

U.S. Securities and Exchange Commission

Washington, D.C. 20549

FORM 10-SB

GENERAL FORM FOR REGISTRATION OF SECURITIES OF  
SMALL BUSINESS ISSUERS

Under Section 12(b) or (g) of the Securities Exchange Act of 1934

INFORMATION ANALYSIS INCORPORATED  
(Name of Small Business Issuer in its charter)

Virginia  
(State of incorporation)

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

11240 Waples Mill Road  
Suite 400  
Fairfax, VA 22030  
(Address of principal executive offices)

(703) 383-3000  
(Issuer's telephone number)

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

Common Stock, \$.01 par value  
(Title of class)

PART I

Item 1. Description of Business.

Information Analysis Incorporated ("IAI" or the "Company") incorporates by reference Item 1 of Part I to the Company's Form 10-KSB for the fiscal year ending on December 31, 1996 which was filed with the Securities and Exchange Commission ("SEC") on April 14, 1997.

Item 2. Management's Discussion and Analysis or Plan of Operation

The Company incorporates by reference Item 6 to Part II to the Company's Form 10-KSB for the fiscal year ending on December 31, 1996 which was filed with the SEC on April 14, 1997.

Item 3. Description of Property

The Company's offices are located at 11240 Waples Mill Road, Suite 400, Fairfax, VA 22030. These offices comprise 18,280 square feet of space. The Company's lease at this location expires on February 28, 2004.

Item 4. Security Ownership of Certain Beneficial Owners and Management.

Set forth below is information as of March 31, 1997 concerning beneficial ownership by any person known to the Company to be the owner of more than five percent of the Company's Common Stock, by each director and executive officer and by all directors and executive officers as a group. All information presented below reflects the two three for one stock splits which were declared to shareholders of record on January 15, 1997 and April 7, 1997, the latter of which resulted from a stock dividend of two shares of Common Stock for each share of Common Stock outstanding.

Name and Address of Beneficial -----	Amount and Nature of Beneficial Owner (2) -----	Percentage Class -----
Sandor Rosenberg (1) Chairman and President	1,918,200	33.9%
Richard S. DeRose (1) Executive Vice President	195,900(3)	3.4%

James D. Wester, Director (1)	391,500 (4)	6.5%
John D. Sanders, Director 4600 N. 26th Street Arlington, VA 22207	44,700	*
Bonnie K. Wachtel, Director 1101 14th Street, N.W Washington, D.C. 20001	107,700	1.8%
George T. DeBakey, Director 5303 Marlyn Drive Bethesda, MD 20832	9,000 (5)	*
Kenneth Parsons(1)	342,600 (6)	5.7%
All directors and executive officers as a group	2,667,000	43.3%

\* Less than one percent

- (1) Unless otherwise noted, all addresses are c/o the Company at 11240 Waples Mill Road, Fairfax, VA 22030.
- (2) All shares are held outright by the individual listed below.
- (3) Includes 106,500 options, 16,500 of which are exercisable at \$.50 per share and expire on January 4, 2003 and 90,000 of which are exercisable at \$.444 per share and expire on June 17, 2006. All expiration dates are subject to continuation of Mr. DeRose's employment.
- (4) Includes a warrant exercisable for 108,000 shares at \$.555 per share which expires on February 24, 2003 and 270,000 stock options exercisable at \$.444 per share which expire on June 19, 2006.
- (5) Represents a warrant exercisable for 9,000 shares at a price of \$.8333 per share which expires on June 30, 1999.
- (6) Includes 342,000 options. Mr. Parson also holds 450,000 options, 250,000 of which become exercisable on January 1, 1998 and 250,000 of which become exercisable on January 1, 1999. All options are exercisable at \$.444 per share of the total options, 225,000 expire on June 7, 2006 and 567,000 expire on August 15, 2006. Of the total options Mr. Parsons holds, the 117,000 are subject to the continuation of Mr. Parson's employment.

Item 5. Directors, Executive Officers, Promoters and Control Persons.

The Company incorporates by reference Item 9 of Part III to the Company's Form 10-KSB for the fiscal year ending on December 31, 1996 which was filed with the SEC on April 14, 1997.

Item 6. Executive Compensation.

The following table sets forth the compensation paid over the last three fiscal years to the Company's chief executive officer and other individuals serving as executive officers as of December 31, 1996:

Summary Compensation Table

<TABLE>  
<CAPTION>

Name and Principal Position	Year	Salary	Bonus	Number of Stock Options Granted
<S> <C> Sandor Rosenberg President	1996	\$100,000	\$15,000	-
	1995	\$100,007	\$25,900	-
	1994	\$ 99,910	\$30,000	-
Richard S. DeRose Exec Vice President and Treasurer	1996	\$110,730	\$27,500	90,000*
	1995	\$109,730	\$30,900	-
	1994	\$ 99,622	\$30,000	-

</TABLE>

the total annual salary and bonus reported for such executive officer.

