

INFORMATION ANALYSIS INC
Form 10KSB
April 15, 2008
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-KSB

(Mark One)

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2007

TRANSITION REPORT UNDER 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

(Name of small business issuer in its charter)

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| | |
|---|--|
| 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 (Address of principal executive offices) | 22030 (Zip Code) |
| Issuer's telephone number (703) 383-3000 | |

Securities registered under Section 12(b) of the Exchange Act:

| | |
|---|--|
| Title of each class | Name of each exchange on which registered |
| Securities registered under Section 12(g) of the Exchange Act: | |

Common Stock, \$0.01 par value

(Title of class)

Check whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act.

Check whether the Issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

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

State issuer's revenues for its most recent fiscal year. \$ 9,953,284

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was sold, or the average bid and asked price of such common equity, as of a specified date within the past 60 days. (See definition of affiliate in Rule 12b-2 of the Exchange Act.)

\$2,472,923 as of April 10, 2008

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date. 11,196,760 shares Common Stock, \$0.01 par value, as of April 10, 2008

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DOCUMENTS INCORPORATED BY REFERENCE

Definitive Proxy Statement for the 2008 Annual Meeting is incorporated by reference in Part III of this Annual Report on Form 10-KSB.

Transitional Small Business Disclosure Format (Check one): Yes ; No

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**Information Analysis Incorporated
Cautionary Statement Regarding Forward-Looking Statements**

2007 Annual Report on Form 10-KSB

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

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;

changes in the way the US government contracts with businesses and changes in the budgetary priorities;

non-performance by our subcontractors and suppliers;

terms specific to US government contracts;

our dependence on key personnel;

our failure to adequately integrate businesses we may acquire;

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

changes in Accounting Principles Generally Accepted in the United States;

the exercise of outstanding options and warrants;

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.

PART I

Item 1. Description of Business

Overview of Market

Founded in 1979, Information Analysis Incorporated, which we sometimes refer to 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 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. 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 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.

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

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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 size of this segment, but even a 5% share of this market would represent hundreds of prospective customers.

The web solutions market continues to be one of the fastest growing segments of the computer consulting business as individuals, small companies, large companies, and governmental agencies 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 having this expertise that is usually associated with larger companies. These types of applications should become more prominent in the future as web-based solutions continue to evolve thereby resulting in increasing opportunities for those firms with the requisite skill sets and experience, such as those possessed by IAI.

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.

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.

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Over the last year we have successfully completed engagements for the Department of Defense and several commercial companies that have proven the viability and efficacy of these tools. In addition, Micro Focus has provided us with dozens of qualified leads, both commercial and government, that both companies are working on as a team. In addition, we have joined the Mainframe Migration Alliance (MMA) composed of companies such as Microsoft and Micro Focus. This alliance brought us increased market exposure and additional sales leads. We expect this strategy to be a major contributor to our growth and profitability over the next three years.

Over the last ten years we have developed a series of workbench tools called ICONS. These tools, used in conjunction with our methodology, enhance a programmer's ability to convert code to new platforms and/or computer languages. ICONS can be used with a variety of languages such as DATACOM COBOL and IDEAL and Unisys COBOL. ICONS facilitates our ability to provide systems modernization services to companies and government agencies that seek to migrate from mainframe legacy systems to modern environments, including current computer languages, data bases, and mainframe, midrange, client servers, intranet and Internet platforms. A number of leads derived from Micro Focus and Microsoft require use of our ICONS tools as a precursor to implementing the Micro Focus solution.

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 suite of ICONS tools 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.

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 IBM, EDS, Northrop Grumman, Unisys, SI International, and Oracle. These alliances have resulted in significant contracts in the past and are important in procuring future business.

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 Capture, FormFlow, Capture Enterprise and ReachForm 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. We have used this expertise to penetrate a number of federal government clients and build sophisticated web applications. 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 2008 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.

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In general, IAI management has concentrated over the last five years on stabilizing the company to overcome prior financial losses and solidify our financial base. This has been accomplished by focusing in three areas; legacy modernization, electronic forms related activities, and traditional information technology projects both on-site at client facilities or in our offices. This period has allowed the company to build strong references, establish client and partner relationships, and build our capabilities with excellent staff. Unfortunately, our growth has been stagnant at the ten million dollar level over the last several years. In the coming year, IAI intends to invest more heavily than before in sales and marketing to regain momentum in our growth to reach a higher plateau. Management will not only explore ways to expand our current market spaces, but intends to explore 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. IAI has added more outside assistance through senior consultants that are helping increase our pipeline of opportunities. We expect to see the results of these efforts during 2008.

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.

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 and 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.

Patents and Proprietary Rights

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 ICONS 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.

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Backlog

As of December 31, 2007, we estimated our backlog at approximately \$18.2 million over the next three years, of which \$3.3 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.

Employees

As of December 31, 2007, we employed 34 full-time and 5 part-time individuals. In addition, we maintained subcontractor relationships with companies and individuals that add 16 individuals for professional information technology services. Approximately 75% 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.

Governmental 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.

Risk Factors Related to Our Business

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

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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.

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

Since the US government is our largest customer, both directly and with us as a subcontractor, changes in the way the government awards contracts may create a disadvantage for us to compete in certain markets. Additionally, the funding priorities of the US government are subject to change. If the information technology services that we are equipped to provide are no longer a priority, it may materially and adversely affect us as funding is shifted to new priorities.

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.

US government contracts are generally subject to terms more favorable to the customer than commercial contracts.

US 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 federal government may terminate a contract with us either for convenience (for instance, due to a change in its perceived needs or its desire to consolidate work under another contract) or if we default by failing to perform under the contract. If the federal government terminates a contract with us 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 with us based upon our default, we generally would be denied any recovery for undelivered work, and instead may be liable for

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excess costs incurred by the federal government in procuring undelivered items from an alternative source and other damages as authorized by law.

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.

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. We successfully integrated prior acquisitions or investments in the early and mid-1990 s, but such proven success is not necessarily an indication of future ability to perform. 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.

Changes in generally accepted accounting principles could have an adverse effect on the quantification and presentation of our financial condition.

