWS

|   | For the years ended<br>December 31, |              |
|---|-------------------------------------|--------------|
|   | 2012                                | 2011         |
| Cash flows from operating activities:   |                                     |              |
| Net income  | \$ 100,423                          | \$ 153,401   |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |                                     |              |
| Depreciation and amortization   | 27,464                              | 19,464       |
| Stock option compensation   | 7,047                               | 6,706        |
| Bad debt expense  | 1,401                               | 52,376       |
| Changes in operating assets and liabilities   |                                     |              |
| Accounts receivable   | 2,150,213                           | (2,170,220)  |
| Prepaid expenses and other current assets   | 595,884                             | (216,342 )   |
| Accounts payable and accrued expenses   | (923,578 )                          | 962,494      |
| Deferred revenue  | (719,359 )                          | 287,192      |
| Commissions payable   | 126,635                             | 232,739      |
| Income taxes payable  | (2,800 )                            | 2,800        |
| Net cash provided by (used in) operating activities   | 1,363,330                           | (669,390 )   |
| Cash flows from investing activities:   |                                     |              |
| Acquisition of furniture and equipment  | (26,250 )                           | (24,199 )    |
| Payments received on notes receivable – employees   | 14,660                              | 6,438        |
| Increase in notes receivable – employees  | (10,000 )                           | -            |
| Net cash used in investing activities   | (21,590 )                           | (17,761 )    |
| Cash flows from financing activities:   |                                     |              |
| Proceeds from the exercise of stock options   | 350                                 | -            |
| Net cash provided by financing activities   | 350                                 | -            |
| Net increase (decrease) in cash and cash equivalents  | 1,342,090                           | (687,151 )   |
| Cash and cash equivalents, beginning of the year  | 1,280,926                           | 1,968,077    |
| Cash and cash equivalents, end of the year  | \$ 2,623,016                        | \$ 1,280,926 |
| Supplemental cash flow information  |                                     |              |
| Interest paid   | \$-                                 | \$-          |
| Income taxes paid   | \$ 2,800                            | \$-          |

The accompanying notes are an integral part of the financial statements



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INFORMATION ANALYSIS INCORPORATED  
NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Operations

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

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”) requires management to make estimates and assumptions that affect the 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 revenues and expenses during the reporting period. Actual results could differ from these estimates.

Revenue Recognition

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

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

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

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

The Company reports revenue on both a gross and net basis on a transaction by transaction analysis using authoritative guidance issued by the Financial Accounting Standards Board (the “FASB”). The Company considers the following factors to determine the gross versus net presentation: if the Company (i) acts as principal in the transaction; (ii) takes title to the products; (iii) has risks and rewards of ownership, such as the risk of loss for collection, delivery



or return; and (iv) acts as an agent or broker (including performing services, in substance, as an agent or broker) with compensation on a commission or fee basis. Generally, sales of third-party software products such as Adobe and Micro Focus products are reported on a gross basis with the Company acting as the principal in these arrangements. This determination is based on the following: 1) the Company has inventory risk as suppliers are not obligated to accept returns, 2) the Company has reasonable latitude, within economic constraints, in establishing price, 3) the Company, in its marketing efforts, frequently aids the customer in determining product specifications, 4) the Company has physical loss and inventory risk as title transfers at the shipping point, 5) the Company bears full credit risk, and 6) the amount the Company earns in the transaction is neither a fixed dollar amount nor a fixed percentage. Generally, revenue derived for facilitating a sales transaction of Adobe products in which a customer introduced by the Company makes a purchase directly from the Company's supplier or another designated reseller is recognized net when the commission payment is received since the Company is merely acting as an agent in these arrangements. Since the Company is not a direct party in the sales transaction, payment by the supplier is the Company's confirmation that the sale occurred.

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

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

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

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

#### Segment Reporting

The Company has concluded that it operates in one business segment, providing products and services to modernize client information systems.

#### Government Contracts

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

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1. Summary of Significant Accounting Policies (continued)

Cash and Cash Equivalents

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

Accounts Receivable

Accounts receivable consist of trade accounts receivable and do not bear interest. The Company typically does not require collateral from its customers. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company reviews its allowance for doubtful accounts monthly. Accounts with receivable balances past due over 90 days are reviewed individually for collectability. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The Company does not have any off-balance sheet credit exposure related to its customers. The Company has recorded an allowance for doubtful accounts of \$381 and \$141,721 at December 31, 2012 and 2011, respectively.