The following table sets forth all option grants in 1996 to all executive officers:

Option Grants in Last Fiscal Year

<TABLE>  
<CAPTION>

---

Name Date	Granted	% Of Total Options Granted To Employees In Fiscal Year	Exercise Price	Expiration
Richard S. DeRose 2006	90,000*	4.6%	\$.444	June 17,

</TABLE>

The following table sets forth information concurring each exercise of stock options during 1996 by all executive officers:

Aggregated Option Exercises in Last Fiscal Year  
and FY End Option Values

<TABLE>  
<CAPTION>

---

of	Value
Unexercised	
Money	Number of Securities
FY	In-The
Name	Options At
Exercise	End (\$)
Shares Acquired on	Underlying Unexercised
Realized	Options At FY End (#)
Value	End (\$)
Richard S. DeRose \$1,331,000	211,500

</TABLE>

\*All option grants and option exercises have been adjusted to account for all stock splits declared and payable through April 21, 1997.

In 1996, the Company compensated each of its outside directors at the rate of \$500 per quarter or \$2,000 per year. No director received any grants of options or other securities in their capacity as a director.

Item 7. Certain Relationships and Related Transactions.

In 1996, the Company repurchased from Sandor Rosenberg, its president and a director, 13,000 shares (or 117,000 after accounting for all stock splits) of its Common Stock at an aggregate purchase price of \$53,250. In 1995, 17,200 shares (or 154,800 after accounting for all stock splits) were repurchased from Mr. Rosenberg at an aggregate purchase price of \$72,663.

In September 1996, in order to provide the Company with additional working capital for development of the CAST product, James C. Wester, a director, agreed to advance up to \$300,000 to the Company. In exchange for these advances, the Company agreed to pay Mr. Wester 20% of all CAST license revenues the Company receives up to 150% of the advances Mr. Wester has extended.

In order to compensate Mr. Wester for various consulting services he has rendered to the Company for which he has received minimal cash remuneration, in June 1996, the Company granted Mr. Wester 30,000 ten year stock options (now 270,000 to account for all stock splits) exercisable at \$4.00 per share (now \$.444 as a result of all stock splits), the then current value of the Company's Common Stock.

In November 1996, the Company agreed to reduce the exercise price from

\$5.50 per share under 10,000 warrants of which John D. Sanders, a director, was the holder of 3,000 and Bonnie K. Wachtel, a director, was the holder of 2,500. These 10,000 warrants were issued in 1986 as partial compensation for underwriting and other investment banking services which were provided by Wachtel & Co., Inc. The reduction was in consideration of the holders of the warrants agreeing to forgo registration rights for the shares obtained upon exercise of the warrants for a period of one year from exercise. The warrants were exercised at the lower price and the holders thereof received 10,000 shares (now increased to 90,000 shares to account for all stock splits).

Item 8. Description of Securities

IAI's capital stock consists of 10,000,000 shares of its \$.10 par value Common Stock. As of March 31, 1997, 5,660,271 shares were issued and outstanding. These issued and outstanding shares reflect two three for one stock splits declared on January 9, 1997 and April, 1997 to all shareholders of record on January 15, 1997 and April 7, 1997, respectively, the latter of which resulted from a stock dividend of two shares of Common Stock for each share of Common Stock outstanding.

Holders of the Common Stock are entitled to one vote per share on all matters to be voted on by the shareholders and are not entitled to cumulative voting. Accordingly, the holders of a majority of the outstanding shares have the power to elect all directors and to control the resolution of all issues put to a vote of the shareholders. The Company's Articles of Incorporation were also amended and restated effective March 18, 1997. As a result of this amendment and restatement, whenever under the Virginia Stock Corporation Act, in the absence of a provision to the contrary in the Articles of Incorporation, a majority of more than two-thirds would be required to undertake any corporate action, by virtue of the Company's Amended and Restated Articles of Incorporation, such majority otherwise required by law has been amended so as only to require a simple majority. The shares of Common Stock have the following rights: (a) to receive dividends, if any, as may be declared and paid from time to time by the board of directors, in its discretion, from funds legally available therefor, and (b) upon liquidation, dissolution or winding up of the Company, to receive pro rata all assets remaining available for distribution. There are no preemptive rights with respect to outstanding shares of Common Stock. All outstanding shares of Common Stock are fully paid and non-assessable.

PART II

Item 1. Market Price of and Dividends on the Registrant's Common Equity and Other Shareholder Matters.

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The Company's Common Stock is traded in the over-the-counter market. The range of bid price quotations for the last two fiscal years on a quarter-by-quarter basis and for the first quarter of 1997 (all as adjusted to reflect the two three for one stock splits declared in January and April, 1997) is as follows:

Qtr.	1995				1996				1997
	1st	2nd	3rd	4th	1st	2nd	3rd	4th	1st
Low Bid	.44	.44	.44	.44	.44	.44	.44	.44	\$ 6.78
High Bid	.44	.44	.44	.44	.44	.44	.44	\$6.78	\$24.00

The quotations on which these data are based reflect inter-dealer prices without adjustment for retail markup, markdown or commission, and may not necessarily represent actual transactions.

