

INFORMATION ANALYSIS INC
Form 10-Q
November 14, 2014

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

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

OR

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

For the transition period from to

Commission File Number 000-22405

Information Analysis Incorporated
(Exact Name of Registrant as Specified in Its Charter)

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

11240 Waples Mill Road

Suite 201
Fairfax, Virginia 22030

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if

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any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(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 Exchange Act).

Yes No

As of November 12, 2014, 11,201,760 shares of common stock, par value \$0.01 per share, of the registrant were outstanding.

INFORMATION ANALYSIS INCORPORATED
FORM 10-Q

Index

		Page Number
PART I.	FINANCIAL INFORMATION	
<u>Item 1.</u>	<u>Financial Statements (unaudited except for the balance sheet as of December 31, 2013)</u>	3
	<u>Balance Sheets as of September 30, 2014 and December 31, 2013</u>	3
	<u>Statements of Operations and Comprehensive Income for the three months ended September 30, 2014 and 2013</u>	4
	<u>Statements of Operations and Comprehensive Loss for the nine months ended September 30, 2014 and 2013</u>	5
	<u>Statements of Cash Flows for the nine months ended September 30, 2014 and 2013</u>	6
	<u>Notes to Financial Statements</u>	7
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	12
<u>Item 3.</u>	<u>Controls and Procedures</u>	15
PART II.	OTHER INFORMATION	
<u>Item 1.</u>	<u>Legal Proceedings</u>	16
<u>Item 1A.</u>	<u>Risk Factors</u>	16
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	16
<u>Item 3.</u>	<u>Defaults Upon Senior Securities</u>	16
<u>Item 4.</u>	<u>Other Information</u>	16
<u>Item 5.</u>	<u>Exhibits</u>	16
<u>SIGNATURES</u>		17

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

INFORMATION ANALYSIS INCORPORATED
BALANCE SHEETS

	September 30, 2014 (Unaudited)	December 31, 2013 (see Note 1)
ASSETS		
Current assets		
Cash and cash equivalents	\$2,066,756	\$2,359,527
Accounts receivable, net	862,411	1,437,754
Prepaid expenses and other current assets	285,168	534,992
Notes receivable, current	4,045	6,294
Total current assets	3,218,380	4,338,567
Property and equipment, net	50,128	52,887
Notes receivable, long-term	5,618	8,665
Other assets	6,281	6,281
Total assets	\$3,280,407	\$4,406,400
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$93,322	\$611,781
Commissions payable	770,079	902,972
Deferred revenue	259,522	503,482
Accrued payroll and related liabilities	220,337	221,378
Other accrued liabilities	49,919	60,796
Total current liabilities	1,393,179	2,300,409
Commitments and contingencies		
Stockholders' equity		
Common stock, par value \$0.01, 30,000,000 shares authorized; 12,844,376 shares issued, 11,201,760 shares outstanding as of September 30, 2014 and December 31, 2013	128,443	128,443
Additional paid-in capital	14,611,763	14,599,696
Accumulated deficit	(11,922,767)	(11,691,937)
Treasury stock, 1,642,616 shares at cost	(930,211)	(930,211)
Total stockholders' equity	1,887,228	2,105,991
Total liabilities and stockholders' equity	\$3,280,407	\$4,406,400

The accompanying notes are an integral part of the financial statements

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

	For the three months ended September 30,	
	2014	2013
Revenues		
Professional fees	\$944,131	\$1,017,243
Software sales	413,016	2,200,602
Total revenues	1,357,147	3,217,845
Cost of revenues		
Cost of professional fees	520,857	510,397
Cost of software sales	232,138	1,951,931
Total cost of revenues	752,995	2,462,328
Gross profit	604,152	755,517
Selling, general and administrative expenses	407,048	371,328
Commissions expense	171,551	278,474
Income from operations	25,553	105,715
Other income	2,435	2,652
Income before provision for income taxes	27,988	108,367
Provision for income taxes	-	-
Net income	\$27,988	\$108,367
Comprehensive income	\$27,988	\$108,367
Income per common share:		
Basic	\$0.00	\$0.01
Diluted	\$0.00	\$0.01
Weighted average common shares outstanding:		
Basic	11,201,760	11,201,760
Diluted	11,347,107	11,211,501

The accompanying notes are an integral part of the financial statements

INFORMATION ANALYSIS INCORPORATED
STATEMENTS OF OPERATIONS AND
COMPREHENSIVE LOSS

(Unaudited)

	For the nine months ended September 30,	
	2014	2013
Revenues		
Professional fees	\$2,608,445	\$3,097,139
Software sales	952,819	2,555,965
Total revenues	3,561,264	5,653,104
Cost of revenues		
Cost of professional fees	1,498,436	1,723,820
Cost of software sales	687,230	2,257,318
Total cost of revenues	2,185,666	3,981,138
Gross profit	1,375,598	1,671,966
Selling, general and administrative expenses	1,278,856	1,263,875
Commissions expense	335,303	494,349
Loss from operations	(238,561)	(86,258)
Other income	7,731	5,965
Loss before provision for income taxes	(230,830)	(80,293)
Provision for income taxes	-	-
Net loss	\$(230,830)	\$(80,293)
Comprehensive loss	\$(230,830)	\$(80,293)
Loss per common share:		
Basic	\$(0.02)	\$(0.01)
Diluted	\$(0.02)	\$(0.01)
Weighted average common shares outstanding:		
Basic	11,201,760	11,201,760
Diluted	11,201,760	11,201,760