Note Receivable

The Company has a note receivable and accrued interest from an employee of \$6,295 and \$10,955 at December 31, 2012 and 2011, respectively. The note bears interest at 3.5% and is payable semi-monthly over 36 months from the date of the note. Interest income recognized was not material for all periods presented.

Property and Equipment

Property and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the assets. Furniture and fixtures are depreciated over the lesser of the useful life or five years, off-the-shelf software is depreciated over the lesser of three years or the term of the license, custom software is depreciated over the least of five years, the useful life, or the term of the license, and computer equipment is depreciated over three years. Leasehold improvements are amortized over the estimated term of the lease or the estimated life of the improvement, whichever is shorter. Maintenance and minor repairs are charged to operations as incurred. Gains and losses on dispositions are recorded in operations.

Stock-Based Compensation

At December 31, 2012, the Company had the stock-based compensation plans described in Note 9 below. Total compensation expense related to these plans was \$7,047 and \$6,706 for the years ended December 31, 2012 and 2011, respectively, of which \$550 and \$0, respectively, related to options awarded to non-employees. The Company estimates the fair value of options granted using a Black-Scholes valuation model to establish the expense. When stock-based compensation is awarded to employees, the expense is recognized ratably over the vesting period. When stock-based compensation is awarded to non-employees, the expense is recognized over the period of performance.



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1. Summary of Significant Accounting Policies (continued)

Income Taxes

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

Earnings Per Share

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

Concentration of Credit Risk

The Company's prime contracts and subcontracts with agencies of the U.S. federal government accounted for 87% and 89% of the Company's revenues during 2012 and 2011, respectively. The Company has prime contracts with one U.S. federal government agency that accounted for 28% and 48% of the Company's 2012 and 2011 revenue, respectively. Also, the Company has subcontracts with other companies for which work is done for a U.S. federal agency that account for 22% and 19% of the Company's 2012 revenue and 16% and 1% of the 2011 revenue.

The Company sold third party software and maintenance contracts under agreements with two major suppliers. These sales accounted for 27% of total revenue in 2012 and 40% of revenue in 2011.

At December 31, 2012, the Company's accounts receivable included receivables from one U.S. federal agency that represented 11% of the Company's outstanding accounts receivable and from two companies under which we subcontract for services to U.S. federal agencies that represented 42% and 18% of the Company's outstanding accounts receivable, respectively. At December 31, 2011, the Company's accounts receivable included receivables from various departments within one U.S. federal agency that collectively represented 75% of the Company's outstanding accounts receivable.

Reclassifications

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

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. The Company does not believe that the impact of recently issued accounting standards that are not yet effective will have a material effect on its financial position or results of operations upon adoption.

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## 2. Receivables

Accounts receivable at December 31, 2012 and 2011, consist of the following:

|                                 | 2012       | 2011         |
|---------------------------------|------------|--------------|
| Billed-federal government       | \$ 664,533 | \$ 2,961,279 |
| Billed-commercial and other     | 73,892     | 70,100       |
| Total billed                    | 738,425    | 3,031,379    |
| Unbilled                        | -          | -            |
| Allowance for doubtful accounts | (381 )     | (141,721 )   |
| Accounts receivable, net        | \$ 738,044 | \$ 2,889,658 |

Billed receivables from the federal government include amounts due from both prime contracts and subcontracts where the federal government is the end customer. Unbilled receivables are for services provided through the balance sheet date that are expected to be billed and collected within one year.

## 3. Fair Value Measurements

The Company defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value which are the following:

Level 1—Quoted prices in active markets for identical assets or liabilities;

Level 2—Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and

Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The following table represents the fair value hierarchy for our financial assets (cash equivalents and marketable securities) measured at fair value on a recurring basis as of December 31, 2012 and 2011 (in thousands):

|                       | Level 1  | Level 2 | Level 3 |
|-----------------------|----------|---------|---------|
| December 31, 2012     |          |         |         |
| Money market accounts | \$ 2,003 | \$ -    | \$ -    |
| Total                 | \$ 2,003 | \$ -    | \$ -    |

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December 31, 2011

|                       |          |      |      |
|-----------------------|----------|------|------|
| Money market accounts | \$ 1,022 | \$ - | \$ - |
| Total                 | \$ 1,022 | \$ - | \$ - |



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## 3. Fair Value Measurements (continued)

Money market accounts are highly liquid investments. The pricing information on these investment instruments are readily available and can be independently validated as of the measurement date. This approach results in the classification of these securities as Level 1 of the fair value hierarchy.