We are subject to changes in and interpretations of financial accounting matters that govern the measurement of our performance. Based on our reading and interpretations of relevant guidance, principles or concepts issued by, among other authorities, the American Institute of Certified Public Accountants, the Financial Accounting Standards Board, and the United States Securities and Exchange Commission, we believe that our current contract terms and business arrangements have been properly reported. However, there continue to be issued interpretations and guidance for applying the relevant standards to a wide range of contract terms and business arrangements that are prevalent in the industries in which we operate. Future interpretations or changes by the regulators of existing accounting standards or changes in our business practices could result in future changes in our revenue recognition and/or other accounting policies and practices that could have a material adverse effect on the ways our business, financial condition, cash flows, revenue and results of operations are quantified and presented.

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

Under the terms of existing warrants to purchase our common stock, non compensatory options to acquire our common stock, and other 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 warrants and/or options or conversion of such notes, 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 the 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.

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-KSB speak only as of the date of this Form 10-KSB. We expressly disclaim a duty to provide updates to forward-looking statements after the date of this Form 10-KSB 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-KSB are intended to be subject to the safe harbor protection provided by the federal securities laws.

Item 2. Description of Property

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 March 31, 2010.

The property is leased from an unaffiliated party. We maintain tenant fire and casualty insurance on the property in an amount deemed appropriate by our management.

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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Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security shareholders in the fourth quarter of 2007.

PART II**Item 5. Market for Common Equity and Related Stockholder Matters and Small Business Issuer Purchases of Equity Securities*****a. Market Information***

Our Common Stock (symbol: IAIC) has been traded on the OTC Bulletin Board (OTCBB) since July 29, 1999. 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, 2007 | | | | Fiscal Year Ended December 31, 2006 | | | |
|------|--|---------|---------|----------|--|---------|---------|----------|
| | Quarter Ended: | | | | Quarter Ended: | | | |
| | 3/31/07 | 6/30/07 | 9/30/07 | 12/31/07 | 3/31/06 | 6/30/06 | 9/30/06 | 12/31/06 |
| High | \$ 0.46 | \$ 0.45 | \$ 0.48 | \$ 0.44 | \$ 0.80 | \$ 0.71 | \$ 0.54 | \$ 0.49 |
| Low | \$ 0.36 | \$ 0.30 | \$ 0.32 | \$ 0.27 | \$ 0.62 | \$ 0.42 | \$ 0.36 | \$ 0.30 |

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 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.

b. Record Holders

As of December 31, 2007, we had 120 holders of record of our Common Stock.

c. Dividends

We have never paid any cash dividends on our common stock and do not anticipate paying cash dividends within the foreseeable future. Management anticipates that all earnings, if any, will be retained for development of its 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.

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d. 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 (a) | Weighted-average exercise price of outstanding options, warrants, and rights (b) | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c) |
|---|---|---|--|
| Equity compensation plans approved by security holders ^{1,2} | 1,109,000 | \$ 0.41 | 625,000 |
| Equity compensation plans not approved by security holders | | | |
| Total | 1,109,000 | \$ 0.41 | 625,000 |

¹ 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 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.

² The Company had a stock option plan, which became effective June 25, 1996, and expired May 29, 2006 (the 1996 Plan). The 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 when employment ceases, whichever comes first, and vest over periods determined by the Board of Directors.

Recent Sales of Unregistered Securities

There have been no recent sales of unregistered securities that have not been previously disclosed in a Form 10-QSB, Form 8-K, or Form 10-KSB for this filer.

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Item 6. Management's Discussion and Analysis

The following discussion should be read in conjunction with the attached financial statements and notes thereto. Except for the historical information contained herein, any statements that refer to expectations, projections or other characterization of future events or circumstances, and especially those which include variations of the words believes, intends, estimates, anticipates, expects, plans, or similar words or variations thereof, are likely to be forward-looking statements, and as such, are likely to concern matters involving risk, uncertainty, unpredictability and other factors that could materially and adversely affect the outcome or results indicated by or inferred from the statements themselves. Therefore, the reader is advised that the following discussion should be considered in light of the discussion of risks and other factors contained in this annual report on Form 10-KSB and in our other filings with the Securities and Exchange Commission, and that no statements contained in the following discussion or in this Form 10-KSB should be construed as a guarantee or assurance of future performance or future results.

Overview

During 2007 our sales and marketing efforts were focused to capitalize on our expertise in these areas – services and tools to address the legacy modernization/conversion market, including third party tools, legacy and post-conversion database support, electronic forms software, conversion, modernization, accessibility, and web-enablement, development and support of database-backed web portals, other web-based solutions, and management consulting services.

In 2007 we had net income from operations of \$191,400. Our stockholders' equity is \$1,918,893 at December 31, 2007. Our expenses related to sales, marketing, and administrative infrastructure increased in 2007 due to such factors as increases in stock compensation expense, recruiting fees, commissions earned, administrative staff hires, fringe benefits allocation, and rent. Our strategic partnerships with software development companies contributed to a constant stream of bidding opportunities that increased the percentage of our revenue that is derived from sales of third party software and related maintenance contracts. Our deferred revenue decreased due to the recognition of the prior year's deferred revenue, a change in the mix of our product and maintenance sales, and the timing of our invoicing due to funding restrictions of US government purchase contracts due to budget uncertainty in the US Congress.

Our cash and cash equivalents increased due to a combination of profits, collections of notes receivable, and more timely collections of accounts receivable. We were able to maintain and grow our investment in interest bearing accounts, and we were able to operate throughout 2007 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 31, 2007 | December 31, 2006 |
| Revenue | 100.0% | 100.0% |
| Cost of Goods Sold | 77.0% | 74.2% |
| Gross Profit | 23.0% | 25.8% |
| Operating Expenses | | |
| Selling, general and administrative | (21.1)% | (20.4)% |
| Income from operations | 1.9% | 5.4% |
| Other expense | (0.0)% | (0.1)% |
| Income before income taxes | 1.9% | 5.3% |
| Provision for income taxes | (0.0)% | (0.0)% |
| Net income | 1.9% | 5.3% |

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2007 Compared to 2006

Revenue. Revenue for 2007 increased \$494,000, or 5.2%, to \$10.0 million from \$9.5 million in 2006. Revenue from professional services decreased \$1.4 million, or 17.0%, to \$7.0 million in 2007 from \$8.5 million in 2006. Revenue from software sales increased \$1.9 million, or 198.5%, to \$2.9 million in 2007 from \$1.0 million in 2006. One of our biggest avenues of professional services sales is through strategic partnerships with third party software vendors. In 2007, our sales of third party software did not lead to a significant amount of additional professional services work, though product sales increased. At the same time, a few long-term contracts expired in the latter part of 2006 and in 2007. In addition, we believe that budget stalemates and general economic uncertainty lead to a decrease in the ability and willingness of several US government agencies to commit to new long-term projects. Our cultivation of strategic alliances, the increased market presence of some of our partners' third-party software solutions, and our increasing referral base led to increased opportunities for software and related maintenance contract sales.