The accompanying notes are an integral part of the financial statements

INFORMATION ANALYSIS INCORPORATED
STATEMENTS OF CASH FLOWS

(Unaudited)

For the nine months ended
September 30,
2014 2013

Cash flows from operating activities		
Net loss	\$(230,830)	\$(80,293)
Adjustments to reconcile net loss to		
net cash used in operating activities		
Depreciation and amortization	23,662	18,034
Stock-based compensation	12,067	11,448
Bad debt expense	1,458	-
Changes in operating assets and liabilities:		
Accounts receivable	573,885	(2,079,189)
Prepaid expenses and other current assets	249,824	(448,069)
Accounts payable and accrued expenses	(530,377)	1,826,100
Commissions payable	(132,893)	74,643
Deferred revenue	(243,960)	376,522
Net cash used in operating activities	(277,164)	(300,804)
Cash flows from investing activities		
Capital expenditures	(20,903)	(38,495)
Payments received on notes receivable	5,296	3,500
Increase in note receivable	-	(14,250)
Net cash used in investing activities	(15,607)	(49,245)
Net decrease in cash and cash equivalents	(292,771)	(350,049)
Cash and cash equivalents, beginning of the period	2,359,527	2,623,016
Cash and cash equivalents, end of the period	\$2,066,756	\$2,272,967
Supplemental cash flow information		
Interest paid	\$-	\$-
Income taxes paid	\$-	\$-

The accompanying notes are an integral part of the financial statements

INFORMATION ANALYSIS INCORPORATED
NOTES TO FINANCIAL STATEMENTS

1. Basis of Presentation

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

The accompanying unaudited financial statements have been prepared in conformity with U.S. generally accepted accounting principles ("GAAP") for interim financial information and with the instructions for Form 10-Q and Article 8-03 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, the unaudited financial statements include all adjustments necessary (which are of a normal and recurring nature) for the fair and not misleading presentation of the results of the interim periods presented. These unaudited financial statements should be read in conjunction with our audited financial statements for the year ended December 31, 2013 included in the Annual Report on Form 10-K filed by the Company with the Securities and Exchange Commission on March 31, 2014 (the "Annual Report"). The accompanying December 31, 2013 financial information was derived from our audited financial statements included in the Annual Report. The results of operations for any interim period are not necessarily indicative of the results of operations for any other interim period or for a full fiscal year.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09 ("Topic 606"), "Revenue from Contracts with Customers." This new standard will replace most existing revenue recognition guidance in U.S. GAAP. The core principle of the ASU is that an entity should recognize revenue for the transfer of goods or services equal to the amount it expects to receive for those goods and services. The ASU requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and estimates and changes in those estimates. The ASU will be effective for the Company beginning January 1, 2017, and allows for both retrospective and modified-retrospective methods of adoption. The Company is in the process of determining the method of adoption it will elect and is currently assessing the impact of this ASU on its financial statements and footnote disclosures.

In June 2014, the FASB issued ASU 2014-12, "Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period—a consensus of the FASB Emerging Issues Task Force" ("ASU 2014-12"). ASU 2014-12 clarifies that performance targets associated with stock compensation should be treated as a performance condition and should not be reflected in the grant date fair value of the stock award. The amendments will be effective for the Company for fiscal years that begin after December 15, 2015. The Company will apply the guidance to all stock awards granted or modified after the amendments are effective. The Company does not expect these amendments to have a material effect on its financial statements.

In August 2014, the FASB issued ASU 2014-15, "Presentation of Financial Statements – Going Concern (Subtopic 205-40: Disclosure about an Entity's Ability to Continue as a Going Concern." The amendment establishes management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern in connection with preparing financial statements for each annual and interim reporting period. The amendment also gives guidance to determine whether to disclose information about relevant conditions and events when there is substantial doubt about an entity's ability to continue as a going concern. The amended guidance is

effective prospectively for fiscal years beginning after December 15, 2016. The new guidance is not expected to have an impact on the Company's financial position, results of operations or cash flows.

2. Summary of Significant Accounting Policies

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 the 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 a gross basis in certain instances and a net basis in other instances based upon a transaction by transaction analysis using authoritative guidance issued by 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.

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.

2. Summary of Significant Accounting Policies (continued)

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.