The carrying amount of financial instruments such as accounts receivable, accounts payable, and accrued liabilities approximate the related fair value due to the short-term maturities of these instruments. The carrying amount of notes receivable approximate fair value based on interest rates currently available.

## 4. Fixed Assets

A summary of fixed assets and equipment at December 31, 2012 and 2011, consist of the following:

|   | 2012       | 2011       |
|---|------------|------------|
| Furniture and equipment                         | \$ 93,391  | \$ 93,391  |
| Computer equipment and software                 | 238,136    | 211,886    |
| Subtotal  | 331,527    | 305,277    |
| Less: accumulated depreciation and amortization | (292,301 ) | (264,837 ) |
| Total   | \$ 39,226  | \$ 40,440  |

Depreciation expense for the years ended December 31, 2012 and 2011, was \$27,464 and \$19,464, respectively.

## 5. Revolving Line of Credit

On December 20, 2005, the Company entered into a revolving line of credit agreement with TD Bank providing for demand or short-term borrowings up to \$1,000,000. The credit agreement includes an interest rate indexed to 3.00% above the British Bankers' Association London Interbank Offered Rate (BBA LIBOR). The line of credit was renewed on November 30, 2012, and expires on December 1, 2013. Draws against the line are limited by varying percentages of the Company's eligible accounts receivable. The bank is granted a security interest in all company assets if there are borrowings under the line of credit. Interest on outstanding balances is payable monthly. The effective rate at December 31, 2012, was 3.21%. At December 31, 2011, the effective rate was 4.02%.

The bank has a first priority security interest in the Company's receivables and a direct assignment of its U.S. federal government contracts. Under the line of credit agreement, the Company is bound by certain covenants, including maintaining positive net income as tested on an annual basis, maintaining a minimum tangible net worth, and producing a number of periodic financial reports for the benefit of the bank. There was no outstanding balance on the line of credit at December 31, 2012 or 2011.

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## 6. Commitments and Contingencies

## Operating Leases

The Company leases facilities under long-term operating lease agreements through May 2017. Rent expense was \$89,597 and \$88,894 for the years ended December 31, 2012 and 2011, respectively.

The future minimum rental payments to be made under long-term operating leases are as follows:

|                             |      |           |
|-----------------------------|------|-----------|
| Year ending                 |      |           |
| December 31,:               | 2013 | \$88,954  |
|                             | 2014 | 99,255    |
|                             | 2015 | 102,232   |
|                             | 2016 | 105,299   |
|                             | 2017 | 44,414    |
| Total minimum rent payments |      | \$440,154 |

The above minimum lease payments reflect the base rent under the lease agreements. However, these base rents can be adjusted each year to reflect the Company's proportionate share of increases in the building's operating costs and the Company's proportionate share of real estate tax increases on the leased property.

## 7. Income Taxes

The tax effects of significant temporary differences representing deferred tax assets at December 31, 2012 and 2011, are as follows:

|                                  | 2012         | 2011         |
|----------------------------------|--------------|--------------|
| Deferred tax assets:             |              |              |
| Net operating loss carryforward  | \$ 5,501,500 | \$ 5,559,500 |
| Accrued vacation and commissions | 312,200      | 261,800      |
| Fixed assets                     | 48,100       | 46,100       |
| Allowance for doubtful accounts  | 100          | 53,400       |
| AMT tax credit carryforward      | 6,600        | 9,500        |
| Other                            | 9,700        | 8,200        |
| Subtotal                         | 5,878,200    | 5,938,500    |
| Valuation allowance              | (5,878,200)  | (5,938,500)  |
| Total                            | \$ -         | \$ -         |

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## 7. Income Taxes (continued)

