INFORMATION ANALYSIS INC
Form 10-Q
August 14, 2014

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

Form 10-Q

(Mark One)

þ	QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the quarterly period ended June 30, 2014

OR

o	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 þ No o

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 þ No o

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 o	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

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

INFORMATION ANALYSIS INCORPORATED

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

INFORMATION ANALYSIS INCORPORATED
BALANCE SHEETS

	June 30, 2014 (Unaudited)	December 31, 2013 (see Note 1)
ASSETS		
Current assets		
Cash and cash equivalents	$1,926,333	$2,359,527
Accounts receivable, net	886,341	1,437,754
Prepaid expenses and other current assets	436,871	534,992
Notes receivable, current	5,559	6,294
Total current assets	3,255,104	4,338,567
Property and equipment, net	55,110	52,887
Notes receivable, long-term	6,642	8,665
Other assets	6,281	6,281
Total assets	$3,323,137	$4,406,400
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$65,238	$611,781
Commissions payable	752,933	902,972
Deferred revenue	393,126	503,482
Accrued payroll and related liabilities	212,947	221,378
Other accrued liabilities	42,915	60,796
Total current liabilities	1,467,159	2,300,409
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 June 30, 2014 and December 31, 2013	128,443	128,443
Additional paid-in capital	14,608,501	14,599,696
Accumulated deficit	(11,950,755)	(11,691,937)
Treasury stock, 1,642,616 shares at cost	(930,211)	(930,211)
Total stockholders' equity	1,855,978	2,105,991
Total liabilities and stockholders' equity	$3,323,137	$4,406,400

The accompanying notes are an integral part of the financial statements

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

	For the three months ended June 30, 2014	2013
Revenues		
Professional fees	$789,054	$899,090
Software sales	235,253	219,120
Total revenues	1,024,307	1,118,210
Cost of revenues		
Cost of professional fees	479,751	522,780
Cost of software sales	227,387	192,044
Total cost of revenues	707,138	714,824
Gross profit	317,169	403,386
Selling, general and administrative expenses	425,989	438,268
Commissions on sales	55,076	103,569
Loss from operations	(163,896)	(138,451)
Other income	2,597	1,932
Loss before provision for income taxes	(161,299)	(136,519)
Provision for income taxes	--	--
Net loss	$(161,299)	$(136,519)
Comprehensive loss	$(161,299)	$(136,519)
Loss per common share:		
Basic	$(0.01)	$(0.01)
Diluted	$(0.01)	$(0.01)
Weighted average common shares outstanding:		
Basic	11,201,760	11,201,760
Diluted	11,201,760	11,201,760

The accompanying notes are an integral part of the financial statements

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

	For the six months ended June 30, 2014	2013
Revenues		
Professional fees	$1,664,314	$2,079,896
Software sales	539,803	355,363
Total revenues	2,204,117	2,435,259
Cost of revenues		
Cost of professional fees	977,579	1,213,423
Cost of software sales	455,092	305,386
Total cost of revenues	1,432,671	1,518,809
Gross profit	771,446	916,450
Selling, general and administrative expenses	871,808	892,548
Commissions on sales	163,752	215,875
Loss from operations	(264,114)	(191,973)
Other income	5,296	3,313
Loss before provision for income taxes	(258,818)	(188,660)
Provision for income taxes	--	--
Net loss	$(258,818)	$(188,660)
Comprehensive loss	$(258,818)	$(188,660)
Loss per common share:		
Basic	$(0.02)	$(0.02)
Diluted	$(0.02)	$(0.02)
Weighted average common shares outstanding:		
Basic	11,201,760	11,201,760
Diluted	11,201,760	11,201,760

The accompanying notes are an integral part of the financial statements

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INFORMATION ANALYSIS INCORPORATED
STATEMENTS OF CASH FLOWS
(Unaudited)

	For the six months ended June 30, 2014	2013
Cash flows from operating activities		
Net loss	$(258,818)	$(188,660)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	15,482	11,496
Stock-based compensation	8,805	7,427
Changes in operating assets and liabilities:		
Accounts receivable	551,413	(6,243)
Prepaid expenses and other current assets	98,121	(113,024)
Accounts payable and accrued expenses	(572,855)	116,014
Commissions payable	(150,039)	(49,567)
Deferred revenue	(110,356)	64,286
Net cash used in operating activities	(418,247)	(158,271)
Cash flows from investing activities		
Capital expenditures	(17,705)	(14,440)
Payments received on notes receivable	2,758	1,771
Increase in note receivable	--	(10,000)
Net cash used in investing activities	(14,947)	(22,669)
Net decrease in cash and cash equivalents	(433,194)	(180,940)
Cash and cash equivalents, beginning of the period	2,359,527	2,623,016
Cash and cash equivalents, end of the period	$1,926,333	$2,442,076
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 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.