Gross Profit. Gross profit decreased \$145,000, or 5.9% in 2007 versus 2006, despite an increase in revenue. Gross profit as a percentage of revenue decreased from 25.8% of revenue in 2006 to 23.0% of revenue in 2007. This decrease in gross profit and gross profit as a percentage of revenue is due to a shift in both the mix of our professional services versus software sales and a shift within software sales of the product mix. Professional services gross margin was \$1.7 million or 23.9% of revenue in 2007, compared to \$2.1 million, or 24.5% of revenue in 2006. This decrease is due largely to a 15.7% increase in labor costs in the forms conversion market. Software sales gross margin increased from \$354,000 in 2006 to \$610,000 in 2007. Gross margin as a percentage of revenue for software sales decreased from 36.3% in 2006 to 21.0% in 2007. If you remove the effect of a \$100,000 referral fee we received in 2006 for facilitating a vendor-direct software sale, the 2006 gross margin was 29.0%. The additional difference in gross margin as a percentage of revenue is based on what software products were sold. While sales of third party software and related maintenance increased across all product families, the mix between our two primary product families shifted from 65% of our software sales being from our higher margin family in 2006 to 65% of our software sales being from our lower margin family in 2007.

Selling, General and Administrative. Selling, general and administrative expense for 2007 increased 8.9% to \$2.1 million, or 21.1% of revenue, from \$1.9 million, or 20.4% of revenue, in 2006. The increase is due to increases in stock compensation expense, recruiting fees, which were necessary to attract people who have certain technical expertise and high-level security clearances, sales commissions earned, largely due to software sales increases, administrative staff hires, fringe benefits allocation, and rent, for which a new three-year term with increased costs began in April.

Recent Accounting Pronouncements Not Yet Adopted

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with U.S. generally accepted accounting principles, and expands disclosures about fair value measurements. The statement clarifies that the exchange price is the price in an orderly transaction between market participants to sell an asset or transfer a liability at the measurement date. The statement emphasizes that fair value is a market-based measurement and not an entity-specific measurement. It also establishes a fair value hierarchy used in fair value measurements and expands the required disclosures of assets and liabilities measured at fair value. This standard is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of SFAS 157 on its results of operations and financial condition.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159), which provides companies with an option to report selected financial assets and liabilities at fair value. SFAS No. 159's objective is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. Generally accepted accounting principles have required different measurement attributes for different assets and liabilities that can create artificial volatility in earnings. SFAS No. 159 helps to mitigate this type of accounting-induced volatility by enabling companies to report related assets and liabilities at fair value, which would likely reduce the need for

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companies to comply with detailed rules for hedge accounting. SFAS No. 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 requires companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of the company's choice to use fair value on its earnings. SFAS No. 159 also requires companies to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. SFAS No. 159 does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in SFAS No. 157 and SFAS No. 107. SFAS No. 159 is effective as of the beginning of a company's first fiscal year beginning after November 15, 2007. Early adoption is permitted as of the beginning of the previous fiscal year provided the company makes that choice in the first 120 days of that fiscal year and also elects to apply the provisions of SFAS No. 157. The Company is currently assessing the potential effect of SFAS No. 159 on its financial statements.

Liquidity and Capital Resources

Our profits in 2007, when combined with our beginning cash and cash equivalents balance, were sufficient to provide financing for our operations. For 2007, net cash provided by operating, investing and financing activities was \$414,384, which when added to a beginning balance of \$808,358 yielded cash and cash equivalents of \$1,222,742 at December 31, 2007. Although revenue increased in 2007, our accounts receivable balances decreased \$197,476, due to concerted efforts to get invoices out more quickly and to collect balances on them in a more timely way.

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, 2006, and expires on May 1, 2008. As of December 31, 2007, no amounts were outstanding under this line of credit.

We expect the bank to renew our line of credit. If it does not, we still anticipate that we will be able to meet our cash requirements for at least twelve months, based on our current operating plan.

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.

Revenue Recognition

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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 collectibility of the contract price is considered probable and can be reasonably estimated. Revenue is earned under time and materials and fixed price contracts.

Revenue on time and materials contracts is recognized based on direct labor hours expended at contract billing rates and other billable direct costs. For fixed price contracts that are based on unit pricing or level of effort, the Company recognizes revenue for the number of units delivered in any given fiscal period. For fixed price contracts in which the Company is paid a specific amount to provide a particular service for a stated period of time, revenue is recognized ratably over the service period.

For fixed price contracts that provide for the delivery of a specific product with related customer acceptance provisions, revenues are recognized upon product delivery and customer acceptance. A portion of our fixed price contracts involve the design and development of complex, client systems. For those contracts that are within scope of AICPA Statement of Position (SOP) 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts, revenue is recognized on the percentage-of-completion method using costs incurred in relation to total estimated costs. For those contracts that are within the scope of SOP 97-2, Software Revenue Recognition, our revenues associated with the customized software product are recognized when: 1. pervasive evidence of an arrangement exists; 2. delivery has occurred; 3. our price to the customer is fixed and determinable; and 4. collectibility is probable.

Our contracts with agencies of the 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 or ratably throughout the contract as the services are provided. In evaluating the probability of funding for purposes of assessing collectibility of the contract price, we consider our previous experiences with our 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.