Concentration of Risk

Four of our customers - two of which are U.S. government agencies with which we contract directly, one of which is a company under which we subcontract for services to U.S. government agencies, and one of which is a commercial customer - represent material portions of our revenue. These customers collectively accounted for 57.6% of our revenue in the third quarter of 2014. The two U.S. government agency customers accounted for 18.6% and 15.7%, respectively, of revenue, the company under which we subcontract for services to U.S. government agencies accounted for 11.8% of revenue, and the commercial customer accounted for 11.5% of revenue in the third quarter of 2014. In the nine months ended September, 30, 2014, these two U.S. government agency customers accounted for 19.9% and 15.8%, respectively, of revenue, the company under which we subcontract for services to U.S. government agencies accounted for 10.9% of revenue, and the commercial customer accounted for 13.3% of revenue.

In the third quarter of 2013, two of our customers - both of which are U.S. government agencies with which we contracted directly - represented material portions of our revenue. These customers accounted for 55.6% (all software sales) and 10.5% (mostly professional services) of revenue in the third quarter of 2013. These customers accounted for 32.2% and 16.5%, respectively, of revenue in the first nine months of 2013, and one additional customer, a company under which we subcontract for services to a U.S. government agency, accounted for 10.3% of revenue in the first nine months of 2013.

Stock-Based Compensation

Total stock-based compensation expense was \$3,262 and \$4,021 for the quarters ended September 30, 2014 and 2013, respectively, none of which related to options awarded to non-employees. For the nine months ended September 30, 2014 and 2013, total compensation expense was \$12,067 and \$11,448, respectively, none of which related to options awarded to non-employees. The Company estimates the fair value of options granted using the 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.

Income Taxes

As of September 30, 2014, there have been no material changes to the Company's uncertain tax position disclosures as provided in Note 7 of the Annual Report. The Company does not anticipate that total unrecognized tax benefits will significantly change prior to September 30, 2015.

3. Stock-Based Compensation

There were 20,000 option awards granted to employees and no option awards granted to non-employees in the three months ended September 30, 2014 and there were 32,000 option awards granted to employees and no option awards granted to non-employees in the three months ended September 30, 2013. There were 21,000 option awards granted to employees and no option awards granted to non-employees in the nine months ended September 30, 2014 and there were 212,000 option awards granted to employees and no option awards granted to non-employees in the nine months ended September 30, 2013. The fair values of option awards granted in the three months and nine months ended September 30, 2014 and 2013 were estimated using the Black-Scholes option pricing model using the following assumptions:

	Three Months ended September 30,		Nine Months ended September 30,	
	2014	2013	2014	2013
Risk free interest rate	1.78%	1.36%	1.77 - 1.78%	0.70 - 1.36%
Dividend yield	0%	0%	0%	0%
Expected term	5 years	5 years	5 years	5 years
Expected volatility	43.3%	57.3%	43.3 - 47.3%	57.3 - 62.8%

The status of the options issued as of September 30, 2014 and changes during the nine months ended September 30, 2014 and 2013, were as follows:

	Options outstanding	
	Number of shares	Weighted average price per share
Balance at December 31, 2013	1,187,000	\$0.26
Options granted, exercised, expired or forfeited	--	--
Balance at March 31, 2014	1,187,000	\$0.26
Options granted	1,000	0.24
Options exercised, expired or forfeited	(3,000)	0.11
Balance at June 30, 2014	1,185,000	\$0.26
Options granted	20,000	0.17
Options exercised, expired or forfeited	--	--
Balance at September 30, 2014	1,205,000	\$0.26
	Options outstanding	
	Number of shares	Weighted average price per share
Balance at December 31, 2012	1,032,500	\$0.29
Options granted	160,000	0.16
Options exercised, expired or forfeited	(10,000)	0.15
Balance at March 31, 2013	1,182,500	\$0.28
Options granted	20,000	0.18
Options exercised, expired or forfeited	(226,000)	0.22
Balance at June 30, 2013	976,500	\$0.29
Options granted	32,000	0.16

Options exercised, expired or forfeited	(7,500)	0.19
Balance at September 30, 2013	1,001,000	\$0.29

The following table summarizes information about options at September 30, 2014:

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
1,205,000	\$0.26	5.58	\$ 11,238	955,000	\$0.29	4.67	\$ 5,989

3. Stock-Based Compensation (continued)

Nonvested stock awards as of September 30, 2014 and changes during the nine months ended September 30, 2014 were as follows:

	Number of shares	Nonvested Weighted average grant date fair value
Balance at December 31, 2013	431,250	\$0.08
Vested	(155,000)	0.08
Balance at March 31, 2014	276,250	\$0.08
Granted	1,000	0.10
Vested	(31,250)	0.08
Balance at June 30, 2014	246,000	\$0.08
Granted	20,000	0.07
Vested	(16,000)	0.08
Balance at September 30, 2014	250,000	\$0.08

As of September 30, 2014 and 2013, unrecognized compensation cost associated with non-vested share-based employee and non-employee compensation totaled \$6,156 and \$8,806, respectively, which are expected to be recognized over weighted average periods of seven months and five months, respectively.

4. Income (Loss) Per Share

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

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

	Net Income (loss)	Shares	Per Share Amount
Basic net income per common share for the three months ended September 30, 2014:			
Income available to common stockholders	\$27,988		