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.

2. Summary of Significant Accounting Policies (continued)

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.

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.

2. Summary of Significant Accounting Policies (continued)

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 69.5% of our revenue in the second quarter of 2014. The two U.S. government agency customers accounted for 24.2% and 18.5%, respectively, of revenue, the company under which we subcontract for services to U.S. government agencies accounted for 12.1% of revenue, and the commercial customer accounted for 14.7% of revenue in the second quarter of 2014. In the six months ended June, 30, 2014, these two U.S. government agency customers accounted for 20.7% and 16.5%, respectively, of revenue, the company under which we subcontract for services to U.S. government agencies accounted for 10.3% of revenue, and the commercial customer accounted for 14.4% of revenue.

In the second quarter of 2013, four of our customers – one of which is a U.S. government agency with which we contract directly, two of which are companies under which we subcontract for services to U.S. government agencies, and one of which is a commercial customer - represented material portions of our revenue. These customers collectively accounted for 73.3% of our revenue. The U.S. government agency customer accounted for 31.2% of revenue, the companies under which we subcontract for services to U.S. government agencies accounted for 15.9% and 12.8% of revenue, and the commercial customer accounted for 13.4% of revenue. In the six months ended June, 30, 2013, this U.S. government agency customer accounted for 24.4% of revenue, the companies under which we subcontract for services to U.S. government agencies accounted for 19.4% and 17.0% of revenue, and the commercial customer accounted for 13.0% of revenue.

Notes Receivable

The notes receivable balance consists of two notes issued to non-officer employees of the Company. The first note bears interest compounded at 3.5% per annum, requires equal semi-monthly payments, and will mature on January 25, 2017. The second note was issued August 8, 2013, bears interest compounded at 3.5%, requires equal semi-monthly payments, and will mature on April 10, 2015.

Stock-Based Compensation

Total stock-based compensation expense was \$3,551 and \$3,940 for the quarters ended June 30, 2014 and 2013, respectively, none of which related to options awarded to non-employees. For the six months ended June 30, 2014 and 2013, total compensation expense was \$8,805 and \$7,427, 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 June 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 June 30, 2015.

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3. Stock-Based Compensation

There were 1,000 option awards granted to employees and no option awards granted to non-employees in the three months ended June 30, 2014 and there were 20,000 option awards granted to employees and no option awards granted to non-employees in the three months ended June 30, 2013. There were 1,000 option awards granted to employees and no option awards granted to non-employees in the six months ended June 30, 2014 and there were 180,000 option awards granted to employees and no option awards granted to non-employees in the six months ended June 30, 2013. The fair values of option awards granted in the three months and six months ended June 30, 2014 and 2013 were estimated using the Black-Scholes option pricing model using the following assumptions:

	Three Months ended June 30,		Six Months ended June 30,	
	2014	2013	2014	2013
Risk free interest rate	1.77%	0.70%	1.77%	0.70 – 0.90%
Dividend yield	0%	0%	0%	0%
Expected term	5 years	5 years	5 years	5 years
Expected volatility	47.3%	62.2%	47.3%	62.2 - 62.8%

The status of the options issued as of June 30, 2014 and changes during the six months ended June 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

	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

The following table summarizes information about options at June 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
1,185,000	$0.26	5.76	$ 52,808	939,000	$0.29	4.85	$ 32,735

3. Stock-Based Compensation (continued)

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

	Nonvested	
	Number of shares	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

As of June 30, 2014 and 2013, unrecognized compensation cost associated with non-vested share-based employee and non-employee compensation totaled $8,018 and $10,267, respectively, which are expected to be recognized over weighted average periods of 6 months and 5 months, respectively.