Contract revenue recognition inherently involves estimation, including the contemplated level of effort to accomplish the tasks under the contract, the cost of the effort, and an ongoing assessment of progress toward completing the contract. From time to time, as part of the normal management process, facts develop that require revisions to estimated total costs or revenues expected. The cumulative impact of any revisions to estimates and the full impact of anticipated losses on any type of contract are recognized in the period in which they become known.

In July 2006, the FASB issued Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes: an interpretation of FASB Statement No. 109. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement principles for financial statement disclosure of tax positions taken or expected to be taken on a tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. The adoption of the provisions of FIN 48 did not have a material effect on our financial statements.

Effects of Inflation

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

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Item 7. Financial Statements

PART F/S

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| <u>Statements of Operations and Comprehensive Income for the years ended December 31, 2007 and 2006</u> | 18 |
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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 sheets of Information Analysis Incorporated as of December 31, 2007 and 2006, and the related statements of operations and comprehensive income, changes in stockholders' equity, and cash flows for the years 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 audits.

We conducted our audits 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 audits provide 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, 2007 and 2006, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ Reznick Group, P.C.

Vienna, Virginia

April 15, 2008

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INFORMATION ANALYSIS INCORPORATED**BALANCE SHEETS**

| | December 31, 2007 | December 31, 2006 |
|---|-------------------|-------------------|
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 1,222,742 | \$ 808,358 |
| Accounts receivable | 1,560,030 | 1,757,506 |
| Prepaid expenses | 462,802 | 382,095 |
| Other assets | 4,300 | 4,300 |
| Other receivables | 2,630 | 6,427 |
| Notes receivable | | 115,550 |
| Total current assets | 3,252,504 | 3,074,236 |
| Fixed assets, net of accumulated depreciation and amortization of \$491,565 and \$457,317 | 79,145 | 67,317 |
| Other assets | 8,782 | 8,782 |
| Total assets | \$ 3,340,431 | \$ 3,150,335 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities | | |
| Accounts payable | \$ 720,830 | \$ 643,838 |
| Deferred revenue | 393,974 | 513,522 |
| Accrued payroll and related liabilities | 257,649 | 264,660 |
| Other accrued liabilities | 45,585 | 53,354 |
| Income taxes payable | 3,500 | |
| Total liabilities | 1,421,538 | 1,475,374 |
| Stockholders' equity | | |
| Common stock, \$0.01 par value, 30,000,000 shares authorized, 12,839,376 issued, 11,196,760 outstanding as of December 31, 2007 and 2006 | 128,393 | 128,393 |
| Additional paid-in capital | 14,545,367 | 14,485,770 |
| Accumulated deficit | (11,824,656) | (12,008,991) |
| Treasury stock, 1,642,616 shares at cost at December 31, 2007 and 2006 | (930,211) | (930,211) |
| Total stockholders' equity | 1,918,893 | 1,674,961 |
| Total liabilities and stockholders' equity | \$ 3,340,431 | \$ 3,150,335 |

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 December 31, | |
|---|---|--------------|
| | 2007 | 2006 |
| Sales | | |
| Professional fees | \$ 7,042,254 | \$ 8,484,112 |
| Software sales | 2,911,030 | 975,269 |
| Total sales | 9,953,284 | 9,459,381 |
| Cost of sales | | |
| Cost of professional fees | 5,361,205 | 6,401,744 |
| Cost of software sales | 2,300,561 | 621,583 |
| Total cost of sales | 7,661,766 | 7,023,327 |
| Gross profit | 2,291,518 | 2,436,054 |
| Selling, general and administrative expenses | 2,100,118 | 1,928,566 |
| Income from operations | 191,400 | 507,488 |
| Other expenses | 3,565 | 3,843 |
| Income before provision for income taxes | 187,835 | 503,645 |
| Provision for income taxes | 3,500 | 1,200 |
| Net income | 184,335 | 502,445 |
| Unrealized losses on available-for-sale securities | | |
| Reclassification adjustment for losses included in net income | | 12,000 |
| Comprehensive income | \$ 184,335 | \$ 514,445 |
| Earnings per common share - basic | \$ 0.02 | \$ 0.05 |
| Earnings per common share - diluted | \$ 0.02 | \$ 0.04 |
| Weighted average common shares outstanding | | |
| Basic | 11,196,760 | 11,018,317 |
| Diluted | 11,398,180 | 11,342,072 |

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 Common Stock Issued | Common Stock | Additional Paid-in Capital | Accumulated Deficit | Accumulated Other Comprehensive Loss | Treasury Stock | Total |
|---|--|-----------------|----------------------------------|------------------------|---|-------------------|--------------|
| Balances, December 31, 2005 | 12,127,626 | \$ 121,276 | \$ 14,212,165 | \$ (12,511,436) | \$ (12,000) | \$ (854,313) | \$ 955,692 |
| Net Income | | | | 502,445 | | | 502,445 |
| Reclassification adjustment for loss on available-for- sale securities | | | | | 12,000 | | 12,000 |
| Comprehensive income | | | | | | | 514,445 |
| Option exercises | 617,220 | 6,172 | 242,076 | | | (75,898) | 172,350 |
| Warrant exercises | 94,530 | 945 | (945) | | | | |
| Stock option compensation | | | 32,474 | | | | 32,474 |
| Balances, December 31, 2006 | 12,839,376 | \$ 128,393 | \$ 14,485,770 | \$ (12,008,991) | \$ | \$ (930,211) | \$ 1,674,961 |
| Net Income | | | | 184,335 | | | 184,335 |
| Comprehensive income | | | | | | | 184,335 |
| Stock option compensation | | | 59,597 | | | | 59,597 |
| Balances, December 31, 2007 | 12,839,376 | \$ 128,393 | \$ 14,545,367 | \$ (11,824,656) | \$ | \$ (930,211) | \$ 1,918,893 |