The provision for income taxes is at an effective rate different from the federal statutory rate due principally to the following:

|  | December 31, |            |
|--|--------------|------------|
|  | 2012         | 2011       |
| Income before taxes  | \$ 100,423   | \$ 156,201 |
| Income tax expense (benefit) on above amount at federal statutory rate | 34,100       | 53,100     |
| State income tax expense (benefit), net of federal expense (benefit)   | 4,000        | 6,200      |
| Permanent differences  | 7,600        | 5,600      |
| Other  | 14,600       | (800 )     |
| Change in valuation allowance  | (60,300 )    | (61,300 )  |
| Provision for income taxes   | \$ -         | \$ 2,800   |

Income tax expense for the years ended December 31, 2012 and 2011 consists of the following:

|  | December 31, |            |
|--|--------------|------------|
|  | 2012         | 2011       |
| Current income taxes                             |              |            |
| Federal  | \$ 83,900    | \$ 179,000 |
| State  | 9,900        | 21,100     |
| Alternative minimum tax                          | -            | 2,800      |
| Benefit from utilization of net operating losses | (93,800 )    | (200,100 ) |
|  | -            | 2,800      |
| Deferred taxes                                   | -            | -          |
|  | \$ -         | \$ 2,800   |

The Company has recorded a valuation allowance to the full extent of its currently available net deferred tax assets which the Company determined to be not more-likely-than-not realizable. The Company has net operating loss carryforwards of approximately \$14.5 million, which expire, if unused, between the years 2017 and 2028.

The Company may have been deemed to have experienced changes in ownership which may impose limitations on its ability to utilize net operating loss carryforwards under Section 382 of the Internal Revenue Code. However, as the deferred tax asset is fully offset by a valuation allowance, the Company has not yet conducted a Section 382 study to determine the extent of any such limitations.

The Company has analyzed its income tax positions using the criteria required by U.S. GAAP and concluded that as of December 31, 2012 and 2011, it has no material uncertain tax positions and no interest or penalties have been accrued. The Company has elected to recognize any estimated penalties and interest on its income tax liabilities as a component of its provision for income taxes.



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## 8. Retirement Plans

The Company has a Cash or Deferred Arrangement Agreement (CODA), which satisfies the requirements of section 401(k) of the Internal Revenue Code. This defined contribution retirement plan covers substantially all employees. Participants can elect to have up to the maximum percentage allowable of their salaries reduced and contributed to the plan. The Company may make matching contributions equal to a discretionary percentage of the participants' elective deferrals. In 2012 and in 2011, the Company matched 25% of the first 6% of the participants' elective deferrals. The Company may also make additional contributions to all eligible employees at its discretion. The Company did not make additional contributions during 2012 or 2011. Expenses for matching contributions for the years ended December 31, 2012 and 2011 were \$30,680 and \$20,303, respectively. The balance of funds forfeited by former employees from unvested employer matching contribution accounts may be used to offset current and future employer matching contributions.

## 9. Stock Options and Warrants

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

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

The Company recognizes compensation costs only for those shares expected to vest on a straight-line basis over the requisite service period of the awards. Generally such options vest over periods of six months to two years. The fair values of option awards granted in 2012 and 2011 were estimated using the Black-Sholes option pricing model under the following assumptions:

|                         | 2012         |   | 2011         |   |
|-------------------------|--------------|---|--------------|---|
| Risk free interest rate | 0.62% -      |   | 1.65% -      |   |
| Dividend yield          | 2.31         | % | 2.30         | % |
| Expected term           | 5-10 years   |   | 5 years      |   |
| Expected volatility     | 62.8 - 67.9% |   | 61.7 - 61.9% |   |

## 2006 Stock Incentive Plan

The 2006 Plan became effective May 18, 2006, and expires May 17, 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 may be granted under the 2006 Plan is 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. The average vesting period for options granted to employees under the 2006 Plan in the years ended December 31, 2012 and 2011, were twelve months and nineteen months, respectively. The exercise price of each option equals the quoted market price of the Company's stock on the date of grant.



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## 9. Stock Options and Warrants (continued)

## 1996 Stock Option Plan

The 1996 Plan provided for the granting of options to purchase shares of our common stock to key employees, including officers and directors. The maximum number of shares for which options could be granted under the 1996 Plan was 3,075,000. Options expire no later than ten years from the date of grant or when employment ceases, whichever comes first, and vest over periods determined by the Board of Directors. There were 360,000 and 411,000 unexpired exercisable options remaining from the 1996 Plan at December 31, 2012 and 2011, respectively.