4. Loss Per Share

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

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

	Net Loss	Shares	Per Share Amount
Basic net loss per common share for the three months ended June 30, 2014:			
Loss available to common stockholders	$(161,299)	11,201,760	$(0.01)
Effect of dilutive stock options	--	--	--
Diluted net loss per common share for the three months ended June 30, 2014:	$(161,299)	11,201,760	$(0.01)
Basic net loss per common share for the three months ended June 30, 2013:			
Loss available to common stockholders	$(136,519)	11,201,760	$(0.01)
Effect of dilutive stock options	--	--	--
Diluted net loss per common share for the three months ended June 30, 2013:	$(136,519)	11,201,760	$(0.01)

Basic net loss per common share for the six months ended June 30, 2014:			
Loss available to common stockholders	$(258,818)	11,201,760	$(0.02)
Effect of dilutive stock options	--	--	--
Diluted net loss per common share for the six months ended June 30, 2014:	$(258,818)	11,201,760	$(0.02)
Basic net loss per common share for the six months ended June 30, 2013:			
Loss available to common stockholders	$(188,660)	11,201,760	$(0.02)
Effect of dilutive stock options	--	--	--
Diluted net loss per common share for the six months ended June 30, 2013:	$(188,660)	11,201,760	$(0.02)

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Cautionary Statement Regarding Forward-Looking Statements

This Form 10-Q contains forward-looking statements regarding our business, customer prospects, or other factors that may affect future earnings or financial results that are subject to the safe harbor created by the Private Securities Litigation Reform Act of 1995. Such statements involve risks and uncertainties which could cause actual results to vary materially from those expressed in the forward-looking statements. Investors should read and understand the risk factors detailed in our Form 10-K for the fiscal year ended December 31, 2013 and in other filings with the Securities and Exchange Commission.

We operate in a rapidly changing environment that involves a number of risks, some of which are beyond our control. This list highlights some of the risks which may affect future operating results. These are the risks and uncertainties we believe are most important for you to consider. Additional risks and uncertainties, not presently known to us, which we currently deem immaterial or which are similar to those faced by other companies in our industry or business in general, may also impair our business operations. If any of the following risks or uncertainties actually occurs, our business, financial condition and operating results would likely suffer. These risks include, among others, the following:

changes in the funding priorities of the U.S. federal government;
changes in the way the U.S. federal government contracts with businesses;
terms specific to U.S. federal government contracts;
our failure to keep pace with a changing technological environment;
intense competition from other companies;
inaccuracy in our estimates of the cost of services and the timeline for completion of contracts;
non-performance by our subcontractors and suppliers;
our dependence on key personnel;
our dependence on third-party software and software maintenance suppliers;
our failure to adequately integrate businesses we may acquire;
fluctuations in our results of operations and the resulting impact on our stock price;
the exercise of outstanding options;
our failure to adequately protect our intellectual property;
the limited public market for our common stock; and
our forward-looking statements and projections may prove to be inaccurate.

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

Our Business

Founded in 1979, IAI is in the business of modernizing client information systems, developing and maintaining information technology systems, developing electronic forms, and performing consulting services to government and commercial organizations. We have performed software conversion projects for over 100 commercial and government customers, including Computer Sciences Corporation, IBM, Computer Associates, Sprint, Citibank, U.S. Department of Homeland Security, U.S. Treasury Department, U.S. Department of Agriculture, U.S. Department of Energy, U.S. Army, U.S. Air Force, U.S. Department of Veterans Affairs, and the Federal Deposit Insurance Corporation. Today, we primarily apply our technology, services and experience to legacy software migration and modernization for commercial companies and government agencies, and to developing web-based solutions for agencies of the U.S. federal government.

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 69.5% of our revenue in the second quarter of 2014. The two U.S. government agency customers accounted for 24.2% and 18.5%, respectively, of revenue, the company under which we subcontract for services to U.S. government agencies accounted for 12.1% of revenue, and the commercial customer accounted for 14.7% of revenue in the second quarter of 2014. In the six months ended June, 30, 2014, these two U.S. government agency customers accounted for 20.7% and 16.5%, respectively, of revenue, the company under which we subcontract for services to U.S. government agencies accounted for 10.3% of revenue, and the commercial customer accounted for 14.4% of revenue.

In the second quarter of 2013, four of our customers – one of which is a U.S. government agency with which we contract directly, two of which are companies under which we subcontract for services to U.S. government agencies, and one of which is a commercial customer - represented material portions of our revenue. These customers collectively accounted for 73.3% of our revenue. The U.S. government agency customer accounted for 31.2% of revenue, the companies under which we subcontract for services to U.S. government agencies accounted for 15.9% and 12.8% of revenue, and the commercial customer accounted for 13.4% of revenue. In the six months ended June, 30, 2013, this U.S. government agency customer accounted for 24.4% of revenue, the companies under which we subcontract for services to U.S. government agencies accounted for 19.4% and 17.0% of revenue, and the commercial customer accounted for 13.0% of revenue.