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 December 31, | |
|--|---|-------------------|
| | 2007 | 2006 |
| Cash flows from operating activities: | | |
| Net income | \$ 184,335 | \$ 502,445 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Stock option compensation | 59,597 | 32,474 |
| Depreciation and amortization | 34,248 | 32,481 |
| Reserve for uncollectible note receivable | 30,550 | |
| Realized loss on investment | | 12,000 |
| Changes in operating assets and liabilities | | |
| Accounts receivable | 197,476 | 236,504 |
| Notes receivable | 85,000 | (25,050) |
| Other receivables and prepaid expenses | (76,910) | (199,714) |
| Accounts payable and accrued expenses | 62,212 | (659,082) |
| Deferred revenue | (119,548) | 299,646 |
| Income taxes payable | 3,500 | (4,500) |
| Net cash provided by operating activities | 460,460 | 227,204 |
| Cash flows from investing activities: | | |
| Acquisition of furniture and equipment | (46,076) | (42,973) |
| Net cash used in investing activities | (46,076) | (42,973) |
| Cash flows from financing activities: | | |
| Stock options exercised | | 172,350 |
| Net cash provided by (used in) financing activities | | 172,350 |
| Net increase in cash and cash equivalents | 414,384 | 356,581 |
| Cash and cash equivalents, beginning of the year | 808,358 | 451,777 |
| Cash and cash equivalents, end of the year | \$ 1,222,742 | \$ 808,358 |
| Supplemental cash flow information | | |
| Interest paid | \$ | \$ 657 |
| Income taxes paid | \$ | \$ 10,000 |

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 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 provides services under various pricing arrangements. 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 collectibility of the contract price is considered probable and can be reasonably estimated. Revenue is earned under time and materials and fixed price contracts.

Revenue on time and materials contracts are 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 fiscal period. For fixed price contracts in which the Company is paid a specific amount to provide a particular service for a stated period of time, revenue is recognized ratably over the service period.

For fixed price contracts that provide for the delivery of a specific product with related customer acceptance provisions, revenues are recognized upon product delivery and customer acceptance. A portion of the Company's fixed price contracts may involve the design and development of complex client systems. For those contracts that are within the scope of AICPA Statement of Position (SOP) 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts, revenue is recognized on the percentage-of-completion method using costs incurred in relation to total estimated costs. For those contracts that are within the scope of SOP 97-2, Software Revenue

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INFORMATION ANALYSIS INCORPORATED

NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (continued)

Recognition, our revenues associated with the customized software product are recognized when: 1. pervasive evidence of an arrangement exists; 2. delivery has occurred; 3. our price to the customer is fixed and determinable; and 4. collectibility is probable.

The Company's contracts with agencies of the 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 or ratably throughout the contract as the services are provided. In evaluating the probability of funding for purposes of assessing collectibility 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.

Contract revenue recognition inherently involves estimation, including the contemplated level of effort to accomplish the tasks under the contract, the cost of the effort, and an ongoing assessment of progress toward completing the contract. From time to time, facts develop that require revisions to estimated total costs or revenues expected. The cumulative impact of any revisions to estimates and the full impact of anticipated losses on any type of contract are recognized in the period in which they become known.

Segment Reporting

In accordance with Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*, 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 United States government are subject to audit by the Defense Contract Audit Agency (DCAA), which could result in the renegotiation of amounts previously billed. Audits by DCAA were completed through the year ended December 31, 1997. No amounts were changed as a result of the audits. Since the Company has entered into no cost plus fixed fee contracts since 1997, management is of the opinion that any disallowance of costs for subsequent fiscal years by government auditors, other than amounts already provided, will not materially affect the Company's financial statements.

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INFORMATION ANALYSIS INCORPORATED

NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (continued)

Cash and Cash Equivalents

For the purposes of the statement of cash flows, 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 are recorded at the invoiced amount and do not bear interest. 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 collectibility. 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 determined that no allowance for doubtful accounts was required at December 31, 2007 and 2006.

Fixed Assets

Fixed assets 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 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 current operations.

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INFORMATION ANALYSIS INCORPORATED

NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (continued)

Stock-Based Compensation

On January 1, 2006, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123R (SFAS 123R), using the modified prospective transition method.

At December 31, 2007, the Company had the stock-based compensation plans described in Note 10 below. Total compensation expense related to these plans was \$59,597 and \$32,474 for the years ended December 31, 2007 and 2006, respectively, of which \$6,015 and \$520, respectively, related to options awarded to non-employees.

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.

Recent Accounting Pronouncements Not Yet Adopted

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159), which provides companies with an option to report selected financial assets and liabilities at fair value. SFAS No. 159's objective is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. Generally accepted accounting principles have required different measurement attributes for different assets and liabilities that can create artificial volatility in earnings. SFAS No. 159 helps to mitigate this type of accounting-induced volatility by enabling companies to report related assets and liabilities at fair value, which would likely reduce the need for companies to comply with detailed rules for hedge accounting. SFAS No. 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 requires companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of the company's choice to use fair value on its earnings. SFAS No. 159 also requires companies to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. SFAS No. 159 does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in SFAS No. 157 and SFAS No. 107. SFAS No. 159 is effective as of the beginning of a company's first fiscal year beginning after

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Information Analysis Incorporated

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INFORMATION ANALYSIS INCORPORATED

NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (continued)

November 15, 2007. Early adoption is permitted as of the beginning of the previous fiscal year provided the company makes that choice in the first 120 days of that fiscal year and also elects to apply the provisions of SFAS No. 157. The Company is currently assessing the potential effect of SFAS No. 159 on its financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with U.S. generally accepted accounting principles, and expands disclosures about fair value measurements. The statement clarifies that the exchange price is the price in an orderly transaction between market participants to sell an asset or transfer a liability at the measurement date. The statement emphasizes that fair value is a market-based measurement and not an entity-specific measurement. It also establishes a fair value hierarchy used in fair value measurements and expands the required disclosures of assets and liabilities measured at fair value. This standard is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of SFAS 157 on its results of operations and financial condition.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* (SFAS No. 141(R)). SFAS 141(R) requires the acquiring entity in a business combination to recognize the full fair value of assets acquired and liabilities assumed in the transaction (whether a full or partial acquisition); establishes the acquisition date fair value as the measurement objective for all assets acquired and liabilities assumed; requires expensing of most transaction and restructuring costs; and requires the acquirer to disclose to investors and other users all of the information needed to evaluate and understand the nature and financial effect of the business combination. SFAS No. 141(R) applies to all transactions or other events in which the Company obtains control of one or more businesses, including those sometimes referred to as true mergers or mergers of equals and combinations achieved without the transfer of consideration, for example, by contract alone or through the lapse of minority veto rights. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after January 1, 2009.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* an amendment of Accounting Research Bulletin No. 51 (SFAS No. 160). SFAS No. 160 requires reporting entities to present noncontrolling (minority) interests as equity (as opposed to as a liability or mezzanine equity) and provides guidance on the accounting for transactions between an entity and noncontrolling interests. SFAS No. 160 applies prospectively as of January 1, 2009, except for the presentation and disclosure requirements which will be applied retrospectively for all periods presented.