As of March 31, 1997 the Company had 91 shareholders of record and approximately 599 beneficial holders of shares. The Company has never paid a cash dividend on its Common Stock, and intends to follow a policy of retaining earnings to finance future growth and possible acquisitions. Accordingly, the Company does not anticipate the payment of cash dividends to the holders of Common Stock in the foreseeable future.

Item 2. Legal Proceedings

The Company incorporates by reference Item 3 of Part I to the Company's Form 10-KSB for the fiscal year ending on December 31, 1996 which was filed with the SEC on April 14, 1997.

Item 3. Changes in and Disagreements with Accountants.

None.

Item 4. Recent Sales of Unregistered Securities.

Between February 27, 1997 and March 5, 1997, IAI sold 857,142 shares of its Common Stock at a price of \$5.833 per share. (The number of shares and price per share have been adjusted to reflect the three for one stock split

accomplished by a stock dividend of two shares of Common Stock for each outstanding share of Common Stock held by each record holder on April 7, 1997 and payable on April 21, 1997.) The shares were sold only to accredited investors within the meaning of Regulation D promulgated under the Securities Act of 1933, as amended. The shares were sold to several institutional investors along with individuals. The Company relied on Rules 505 and 506 of Regulation D in claiming exemption from registration. All purchasers were required to certify to their assets, net worth or income to substantiate their qualification to purchase shares in this offering.

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For this offering, the Company used the services of Newby & Company of Rockville, Maryland ("Newby") and First Colonial Securities Group, Inc. of Boca Raton, Florida ("FCSG") to assist in the placement of shares. Commissions were paid in the form of ten year warrants equal to ten percent of the shares placed through each company. The warrants are exercisable at \$6.4167 per share. Of the total warrants, Newby received 51,429 and FCGS received 34,284.

Item 5. Indemnification of Directors and Officers

The Virginia Stock Corporation Act provides for the indemnification of directors and officers from liability and expenses they may incur in that capacity. A director is only entitled to indemnification if he conducted himself in good faith, he believed that his conduct was in the best interests of the Company, or not opposed to its best interests, and, in the case of a criminal proceeding, he had no reasonable causes to believe his conduct was unlawful. As a condition precedent to indemnification, the Board of Directors, special counsel or the shareholders must determine that the standard of conduct has been met to authorize indemnification. In no event can an officer or director be indemnified if adjudged liable to the Company, or if in any proceeding charging improper personal benefit, he was adjudged liable on the basis that personal benefit was improperly received by him.

PART F/S

The following Financial Statements are filed as part of this report:

<TABLE>  
<CAPTION>

	Page(s)
	-----
<S> <C>	
(i) Report of Independent Certified Public Accountants	10
(ii) Consolidated Balance Sheet as of December 31, 1996	11-12
(iii) Consolidated Statements of Operations for the Years Ended December 31, 1996 and 1995	13
(iv) Consolidated Statements of Changes in Stockholders' Equity for the Years Ended December 31, 1996 and 1995	14
(v) Consolidated Statements of Cash Flows for the Years Ended December 31, 1996 and 1995	15
(vi) Notes to Consolidated Financial Statements	16-28

</TABLE>

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PART III

Item 1. Index to Exhibits

Exhibit No.	Description	Pages
2.1	Amended and Restated Articles of Incorporation of the Company incorporated by reference from Exhibit No. 3.1 to the Company's Form 10-KSB for the fiscal year ending December 31, 1996 as filed with the Securities and Exchange Commission ("SEC") on April 14, 1997.	

- 2.2 Amended By-Laws of the Company incorporated by reference from the Company's Form S-18 filed with the SEC on November 20, 1988.
- 6.1 Office lease for 18,280 square feet at 11240 Waples Mill Road, Fairfax, VA 22030 incorporated by reference from Exhibit No. 10.1 to the Company's Form 10-KSB for the fiscal year ending December 31, 1996 as filed with the SEC on April 14, 1997.
- 6.2 The Company's 401(k) profit sharing plan through Aetna Life Insurance and Annuity Company incorporated by reference from Exhibit No. 10.2 to the Company's Form 10-KSB for the fiscal year ending December 31, 1996 as filed with the SEC on April 14, 1997.
- 6.3 1986 Stock Option Plan incorporated by reference from the Company's Form S-8 filed with the SEC on December 20, 1988.
- 6.4 1996 Stock Option Plan incorporated by reference from the Company's Form S-8 filed with the SEC on June 25, 1996.
- 6.5 Line of Credit Agreement with First Virginia Bank incorporated by reference from the Company's Form 10-KSB for the fiscal year ending December 31, 1995 filed with the SEC on April 15, 1996.