Three Months Ended June 30, 2014 versus Three Months Ended June 30, 2013

Revenue

Our revenues in the second quarter of 2014 were $1,024,307 compared to $1,118,210 in 2013, a decrease of 8.4%. Professional fees revenue was $789,054 versus $899,090, a decrease of 12.2%, and software product and maintenance revenue was $235,253 versus $219,120, an increase of 7.4%. The decrease in our professional fees revenue is due to the expiration, near completion, or change of phase of certain contracts, reductions in funding of certain contracts, and variations in the quantity of work completed under contracts where the work is done by customer request. The increase in our software product and maintenance revenue is due to a few larger maintenance orders, a change in the product mix sold, and a number of smaller orders that we have won by utilizing some of the auction-style bidding processes now in place for U.S. government agencies. Software product and maintenance sales and associated margins are subject to considerable fluctuation from period to period, based on the product mix sold and the mediums through which contracts are won.

Gross Profit

Gross profit was $317,169, or 31.0% of sales in the second quarter of 2014 versus $403,386, or 36.1% of sales, in the second quarter of 2013. For the quarter ended June 30, 2014, $309,303 of the gross profit was attributable to professional fees at a gross profit percentage of 39.2%, and $7,866 of the gross profit was attributable to software sales at a gross profit percentage of 3.3%. In the same quarter in 2013, we reported gross profits of $376,310, or 41.9% of sales for professional fees and $27,076, or 12.4% of sales for software sales. Gross profit and gross profit as a percentage of sales on professional fees decreased due to expirations and funding decreases in higher profit contracts, the change of phase of certain contracts, and a reduction in the ratio of fixed price per unit billing to hourly billing for our electronic forms professional fees. Gross profit and gross profit as a percentage of sales on software sales decreased due to contract expirations, smaller margins on contracts won through auction-style bidding processes, and a change in the product mix sold. Software product sales and associated profits are subject to considerable fluctuation from period to period, based on the product mix sold.

Selling, General and Administrative Expenses

Selling, general and administrative expenses, exclusive of sales commissions, were $425,989, or 41.6% of revenues, in the second quarter of 2014 versus $438,268, or 39.2% of revenues, in the second quarter of 2013. These expenses decreased $12,279, or 2.8%, due largely to decreases in non-billable labor costs and the associated costs of fringe benefits.

Commission expense was $55,076, or 5.4% of revenues, in the second quarter of 2014 versus $103,569, or 9.3% of revenues, in the second quarter of 2013. This decrease of $48,493, or 46.8%, is due to the decreases in revenue, gross profits, and operating income on commissionable contracts, which drive commission earned at varying rates for each salesperson.

Net Loss

Net loss for the three months ended June 30, 2014, was $161,299, or (15.7%) of revenue, versus $136,519, or (12.2%) of revenue, for the same period in 2013.

Six Months Ended June 30, 2014 versus Six Months Ended June 30, 2013

Revenue
Our revenues in the six months ended June 30, 2014 were \$2,204,117 compared to \$2,435,259 in the first six months of 2013, a decrease of 9.5%. Professional services revenue was \$1,664,314 versus \$2,079,896, a decrease of 20.0%, and software product and maintenance revenue was \$539,803 versus \$355,363, an increase of 51.9%. The decrease in our professional fees revenue is due to the expiration, near completion, or change of phase of certain contracts, reductions in funding of certain contracts, and variations in the quantity of work completed under contracts where the work is done by customer request. The increase in our software product and maintenance revenue is due to a few larger maintenance orders, a change in the product mix sold, an increase in referral fees for facilitating third-party software and maintenance sales, and a number of smaller orders that we have won by utilizing some of the auction-style bidding processes now in place for U.S. government agencies. Software product and maintenance sales and associated margins are subject to considerable fluctuation from period to period, based on the product mix sold and the mediums through which contracts are won.