The status of the options issued under the foregoing option plans as of December 31, 2012, and changes during the years ended December 31, 2012 and 2011, were as follows:

|   | Options outstanding |                                  |
|---|---------------------|----------------------------------|
|   | Number of shares    | Weighted average price per share |
| Balance at December 31, 2010            | 1,119,000           | \$ 0.30                          |
| Options granted                         | 45,500              | 0.17                             |
| Options exercised, expired or forfeited | 161,500             | 0.20                             |
| Balance at December 31, 2011            | 1,003,000           | 0.31                             |
| Options granted                         | 109,500             | 0.14                             |
| Options exercised                       | 5,000               | 0.07                             |
| Options expired or forfeited            | 75,000              | 0.30                             |
| Balance at December 31, 2012            | 1,032,500           | \$ 0.29                          |

The following table summarizes information about options at December 31, 2012:

| Options outstanding |                                 |  |                           | Options exercisable |                                 |  |                           |
|---------------------|---------------------------------|--|---------------------------|---------------------|---------------------------------|--|---------------------------|
| Total shares        | Weighted average exercise price | Weighted average remaining contractual life in years | Aggregate intrinsic value | Total shares        | Weighted average exercise price | Weighted average remaining contractual life in years | Aggregate intrinsic value |
| 1,032,500           | \$0.29                          | 4.32   | \$ 1,770                  | 920,250             | \$0.31                          | 3.73   | \$ 1,770                  |

Nonvested stock awards as of December 31, 2012 and changes during the year ended December 31, 2012, were as follows:

| Nonvested        |                  |
|------------------|------------------|
| Number of shares | Weighted average |

|                              |         | grant date<br>fair value |
|------------------------------|---------|--------------------------|
| Balance at December 31, 2011 | 60,000  | \$ 0.09                  |
| Granted                      | 109,500 | 0.08                     |
| Vested                       | 41,250  | 0.10                     |
| Expired before vesting       | 16,000  | 0.08                     |
| Balance at December 31, 2012 | 112,250 | 0.08                     |



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## 9. Stock Options and Warrants (continued)

As of December 31, 2012 and 2011, unrecognized compensation cost associated with non-vested share based employee and non-employee compensation totaled \$3,094 and \$2,225, respectively, which is expected to be recognized over a weighted average period of 5 months and 7 months, respectively.

## Warrants

The Board of Directors may also grant warrants to directors, employees and others. There were no warrants issued nor exercised during the years ended December 31, 2012 and 2011. As of December 31, 2012 and 2011, there were no outstanding warrants.

## 10. Earnings Per Share

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

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

|   | Net Income | Shares     | Per Share Amount |
|---|------------|------------|------------------|
| Basic net income per common share for the year ended December 31, 2012:   |            |            |                  |
| Income available to common stockholders                                   | \$ 100,423 | 11,200,025 | \$ 0.01          |
| Effect of dilutive stock options  |            | 10,914     | --               |
| Diluted net income per common share for the year ended December 31, 2012: | \$ 100,423 | 11,210,939 | \$ 0.01          |
| Basic net income per common share for the year ended December 31, 2011:   |            |            |                  |
| Income available to common stockholders                                   | \$ 153,401 | 11,196,760 | \$ 0.01          |
| Effect of dilutive stock options  |            | 27,650     | --               |
| Diluted net income per common share for the year ended December 31, 2011: | \$ 153,401 | 11,224,410 | \$ 0.01          |

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ITEM 9A. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended December 31, 2012 that have materially affected, or are reasonably likely to affect, our internal control over financial reporting.

Management’s Annual Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting. A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management, including the Chief Executive Officer and Chief Financial Officer, has conducted an evaluation of the effectiveness of our internal control over financial reporting as of the Evaluation Date, based on the criteria for effective internal control described in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on its assessment, management concluded that our internal control over financial reporting was effective as of the Evaluation Date.

This Annual Report does not include an attestation report of our independent registered public accounting firm regarding internal control over financial reporting. Management’s report was not subject to attestation by our independent registered public accounting firm.