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INFORMATION ANALYSIS INCORPORATED

NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (continued)

Income Taxes

Under Financial Accounting Standards Board Statement No. 109, *Accounting for Income Taxes*, the liability method is used in accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities, and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

In July 2006, the FASB issued Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes: an interpretation of FASB Statement No. 109*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement principles for financial statement disclosure of tax positions taken or expected to be taken on a tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. The adoption of the provisions of FIN 48 did not have a material effect on our financial statements.

Fair Market Value of Financial Instruments

The Company's financial instruments include trade receivables, other receivables, notes receivable, accounts payable, and notes payable. Management believes the carrying value of financial instruments approximates their fair market value, unless disclosed otherwise in the accompanying notes.

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INFORMATION ANALYSIS INCORPORATED**NOTES TO FINANCIAL STATEMENTS****2. Receivables**

Accounts receivable at December 31, 2007 and 2006, consist of the following:

| | 2007 | 2006 |
|---------------------------------------|------------------|------------------|
| Billed-federal government | \$ 1,313,940 | \$ 1,361,255 |
| Billed-commercial and other | 143,564 | 157,952 |
| Total billed | 1,457,504 | 1,519,207 |
| Unbilled | 102,526 | 238,299 |
| Less: allowance for doubtful accounts | | |
| Accounts receivable, net | \$ 1,560,030 | \$ 1,757,506 |

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.

At December 31, 2007 and 2006, there are notes receivable from a former employee in the amounts of \$28,550 and \$2,000. As of December 31, 2007, the notes have been fully reserved, as we have determined they are uncollectible. The notes originally bore interest at a rate of 6% and are due September 20, 2008, but are callable after December 31, 2006. We have ceased accruing interest and fully reserved for accrued interest previously recognized.

3. Fixed Assets

A summary of fixed assets and equipment at December 31, 2007 and 2006, consist of the following:

| | 2007 | 2006 |
|---|------------------|------------------|
| Furniture and equipment | \$ 172,140 | \$ 151,253 |
| Computer equipment and software | 398,570 | 373,381 |
| Subtotal | 570,710 | 524,634 |
| Less: accumulated depreciation and amortization | (491,565) | (457,317) |
| Total | \$ 79,145 | \$ 67,317 |

Depreciation expense for the years ended December 31, 2007 and 2006, were \$34,248 and \$32,481, respectively.

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INFORMATION ANALYSIS INCORPORATED**NOTES TO FINANCIAL STATEMENTS****4. Other Accrued Liabilities**

Other accrued liabilities at December 31, 2007 and 2006, consist of the following:

| | 2007 | 2006 |
|--|------------------|------------------|
| Accrued payables | \$ 28,405 | \$ 46,857 |
| Commissions payable | 17,180 | 6,497 |
| Total other accrued liabilities | \$ 45,585 | \$ 53,354 |

5. Revolving Line of Credit

On December 20, 2005, the Company entered into a revolving line of credit agreement with Commerce Bank providing for demand or short-term borrowings up to \$1,000,000. The line of credit expires on May 1, 2008. Draws against the line are limited by varying percentages of the Company's eligible accounts receivable balances. The bank is granted a security interest in all company assets if there are borrowings under the line of credit. Interest on outstanding amounts is payable monthly at the bank's prime rate plus 0.75% (8.00% and 9.00% at December 31, 2007 and 2006, respectively). The bank has a first priority security interest in the Company's receivables and a direct assignment of its U.S. government contracts. There was no outstanding balance on the line at December 31, 2007 or 2006.

6. Commitments and Contingencies**Operating Leases**

The Company leases facilities under long-term operating lease agreements. Rent expense was \$99,145 and \$79,503 for the years ended December 31, 2007 and 2006, respectively.

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

| | |
|------------------------------------|-------------------|
| Year ending December 31, 2008 | \$ 97,476 |
| 2009 | 100,400 |
| 2010 | 25,284 |
| Total minimum rent payments | \$ 223,160 |

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.

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INFORMATION ANALYSIS INCORPORATED**NOTES TO FINANCIAL STATEMENTS****7. Income Taxes**

The tax effects of significant temporary differences representing deferred tax assets and deferred tax liabilities at December 31, 2007 and 2006, are as follows:

| | 2007 | 2006 |
|------------------------------------|--------------|--------------|
| Deferred tax assets (liabilities): | | |
| Net operating loss carryforward | \$ 5,905,300 | \$ 5,994,900 |
| Accrued vacation and commissions | 46,200 | 48,300 |
| AMT tax credit carryforward | 6,600 | 7,400 |
| Other | 2,500 | 4,700 |
| Fixed assets | (102,200) | (100,000) |
| Subtotal | 5,858,400 | 5,955,300 |
| Valuation allowance | (5,858,400) | (5,955,300) |
| Total | \$ | \$ |

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

| | December 31, | |
|--|--------------|------------|
| | 2007 | 2006 |
| Income before taxes | \$ 187,835 | \$ 503,645 |
| Income tax expense on above amount at federal statutory rate | 63,900 | 171,200 |
| State income tax expense, net of federal benefit | 7,500 | 20,100 |
| Permanent differences | 24,600 | 15,700 |
| Other | 4,400 | (3,300) |
| Change in valuation allowance | (96,900) | (202,500) |
| Provision for income taxes | \$ 3,500 | \$ 1,200 |

There is no federal income tax liability reflected on the balance sheet.