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Exhibit No.	Description	Pages
6.6	Warrant Agreement between George DeBakey, a director, and the Company incorporated by reference from Exhibit 10.6 to the Company's Form 10-KSB for the fiscal year ending December 31, 1996 filed with the SEC on April 14, 1997.	
6.7	Warrant Agreement between James C. Wester, a director, and the Company incorporated by reference from Exhibit 10.7 to the Company's Form 10-KSB for the fiscal year ending December 31, 1996 as filed with the SEC on April 14, 1997.	
6.8	Software Purchase Agreement between Kenneth K. Parsons and the Company for the purchase of CAST software incorporated by reference from Exhibit 10.8 to the Company's Form 10-KSB for the fiscal year ending December 31, 1996 as filed with the SEC on April 14, 1997.	
6.9	Royalty Agreement between James C. Wester and the Company in exchange for development expense advances incorporated by reference from Exhibit 10.9 to the Company's Form 10-KSB for the fiscal year ending December 31, 1996 as filed with the SEC on April 14, 1997.	
6.10	Common Stock Purchase Agreement dated June 5, 1996 between the Company and Stephen E. Petruzzo for the purchase of International Software Services Corporation, incorporated by reference from the Company's Form 8-K filed with the SEC on July 16, 1996.	
6.11	Registration Rights Agreement dated February 27, 1997 between the Company and certain purchasers of its Common Stock incorporated by reference from Exhibit 10.11 to the Company's Form 10-KSB for the fiscal year ending December 31, 1996 as filed with the SEC	

on April 14, 1997.

12.1 The Company's Form 10-KSB for the fiscal year ending December 31, 1996 which was filed with the SEC on April 14, 1997.

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#### SIGNATURES

In accordance with Section 12 of the Securities Exchange Act of 1934, the registrant caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized.

#### INFORMATION ANALYSIS INCORPORATED

By: /s/ Sandor Rosenberg  
-----  
Sandor Rosenberg, Chairman of  
the Board and President

Date: April 18, 1997  
-----

By: /s/ Richard S. DeRose  
-----  
Richard S. DeRose, Executive Vice  
President and Treasurer

Date: April 18, 1997  
-----

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#### INDEPENDENT AUDITORS' REPORT

To the Board of Directors  
Information Analysis Incorporated

We have audited the accompanying consolidated balance sheet of Information Analysis Incorporated and subsidiaries as of December 31, 1996, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for each of the two years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Information Analysis Incorporated and subsidiaries as of December 31, 1996, and the consolidated results of operations and cash flows for each of the two years then ended in conformity with generally accepted accounting principles.

March 7, 1997

Bethesda, Maryland

Rubino & McGeehin, Chartered

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#### INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES CONSOLIDATED BALANCE SHEET December 31, 1996

#### ASSETS

Current assets

Cash and cash equivalents .....	\$ 323,886
Accounts receivable .....	1,355,284
Employee advances .....	34,323
Income taxes receivable .....	201,554
Deferred income taxes .....	98,662
Prepaid expenses .....	104,554
Other receivables .....	192,686
	-----
Total current assets .....	2,310,949
Fixed assets	
At cost, net of accumulated depreciation and amortization of \$1,205,486 .....	241,311
Equipment under capital leases	
Net of accumulated amortization of \$56,053 .....	49,768
Capitalized software .....	186,964
Investments .....	10,000
Goodwill .....	70,554
Other receivables .....	226,694
Other assets .....	24,980
	-----
Total assets .....	\$3,121,220
	=====

The accompanying notes are an integral part of the consolidated financial statements

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INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEET  
December 31, 1996

LIABILITIES & STOCKHOLDERS' EQUITY

Current liabilities	
Accounts payable .....	\$ 413,942
Accrued payroll .....	262,754
Other accrued liabilities .....	58,896
Current portion of long-term debt .....	120,300
Current maturities of capital lease obligations .....	18,229
Deferred rent .....	852
	-----
Total current liabilities .....	874,973
Long-term debt .....	90,380
Capital lease obligations, net of current portion .....	41,334
Deferred income taxes .....	27,020
	-----
Total liabilities .....	1,033,707
	-----
Common stock, par value \$0.01	
1,000,000 shares authorized; 677,178 shares issued .....	6,772
Paid in capital in excess of par value .....	1,139,240
Retained earnings .....	1,795,814
Less treasury stock; 167,179 shares at cost .....	(854,313)
	-----
Total stockholders' equity .....	2,087,513
	-----
Total liabilities and stockholders' equity .....	\$ 3,121,220
	=====

The accompanying notes are an integral part of the consolidated financial statements

INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS

For the Years Ended December 31,  
-----

	1996 -----	1995 -----
Sales		
Professional fees .....	\$ 10,803,341	\$ 15,436,643
Software sales .....	415,504	260,253
	-----	-----
Total sales .....	11,218,845	15,696,896
	-----	-----
Cost of sales		
Cost of professional fees .....	8,675,377	12,511,118
Cost of software sales .....	260,245	224,477
	-----	-----
Total cost of sales .....	8,935,622	12,735,595
	-----	-----
Gross profit .....	2,283,223	2,961,301
Selling, general and administrative expenses .	2,496,591	2,958,722
	-----	-----
(Loss) income from operations .....	(213,368)	2,579
Other income and (expenses)		
Interest income .....	12,716	7,554
Interest expense .....	(35,644)	(110,748)
	-----	-----
Loss before provision for income taxes .....	(236,296)	(100,615)
Benefit for income taxes .....	(76,622)	(25,982)
	-----	-----
Net loss .....	\$ (159,674)	\$ (74,633)
	=====	=====
Loss per common and common equivalent share .....	\$ (0.26)	\$ (0.15)
Weighted average common and common equivalent shares outstanding .....	624,139	478,561

The accompanying notes are an integral part of the  
consolidated financial statements

INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY  
For the Years Ended December 31, 1996 and 1995

<TABLE>  
<CAPTION>

	Shares of Common Stock Outstanding	Common Stock	Additional Paid in Capital	Retained Earnings	Treasury Stock
	-----	-----	-----	-----	-----
Total					--
<S> <C>					
Balances, December 31, 1994 .....	621,178	\$ 6,212	\$ 771,923	\$2,030,121	\$ (720,150)
\$2,088,106					
Exercise of stock options .....	54		296		
296					
Purchase of treasury stock .....					(80,913)

(80,913)						
Net loss .....					(74,633)	
(74,633)						
-----						
Balances, December 31, 1995 .....	621,232	6,212	772,219	1,955,488	(801,063)	
1,932,856						
Exercise of stock options and warrants .	49,696	497	209,580			
210,077						
Tax benefit of stock option compensation			132,504			
132,504						
Stock issued for ISSC acquisition .....	6,250	63	24,937			
25,000						
Purchase of treasury stock .....					(53,250)	
(53,250)						
Net loss .....					(159,674)	
(159,674)						
-----						
Balances, December 31, 1996 .....	677,178	\$ 6,772	\$1,139,240	\$1,795,814	\$ (854,313)	
\$2,087,513						
=====						

</TABLE>

The accompanying notes are an integral part of the consolidated financial statements

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INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS

<TABLE>  
<CAPTION>

	For the Years Ended December 31,	
	1996	1995
	-----	-----
<S> <C>		
Cash flows from operating activities		
Cash received from customers .....	\$ 13,389,621	\$ 16,345,476
Cash paid to suppliers and employees .....	(12,336,956)	(15,279,871)
Interest received .....	12,716	7,554
Interest paid .....	(35,644)	(110,748)
Income taxes received (paid) (net) .....	--	57,293
	-----	-----
Net cash provided by operating expenses .....	1,029,737	1,019,704
	-----	-----
Cash flows from investing activities		
Purchase of ISSC, net of cash received .....	(47,422)	--
Acquisition of furniture and equipment .....	(91,471)	(79,983)
Proceeds from sale of equipment .....	--	25,687
Increase in capitalized software .....	(186,964)	--
	-----	-----
Net cash used in investing activities .....	(325,857)	(54,296)
	-----	-----
Cash flows from financing activities		
Net payments under bank revolving line of credit .....	(550,000)	(842,000)
Reduction of debt related to acquisition of ISSC .....	(26,276)	--
Principal payments on debt and capital leases .....	(17,561)	(20,986)
Repurchase of common stock .....	(53,250)	(80,913)
Proceeds from exercise of incentive stock options .....	210,077	296
	-----	-----
Net cash used by financing activities .....	(437,010)	(943,603)
	-----	-----
Net increase in cash and cash equivalents .....	266,870	21,805
Cash and cash equivalents at beginning of the period .....	57,016	35,211
	-----	-----
Cash and cash equivalents at end of the period .....	\$ 323,886	\$ 57,016
	-----	-----

Reconciliation of net loss to cash provided by operating activities

Net loss .....	\$ (159,674)	\$ (74,633)
Adjustments to reconcile net loss to net cash provided by operating activities		
Depreciation and amortization .....	192,035	173,530
Tax benefit of stock option compensation .....	132,504	--
Gain/loss on sale of fixed assets and investments .....	(231)	(1,113)
Changes in operating assets and liabilities		
Accounts receivable .....	2,170,776	648,580
Other receivables and prepaid expenses .....	(180,483)	(40,275)
Accounts payable and accrued expenses .....	(939,352)	292,528
Deferred rent .....	(10,224)	(10,224)
Income tax receivable/liability .....	(175,614)	31,311
	-----	-----
Net cash provided (used) by operating activities .....	\$ 1,029,737	\$ 1,019,704
	=====	=====

</TABLE>

The accompanying notes are an integral part of the consolidated financial statements

INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES  
NOTES TO CONSOLIDATED 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.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Allied Health & Information Systems, Inc. (AHISI) and International Software System Corporation (ISSC). Upon consolidation, all material intercompany accounts, transactions and profits are eliminated. AHISI commenced operations in 1991; ISSC was acquired in 1996. Goodwill, resulting from the Company's acquisition of ISSC is being amortized over a two-year period which is the expected term of ISSC's contracts.