This report shall not be deemed to be filed for purposes of Section 18 of the Exchange Act, or otherwise subject to the liabilities of that section, and is not incorporated by reference into any filing of Information Analysis Incorporated, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

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PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

(The information required by this Item is incorporated by reference from the corresponding sections and subsections of our Definitive Proxy Statement to be filed pursuant to Section 14(a) of the Exchange Act with respect to our 2013 Annual Meeting of Stockholders.

ITEM 11. EXECUTIVE COMPENSATION.

(The information required by this Item is incorporated by reference from the corresponding sections and subsections of our Definitive Proxy Statement to be filed pursuant to Section 14(a) of the Exchange Act with respect to our 2013 Annual Meeting of Stockholders.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

(The information required by this Item is incorporated by reference from the corresponding sections and subsections of our Definitive Proxy Statement to be filed pursuant to Section 14(a) of the Exchange Act with respect to our 2013 Annual Meeting of Stockholders.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.

(The information required by this Item is incorporated by reference from the corresponding sections and subsections of our Definitive Proxy Statement to be filed pursuant to Section 14(a) of the Exchange Act with respect to our 2013 Annual Meeting of Stockholders.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.

(The information required by this Item is incorporated by reference from the corresponding sections and subsections of our Definitive Proxy Statement to be filed pursuant to Section 14(a) of the Exchange Act with respect to our 2013 Annual Meeting of Stockholders.

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## PART IV

## ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES.

## (a)(1) Financial Statements

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| Report of Independent Registered Public Accounting Firm  | 18   |
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## Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

INFORMATION ANALYSIS INCORPORATED  
(Registrant)

March 29, 2013

By: /s/ Sandor Rosenberg  
Sandor Rosenberg, President

## POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Sandor Rosenberg and Richard S. DeRose, jointly and severally, his attorney-in-fact, each with the full power of substitution, for such person, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney-in-fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he might do or could do in person hereby ratifying and confirming all that each of said attorneys-in-fact and agents, or his substitute, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Signature                                      | Title   | Date           |
|--|---|----------------|
| By: /s/ Sandor Rosenberg<br>Sandor Rosenberg   | Chairman of the Board, Chief<br>Executive Officer and President | March 29, 2013 |
| By: /s/ Charles A. May, Jr.<br>Charles A. May  | Director  | March 29, 2013 |
| By: /s/ Bonnie K. Wachtel<br>Bonnie K. Wachtel | Director  | March 29, 2013 |
| By: /s/ James D. Wester<br>James D. Wester     | Director  | March 29, 2013 |
| By: /s/ Richard S. DeRose<br>Richard S. DeRose | Chief Financial Officer,<br>Secretary and Treasurer             | March 29, 2013 |
| By: /s/ Matthew T. Sands<br>Matthew T. Sands   | Controller  | March 29, 2013 |