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INFORMATION ANALYSIS INCORPORATED**NOTES TO FINANCIAL STATEMENTS****7. Income Taxes (continued)**

Income tax for the years ended December 31, 2007 and 2006 consists of the following:

| | December 31, | |
|--|--------------|------------|
| | 2007 | 2006 |
| Current income taxes | | |
| Federal | \$ 93,900 | \$ 147,200 |
| State | 11,000 | 17,300 |
| Alternative minimum tax | | 1,200 |
| Benefit from utilization of net operating losses | (101,400) | (164,500) |
| | 3,500 | 1,200 |
| Deferred taxes | | |
| | \$ 3,500 | \$ 1,200 |

The Company has recognized a valuation allowance to the full extent of its 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 \$15.5 million, which expire, if unused, between the years 2012 and 2023.

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, this deferred tax asset is fully offset by a valuation allowance.

The Company has adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), as of January, 1, 2007. This standard modifies the previous guidance provided by SFAS No. 5, *Accounting for Contingencies*, and SFAS No. 109, *Accounting for Income Taxes*, for uncertainties related to the Company's income tax liabilities. The Company has analyzed its income tax positions using the criteria required by FIN 48 and concluded that there is no cumulative effect relating to the adoption of FIN 48. In addition, as of December 31, 2007 the company determined it has no material uncertain tax positions and no interest or penalties have been accrued.

Information Analysis Incorporated has elected to recognize its estimated penalties and interest on its income tax liabilities as a component of its provision for income taxes.

8. Major Customers and Major Suppliers

The Company's prime contracts and subcontracts with agencies of the federal government accounted for 91% and 90% of the Company's revenues during 2007 and 2006, respectively. The Company's prime contracts with one federal government agency accounted for 21% of the Company's 2007 revenue.

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INFORMATION ANALYSIS INCORPORATED

NOTES TO FINANCIAL STATEMENTS

8. Major Customers and Major Suppliers (continued)

The Company sold third party software and maintenance contracts under agreements with two major suppliers. These sales accounted for 28% of total revenue.

9. 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 a discretionary percentage of the participants' elective deferrals. In 2007 and in 2006, 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 2007 or 2006. Matching contributions for the year ended December 31, 2007 and 2006 were \$33,198 and \$39,353, respectively.

10. Stock Options and Warrants

The Company uses the Black-Scholes model to estimate grant date fair value. Under the modified prospective transition method adopted by the Company, the Company did not recognize any stock-based compensation expense for 2006 relating to option awards granted prior to January 1, 2006, as all of these option grants were 100% vested. Stock-based compensation expense for all share-based payment awards granted after January 1, 2006 is based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. The Company recognizes these compensation costs only for those shares expected to vest on a straight-line basis over the requisite service period of the awards, generally, the option vesting term of six months to two years.

As a result of adopting SFAS 123R, net income decreased by \$53,582 and \$31,954 for the years ended December 31, 2007 and 2006, respectively, as compared to if the Company had continued to account for stock-based compensation under APB 25. There was no impact on either basic or diluted net income per share in 2007. There was no impact on basic net income per share in 2006, but the impact on diluted net income per share in 2006 was a decrease of \$0.01 per share.

As part of its SFAS 123R adoption the Company evaluated the model input assumptions used in estimating grant date fair value. The Company concluded that its historical realized volatility, calculated using historical stock prices of the Company over the five years preceding the issue, is an appropriate measure of expected volatility. In addition, the Company also examined its historical pattern of option exercises in an effort to identify a discernable pattern and concluded that the expected term for options awarded in 2007 and in 2006 is estimated to be five years, with the exception of non-statutory

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INFORMATION ANALYSIS INCORPORATED**NOTES TO FINANCIAL STATEMENTS****10. Stock Options and Warrants (continued)**

stock options, which have an expected term equal to the term of the option, since these do not expire when employment ceases. The interest rate used in the pricing model is based on the U.S. Treasury yield curve in effect at the time of the grant on issues with remaining terms equal to the estimated expected term used in the model. In addition, the Company has estimated a forfeiture rate based on historical data and current assumptions.

During the years ended December 31, 2007 and 2006, the Company granted options to certain employees to purchase an aggregate of 215,250 and 125,000 shares, respectively, of the Company's common stock, with a per share weighted average fair value of \$0.25 in 2007 and \$0.32 in 2006. Also during the years ended December 31, 2007 and 2006, the Company granted options to non-employee directors and consultants to purchase 18,500 and 1,000 shares, respectively, of the Company's common stock, with a per share fair value of \$0.33 in 2007 and \$0.52 in 2006 at the measurement date. The fair values of option awards granted in 2007 and 2006 were estimated using the Black-Sholes option pricing model under the following assumptions:

| | 2007 | | 2006 | |
|-------------------------|-------------|-------|-------------|-------|
| Risk free interest rate | 3.67% | 5.03% | 4.35% | 5.07% |
| Dividend yield | 0% | | 0% | |
| Expected term | 5-10 years | | 2-5 years | |
| Expected volatility | 65.3 | 73.5% | 89 | 99% |

The Company had a stock option plan, which became effective June 25, 1996, and expired May 29, 2006 (the 1996 Plan). The 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 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 1996 Plan in the year ended December 31, 2006, was eighteen months. The exercise price of each option equals the quoted market price of the Company's stock on the date of grant.

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 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, 2007 and 2006, was seven months and six 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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INFORMATION ANALYSIS INCORPORATED**NOTES TO FINANCIAL STATEMENTS****10. Stock Options and Warrants (continued)**

Option activity under the foregoing option plans as of December 31, 2007, and changes during the years ended December 31, 2007 and 2006, were as follows:

| | Options outstanding | |
|---|---------------------|----------------------------------|
| | Number of shares | Weighted average price per share |
| Balance at December 31, 2005 | 1,963,350 | \$ 0.87 |
| Options granted | 126,500 | 0.54 |
| Options exercised, expired or forfeited | 1,134,050 | 0.49 |
| Balance at December 31, 2006 | 955,800 | \$ 1.28 |
| Options granted | 233,750 | 0.40 |
| Options exercised, expired or forfeited | 80,550 | 10.76 |
| Balance at December 31, 2007 | 1,109,000 | 0.41 |

The following table summarizes information about options at December 31, 2007:

| 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 |
| 1,109,000 | \$ 0.41 | 5.67 | \$ 55,455 | 1,083,500 | \$ 0.41 | 5.61 | \$ 55,455 |

Nonvested stock awards as of December 31, 2007 and changes during the year ended December 31, 2007 and 2006, were as follows:

| | Nonvested | |
|------------------------------|------------------|--|
| | Number of shares | Weighted average grant date fair value |
| Balance at December 31, 2005 | | \$ 0.00 |
| Granted | 126,500 | 0.32 |
| Vested | 91,500 | 0.27 |

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| | | | |
|------------------------------|---------|----|------|
| Balance at December 31, 2006 | 35,000 | \$ | 0.44 |
| Granted | 233,750 | | 0.26 |
| Vested | 235,250 | | 0.27 |
| Expired before vesting | 8,000 | | 0.39 |
| Balance at December 31, 2007 | 25,500 | | 0.34 |

As of December 31, 2007 and 2006, unrecognized compensation cost associated with non-vested share based employee and non-employee compensation approximated \$2,537 and \$7,786, respectively, which is expected to be recognized over a weighted average period of 6 months and 7 months, respectively.