Investments in companies less than 20% owned are reported at cost less allowances for permanent decline in value. Income is recognized when dividends are declared. No dividends were declared in 1996 or 1995.

Accounting Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from these estimates.

Revenue Recognition

Revenue from cost-plus-fixed-fee contracts is recognized on the basis of direct costs plus indirect costs incurred and an allocable portion of the fixed fee. Revenue from fixed-price contracts is recognized on the percentage-of-completion method, measured by the cost-to-cost method for each contract, with costs and estimated profits recorded as work is performed. Revenue from time and material contracts is recognized based on fixed hourly rates for direct hours expended. The fixed hourly rate includes direct labor, indirect expenses and profit. Material and other specified direct costs are recorded at actual cost.

Contract costs include all direct material and labor costs and those indirect costs related to contract performance. Provisions for estimated losses on uncompleted contracts are made in the period in which losses are determined. Changes in job performance, job conditions, and estimated profitability, including final contract settlements, may result in revisions to costs and income and are recognized in the period in which the revisions are determined.

INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cash and Cash Equivalents

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

Fixed Assets

Fixed assets are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the assets. 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.

Software Development Costs

The Company has capitalized costs related to the development of a software product, Computer Aided Software Translator (CAST). In accordance with Statement of Financial Accounting Standards No. 86, capitalization of costs begins when technological feasibility has been established and ends when the product is available for general release to customers. Amortization will be computed and recognized for the product when available for market based on the product's estimated total sales or economic life. Capitalized costs and amortization periods are management's estimates and may have to be modified due to inherent technological changes in software development.

Deferred Rent

Rental expense on operating leases is charged to operations over the life of the lease using the straight-line method. Differences between the amounts charged and the amounts paid are recorded as deferred rent.

Earnings Per Share

Earnings per common equivalent share is based on the weighted average number of common shares and common share equivalents outstanding during the year. When dilutive, stock options are included as share equivalents using the modified treasury stock method. Under that method, earnings per share data are computed as if the options and warrants were exercised at the beginning of the period (or at the time of issuance, if later) and as if the funds obtained thereby were used to purchase common stock during the period. Fully diluted earnings per share amounts have not been presented because they are not materially dilutive.

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INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Income Taxes

Deferred income tax assets and liabilities are recognized for the estimated future tax effects of the differences between the financial statement and tax bases of assets and liabilities given the provisions of enacted tax laws. The provision for income taxes consists of the income tax for the year and the change in the deferred tax liability or asset.

Fair Market Value of Financial Instruments

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

Reclassification

Certain accounts in the prior year financial statements have been reclassified for comparative purposes to conform with the presentation in the current year financial statements.

2. INDUSTRY SEGMENT AND CREDIT CONCENTRATION

During 1996 and 1995, the Company's operations included two reportable segments: computer applications and healthcare. The computer applications segment includes those operations involved in developing and marketing computer application software systems and providing programming services. The Company and its subsidiary, ISSC, operate in this segment. Approximately 92% of this segment's revenue in 1996, and 82% in 1995, came from contracts and subcontracts with departments and agencies of the federal government. In 1996, the Company was informed that it was unsuccessful in obtaining the renewal of a contract with the United States Customs Service. Approximately 58% of this segment's revenue in 1996 and 65% in 1995, came from the contract with the United States Customs Service.

The healthcare segment, operated by AHISI, is involved in providing the services of certified physician assistants, nurses and medical doctors to healthcare facilities operated by third parties in conjunction with state and local governments, and the federal government. The Company has phased out the activities of this business segment and anticipates that no future revenue will be generated from this business segment after 1996.

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INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

2. INDUSTRY SEGMENT AND CREDIT CONCENTRATION (CONTINUED)

Summarized financial information by business segment for 1996 and 1995 is as follows:

	1996 ----	1995 ----
Net Sales		
Computer Applications	\$11,172,702	\$14,012,017
Healthcare	46,143	1,684,879
Income (loss) from operations (pre-tax)		
Computer Application	(95,594)	333,198
Healthcare	(117,774)	(330,619)
Identifiable assets		
Computer Applications	2,007,393	3,361,013
Healthcare	315,868	494,616
Capital Expenditures		
Computer Applications	91,471	79,354
Healthcare	-	629
Depreciation and Amortization		
Computer Applications	180,569	155,289
Healthcare	11,466	18,241

Operating income by business segment excludes interest income, interest expense and miscellaneous income and expense items that could not be identified with either segment. Other than those acquired by AHISI, all furniture, equipment, and capital leases and their related depreciation and amortization are considered the assets and expenses, respectively, of the computer application segment. Capitalized software costs and goodwill and their related amortization are also considered assets and expenses of the computer application segment. In addition, accounts receivable are considered identifiable assets of the respective segment. Cash and cash equivalents, and the remaining other assets are considered corporate assets. There were no significant intersegment sales or transfers during 1996 and 1995.