Gross Profit
Gross profit was \$771,446, or 35.0% of sales in the first six months of 2014 versus \$916,450, or 37.6% of sales, in the first six months of 2013. For the six months ended June 30, 2014, \$686,735 of the gross profit was attributable to professional services at a gross profit percentage of 41.3%, and \$84,711 of the gross profit was attributable to software sales at a gross profit percentage of 15.7%. In the same quarter in 2013, we reported gross profits of \$866,473, or 41.7% of sales for professional services and \$49,977, or 14.1% of sales for software sales. Gross profit on professional fees decreased due to expirations and funding decreases in higher profit contracts and the change of phase of certain contracts,. Gross profit and gross profit as a percentage of sales on software sales increased due to a change in the product mix sold and an increase in referral fees for facilitating third-party software and maintenance sales. Software product sales and associated profits are subject to considerable fluctuation from period to period, based on the product mix sold.

Selling, General and Administrative Expenses
Selling, general and administrative expenses, exclusive of sales commissions, were \$871,808, or 39.6% of revenues, in the first six months of 2014 versus \$892,548, or 36.7% of revenues, in the first six months of 2013. These expenses decreased \$20,740, or 2.3%, due largely to decreases in non-billable labor costs, the costs of fringe benefits associated with that labor, and recruiting fees., offset by increases in advertising and promotion.

Commission expense was \$163,752, or 7.4% of revenues, in the second quarter of 2014 versus \$215,875, or 8.9% of revenues, in the second quarter of 2013. This decrease of \$52,123, or 24.1%, is due to the decreases in revenue, gross profits, and operating income on commissionable contracts, which drive commission earned at varying rates for each salesperson.

Net Loss
Net loss for the six months ended June 30, 2014, was \$258,818, or (11.7%) of revenue, versus \$188,660, or (7.7%) of revenue, for the same period in 2013.

Liquidity and Capital Resources

Our cash and cash equivalents balance, when combined with our cash flow from operations during the first six months of 2014, were sufficient to provide financing for our operations. Our net cash used in the combination of our operating, investing, and financing activities in the first six months of 2014 was \$433,194. This net cash used, when subtracted from a beginning balance of $2,359,527 yielded cash and cash equivalents of $1,926,333 as of June 30, 2014. Our accounts receivable balances decreased $551,413 due to collections on receivables for large software sales orders. Prepaid expenses and other current assets decreased $98,121, due primarily to the recognition of expenses over time for advance payments to third party suppliers of maintenance contracts on software sales. Accounts payable and accrued expenses decreased $572,855 due to the software sales decreases, commissions payable decreased $150,039 due to a reduction in commissions earned while paying out accrued balances more rapidly, and deferred revenue decreased $110,356 due to the recognition of revenue over time from maintenance contracts on software sales. We had no non-current liabilities as of June 30, 2014.

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, 2014. As of June 30, 2014, no amounts were outstanding under this line of credit.

Given our current cash position and operating plan, we anticipate that we will be able to meet our cash requirements for the next twelve months and beyond.

We presently lease our corporate offices on a contractual basis with certain timeframe commitments and obligations. We believe that our existing offices will be sufficient to meet our foreseeable facility requirement. Should we need additional space to accommodate increased activities, management believes we can secure such additional space on reasonable terms.

We have no material commitments for capital expenditures.

We have no off-balance sheet arrangements.

New Accounting Standards

For a discussion of the accounting standards recently adopted or pending adoption and the affect such accounting changes will have on our results of operations, financial position or liquidity, see Note 1 to the financial statements.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

Our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, and people performing similar functions, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act), as of June 30, 2014 (the "Evaluation Date"). Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the Evaluation Date, our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and (ii) is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

Changes in Internal Controls over Financial Reporting

There were no changes in the Company's internal control over financial reporting during the quarter ended June 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Because of the inherent limitations in all control systems, no control system can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. These inherent limitations include the realities that judgments in decision making can be faulty and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of a person, by collusion of two or more people or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and may not be detected. Notwithstanding these limitations, we believe that our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

"Item 1A. Risk Factors" of our annual report on Form 10-K for the year ended December 31, 2013 includes a discussion of our risk factors. There have been no material changes from the risk factors described in our annual report on Form 10-K for the year ended December 31, 2013.

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

None.

Item 3. Defaults Upon Senior Securities

None.

Item 5. Other Information

None.

Item 6. Exhibits

31.1	Certification of Chief Executive Officer Pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934
31.2	Certification of Chief Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

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

Information Analysis Incorporated
(Registrant)

Date: August 14, 2014

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

Date: August 14, 2014

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