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Information Analysis Incorporated

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INFORMATION ANALYSIS INCORPORATED**NOTES TO FINANCIAL STATEMENTS****10. Stock Options and Warrants (continued)**

The Board of Directors has also granted warrants to directors, employees and others. There were no warrants issued in 2007 or 2006. There were no warrants exercised in 2007. In 2006, warrants were exercised by three parties resulting in the issuance of 94,530 unregistered shares of IAI common stock. As of December 31, 2007, outstanding warrants are 12,000, none of which expire within 1 year. The purchase price for shares issued upon exercise of these warrants is \$0.01 per share. These warrants are exercisable immediately.

11. Earnings Per Share

Earnings per share are presented in accordance with SFAS No. 128, *Earnings Per Share*. This statement requires dual presentation of basic and diluted earnings per share on the face of the income statement. 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, 2007: | | | |
| Income available to common stockholders | \$ 184,335 | 11,196,760 | \$ 0.02 |
| Effect of dilutive stock options | | 189,740 | |
| Effect of dilutive warrants | | 11,680 | |
| Diluted net income per common share for the year ended December 31, 2007: | \$ 184,335 | 11,398,180 | \$ 0.02 |
| Basic net income per common share for the year ended December 31, 2006: | | | |
| Income available to common stockholders | \$ 502,445 | 11,018,317 | \$ 0.05 |
| Effect of dilutive stock options | | 311,973 | |
| Effect of dilutive warrants | | 11,782 | |
| Diluted net income per common share for the year ended December 31, 2006: | \$ 502,445 | 11,342,072 | \$ 0.04 |

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Information Analysis Incorporated

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Item 8. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure

There have been no changes in accountants or disagreements with accountants on accounting and financial disclosure.

Item 8A(T). Controls and Procedures

The Company's management, under the supervision of and with the participation of the Company's principal executive and principal financial officers, and people performing similar functions, has evaluated the effectiveness of the Company's disclosure 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, management has concluded that, as of the Evaluation Date, the disclosure controls and procedures are effective in ensuring that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

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 December 31, 2007, 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 December 31, 2007.

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 the our independent registered public accounting firm pursuant to temporary rules of the SEC that permit the Company to provide only management's report in this Annual Report.

This report shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, 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.

Our management, including the Chief Executive Officer and Chief Financial Officer, identified a significant change in the Company's internal control over financial reporting that occurred during our Fiscal Year Ended December 31, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. During the fourth quarter of 2007, we instituted additional control procedures related to the identification and classification of contracts in terms of revenue recognition, external reporting requirements, and compliance with internal policies and external regulations.

Item 8B. Other Information

None

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Information Analysis Incorporated

2007 Annual Report on Form 10-KSB

PART III

Item 9. Directors, Executive Officers, Promoters and Control Persons, and Corporate Governance; Compliance with Section 16(a) of the Exchange Act

(The information required by this Item is incorporated by reference from the corresponding sections and subsections of our Definitive Proxy Statement pursuant to Section 14(a) of the Securities Exchange Act of 1934.)

Item 10. Executive Compensation

(The information required by this Item is incorporated by reference from the corresponding sections and subsections of our Definitive Proxy Statement pursuant to Section 14(a) of the Securities Exchange Act of 1934.)

Item 11. 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 pursuant to Section 14(a) of the Securities Exchange Act of 1934.)

Item 12. Certain Relationships and Related Transactions

(The information required by this Item is incorporated by reference from the corresponding sections and subsections of our Definitive Proxy Statement pursuant to Section 14(a) of the Securities Exchange Act of 1934.)

Item 13. Exhibits

(a) Exhibits:
See Exhibit Index on page 38.

Item 14. Principal Accountant Fees and Services

(The information required by this Item is incorporated by reference from the corresponding sections and subsections of our Definitive Proxy Statement pursuant to Section 14(a) of the Securities Exchange Act of 1934.)

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Signatures

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

INFORMATION ANALYSIS INCORPORATED

By: /s/ Sandor Rosenberg
 Sandor Rosenberg, President
 April 15, 2008

In accordance with the Exchange Act, 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 |
|--|---|----------------|
| /s/ Sandor Rosenberg Sandor Rosenberg | Chairman of the Board, Chief Executive Officer and President | April 15, 2008 |
| /s/ Charles A. May, Jr. Charles A. May | Director | April 15, 2008 |
| /s/ Bonnie K. Wachtel Bonnie K. Wachtel | Director | April 15, 2008 |
| /s/ James D. Wester James D. Wester | Director | April 15, 2008 |
| /s/ Richard S. DeRose Richard S. DeRose | Chief Financial Officer, Secretary and Treasurer | April 15, 2008 |
| /s/ Matthew T. Sands Matthew T. Sands | Controller | April 15, 2008 |

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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 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 | 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 |
| 23.1 | Consent of Independent Registered Public Accounting Firm, Reznick Group, P.C. | Filed with this Form 10-KSB |
| 31.1 | Rule 13a-14(a) / 15a-14(a) Certification by Chief Executive Officer | Filed with this Form 10-KSB |
| 31.2 | Rule 13a-14(a) / 15a-14(a) Certification by Chief Financial Officer | Filed with this Form 10-KSB |

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| 32.1 | 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-KSB |
| 32.2 | 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-KSB |