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INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

3. ACQUISITION

On June 5, 1996, the Company completed an acquisition of the outstanding common stock of International Software Services, Inc. (the predecessor to ISSC) for \$370,289, of which \$133,333 was paid (in cash and stock) at closing and \$236,956

of which is payable by June 1998 to the former owner (see Note 6). The business acquisition was accounted for as a purchase. The operations of ISSC since the date of acquisition are included in the consolidated statement of operations of the Company for the year ended December 31, 1996. The cost of the acquisition exceeded the fair value of the net assets acquired by \$99,605. The excess is being amortized as goodwill on a straight-line basis over a two-year period which is the expected term of ISSC's contracts.

The following summarized pro forma (unaudited) information assumes the acquisition had occurred on January 1, 1995.

		1996 ----	1995 ----
Net sales	As reported	\$11,218,845	\$15,696,896
	Pro forma	\$11,680,000	\$16,460,000
Net Income	As reported	\$ (159,674)	\$ (74,633)
	Pro forma	\$ (75,000)	\$ (73,000)
Primary loss per share	As reported	\$ (0.26)	\$ (0.15)
	Pro forma	\$ (0.12)	\$ (0.15)

#### 4. RECEIVABLES

Accounts receivable at December 31, 1996, consist of the following:

Billed - Federal government	\$124,598
Billed - prime contractors	848,245
Billed - commercial	236,941
	-----
Total billed	1,209,784
	-----
Unbilled - Federal government	2,482
Unbilled - prime contractors	110,726
Unbilled - commercial	32,292
	-----
Total unbilled	145,500
	-----
Total accounts receivable	\$1,355,284
	=====

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#### INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

#### 4. RECEIVABLES (CONTINUED)

Unbilled receivables are for services provided through the balance sheet date which are expected to be billed and collected within one year.

Included in other receivables at December 31, 1996, are the following:

Receivables from former customers net of present value discount and allowance for uncollectibility totaling \$274,880	\$ 258,809
Receivable from employee, due in monthly payments of \$386 plus interest at 8.75%. Final payment due in 2001.	27,885
Other non-trade receivables expected to be collected by December 31, 1997	132,686
	-----
Total	419,380
Less current portion	(192,686)
	-----
Non current portion	\$ 226,694
	=====

#### 5. FIXED ASSETS

A summary of fixed assets and equipment under capital leases at December 31, 1996, is as follows:

Furniture and equipment	\$ 1,474,939
Leasehold improvements	40,666
Motor vehicles	37,013
	-----
	1,552,618
Accumulated depreciation and amortization	(1,261,539)
	-----
Total	\$ 291,079
	=====

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INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

6. FINANCING

At December 31, 1996, the Company had a revolving line of credit with a bank providing for demand or short-term borrowings of up to \$1,500,000. This line expires on June 19, 1997. Drawings against this line are based on varying percentages of the Company's accounts receivable balances depending on the source of the receivables and their age. Interest on outstanding amounts is payable monthly at the bank's prime rate (8.75% at December 31, 1996) plus 1/2%. The lender has a first priority security interest in the Company's receivables and a direct assignment of its major U.S. Government contracts. The line of credit, among other covenants, requires the Company to comply with certain financial ratios. At December 31, 1996, there was no outstanding balance on the line.

Additionally, at December 31, 1996, the Company is liable to the former owner of ISSC (see Note 3) in the amount of \$210,680. This liability is payable as follows: 1997 - \$120,300; 1998 - \$90,380.

7. COMMITMENTS AND CONTINGENCIES

Capital Leases

The future minimum payments under capital leases for equipment and the present value of the minimum lease payments are as follows:

Year ending December 31	
-----	
1997	\$ 24,318
1998	27,367
1999	15,132
	-----
Total minimum lease payments	66,817
Less amount representing interest	(7,254)
	-----
Total obligation representing principal	59,563
Less current portions of capital lease obligations	(18,229)
	-----
Long-term portion of capital lease obligations	\$ 41,334
	=====

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INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

7. COMMITMENTS AND CONTINGENCIES (CONTINUED)

Operating Leases

Rent expense was \$236,466, and \$263,031 for the years ended December 31, 1996 and 1995, respectively.

The future minimum rental payments to be made under noncancelable operating leases, principally for facilities, are as follows:

Year ending December 31	
-----	
1997	\$284,512
1998	295,709
1999	304,580
2000	313,717

2001	323,129
2002 through 2004	675,630
	-----
Total minimum rent payments	\$2,197,277
	=====

The above minimum lease payments reflect the base rent under the lease agreements. However, these base rents shall be adjusted each year to reflect increases in the consumer price index and the Company's proportionate share of real estate tax increases on the leased property. The Company entered into a new lease in February 1997 with a seven-year term ending in 2004. The minimum lease payments are included in the above amounts.

The leases are secured by irrevocable letters of credit for \$26,982. As of December 31, 1996, none of the letters of credit have been used.