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## Exhibit Index

| Exhibit No. | Description  | Location   |
|-------------|--|--|
| 3.1         | Amended and Restated Articles of Incorporation effective March 18, 1997  | Incorporated by reference from the Registrant's Form 10-KSB/A for the fiscal year ending December 31, 1996 and filed on July 3, 1997   |
| 3.2         | Articles of Amendment to the Articles of Incorporation   | Incorporated by reference from the Registrant's Form 10-KSB/A for the fiscal year ending December 31, 1997 and filed on March 30, 1998 |
| 3.3         | Amended By-Laws of the Company   | Incorporated by reference from the Registrant's Form S-18 dated November 20, 1986 (Commission File No. 33-9390).                       |
| 4.1         | Copy of Stock Certificate  | Incorporated by reference from the Registrant's Form 10-KSB/A for the fiscal year ending December 31, 1997 and filed on March 30, 1998 |
| 10.1        | Office Lease for 18,280 square feet at 11240 Waples Mill Road, Fairfax, Virginia 22030.  | Incorporated by reference from the Registrant's Form 10-KSB/A for the fiscal year ending December 31, 1996 and filed on July 3, 1997   |
| 10.2        | Company's 401(k) Profit Sharing Plan through Aetna Life Insurance and Annuity Company (now ING).                               | Incorporated by reference from the Registrant's Form 10-KSB/A for the fiscal year ending December 31, 1996 and filed on July 3, 1997   |
| 10.3        | 1996 Stock Option Plan   | Incorporated by reference from the Registrant's Form S-8 filed on June 25, 1996  |
| 10.4        | Modification of Office Lease to 12,345 square feet at 11240 Waples Mill Road, Fairfax, Virginia 22030                          | Incorporated by reference from the Registrant's Form 10-QSB for the period ended March 31, 2001 and filed on May 11, 2001              |
| 10.5        | Second Modification of Lease, dated February 10, 2004, to 4,434 square feet at 11240 Waples Mill Road, Fairfax, Virginia 22030 | Incorporated by reference from the Registrant's Form 10-KSB for the period ended December 31, 2003, and filed on March 30, 2004        |
| 10.6        | Termination and/or change in control arrangement for Richard S. DeRose dated June 18, 1997                                     | Incorporated by reference from the Registrant's Form 10-KSB for the year ended December 31, 2004, and filed on March 30, 2005          |
| 10.7        | Line of Credit Agreement with TD Bank, N.A. (formerly Commerce Bank, N.A.)   | Incorporated by reference from the Registrant's Form 10-KSB for the year ended December 31, 2005, and filed on March 31, 2006          |
| 10.8        | Information Analysis Incorporated 2006 Stock Incentive Plan  | Incorporated by reference from the Registrant's definitive proxy statement on Schedule 14A filed on April 19, 2006                     |
| 10.9        | Third Modification of Lease, dated November 8, 2006, to extend term of lease three years.                                      | Incorporated by reference from the Registrant's Form 10-KSB for the period ended December 31, 2006, and filed on April 2, 2007         |

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|-------|--|---|
| 10.10 | Modification Agreement regarding Line of Credit Agreement with TD Bank, N.A., successor to Commerce Bank, N.A., dated July 18, 2008.     | Incorporated by reference from the Registrant's Form 10-K for the period ended December 31, 2008, and filed on March 31, 2009 |
| 10.11 | Fourth Modification of Lease, dated November 12, 2009, to extend term of lease three years.  | Incorporated by reference from the Registrant's Form 10-K for the period ended December 31, 2009, and filed on March 31, 2010 |
| 10.12 | Modification Agreement regarding Line of Credit Agreement with TD Bank, N.A., successor to Commerce Bank, N.A., dated December 29, 2009. | Incorporated by reference from the Registrant's Form 10-K for the period ended December 31, 2009, and filed on March 31, 2010 |



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| Exhibit No.  | Description   | Location  |
|--------------|---|---|
| 10.13        | Modification Agreement regarding Line of Credit Agreement with TD Bank, N.A., successor to Commerce Bank, N.A., dated December 13, 2010.          | Incorporated by reference from the Registrant's Form 10-K for the period ended December 31, 2010, and filed on March 31, 2011 |
| 10.14        | Modification Agreement regarding Line of Credit Agreement with TD Bank, N.A., successor to Commerce Bank, N.A., dated November 30, 2011.          | Incorporated by reference from the Registrant's Form 10-K for the period ended December 31, 2011, and filed on March 30, 2012 |
| <u>10.15</u> | Modification Agreement regarding Line of Credit Agreement with TD Bank, N.A., successor to Commerce Bank, N.A., dated November 30, 2012.          | Filed with this Form 10-K   |
| <u>10.16</u> | Fifth Modification of Lease, dated February 6, 2013, to extend term of lease four years.  | Filed with this Form 10-K   |
| <u>23.1</u>  | Consent of Independent Registered Public Accounting Firm, CohnReznick LLP   | Filed with this Form 10-K   |
| <u>23.2</u>  | Consent of Independent Registered Public Accounting Firm, Reznick Group, P.C.   | Filed with this Form 10-K   |
| <u>31.1</u>  | Rule 13a-14(a) / 15a-14(a) Certification by Chief Executive Officer   | Filed with this Form 10-K   |
| <u>31.2</u>  | Rule 13a-14(a) / 15a-14(a) Certification by Chief Financial Officer   | Filed with this Form 10-K   |
| <u>32.1</u>  | Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | Filed with this Form 10-K   |
| <u>32.2</u>  | Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | Filed with this Form 10-K   |