#### Royalties

In August 1996, the Company entered into an agreement to purchase the software product CAST (see Note 1). As part of the agreement, royalties of 10% of the CAST licensing fees collected by the Company will be paid to the seller. The aggregate amount of the royalties pursuant to this agreement will not exceed \$1,000,000.

Also in August 1996, the Company entered into an agreement whereby, in consideration of an expense sharing arrangement, the Company will pay royalties of 20% of the CAST licensing fees collected by the Company. The royalties will not exceed \$150,000.

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### INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

#### 7. COMMITMENTS AND CONTINGENCIES (CONTINUED)

In October 1993, the Company purchased ownership rights to a software product called Migrator. Included in the purchase price is an obligation for royalty payments of 10% on all Migrator licensing fees collected during the four year period following the sale. As of December 31, 1996, no license fees have been collected.

#### Government Contracts

Company sales to departments or agencies of the United States Government are subject to audit by the Defense Contract Audit Agency (DCAA). Audits by DCAA have not been performed for any years. Management is of the opinion that disallowances, if any, by DCAA for unaudited years will not result in any material adjustments to the financial statements.

#### 8. INCOME TAXES

The provision for income taxes consists of the following:

	December 31	
	-----	-----
	1996	1995
	----	----
Current (benefit) expense		
Federal .....	\$ (67,021)	\$ 9,996
State .....	(14,846)	2,216
	-----	-----
	(81,867)	12,212
	-----	-----
Deferred expense (benefit)		
Federal .....	4,294	(31,268)
State .....	951	(6,926)
	-----	-----
	5,245	(38,194)
	-----	-----
Benefit for income taxes .....	\$ (76,622)	\$ (25,982)
	=====	=====

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INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

8. INCOME TAXES (CONTINUED)

The items that give rise to the deferred tax expense (benefit) shown above are as follows:

	December 31	
	1996	1995
	-----	-----
Depreciation .....	\$ 8,020	\$ 9,500
Vacation expense .....	(2,775)	13,106
Bad debt expense .....	--	(60,800)
	-----	-----
Tax effects of temporary differences .....	\$ 5,245	\$ (38,194)
	=====	=====

The tax effect of significant temporary differences representing deferred tax assets and liabilities at December 31, 1996, are as follows:

Vacation .....	\$37,862
Bad debt expense .....	60,800
	-----
Deferred tax asset .....	\$98,662
	=====
Depreciation - deferred tax liability .....	\$27,020
	=====

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

	December 31	
	1996	1995
	-----	-----
Loss before taxes .....	\$ (236,296)	\$ (100,615)
	=====	=====
Income taxes (benefit) on above amount		
at federal statutory rate .....	(80,341)	(34,209)
State income taxes net of federal benefit .....	(10,870)	(4,648)
Effect of graduated tax brackets, change		
in estimates, and other non deductible		
items .....	14,589	12,875
	-----	-----
Benefit for income taxes .....	\$ (76,622)	\$ (25,982)
	=====	=====

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INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

9. STOCK OPTIONS AND WARRANTS

The Company has two stock option plans, the second plan becoming effective June 25, 1996. The combined plans provide for the granting of stock options to certain employees, directors and consultants. The maximum number of shares for which options may be granted under the plans is 200,000 (increased to 250,000 in January 1997). 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 exercise price of each option equals the quoted market price of the Company's stock on the date of grant.

The stock option plan is accounted for under Accounting Principles Board (APB) Opinion No. 25. Accordingly, no compensation has been recognized for the plan. Had compensation cost for the plans been determined based on the estimated fair value of the options at the grant dates consistent with the method of Statement of Financial Accounting Standards (SFAS) No. 123, the Company's net income and earnings per share would have been:

1996

1995

		----	----
Net loss	As reported	\$ (159,674)	\$ (74,633)
	Pro forma	\$ (424,000)	Not applicable
Loss per share	As reported	\$ (0.26)	\$ (0.15)
	Pro forma	\$ (0.68)	Not applicable

The fair value of the options granted in 1996 is estimated on the date of the grant using the Black-Scholes options - pricing model assuming the following: no dividend yield, risk-free interest rate of 6 %, expected volatility of 40 percent, and an expected term of the options of two years.

At December 31, 1996, options to purchase stock under this plan were outstanding to employees as follows:

Number of shares -----	Exercise price per share -----
32	\$ 3.00
168,200	4.00
10,200	4.50
4,500	5.00
200	5.50
1,500	11.75
10,000	14.50

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INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

9. STOCK OPTIONS AND WARRANTS (CONTINUED)

Of these 194,632 options, 134,632 options are exercisable immediately, 50,000 options at \$4 per share are exercisable over two years, and 10,000 options at \$4 per share are exercisable when certain revenue amounts are realized. Transactions involving the plan were as follows:

	December 31 -----			
	1996		1995	
	Shares	Weighted Average Price	Shares	Weighted Average Price
	-----	-----	-----	-----
Outstanding, beginning of year	37,828	\$ 4.73	43,443	\$ 4.77
Granted	215,500	\$ 4.54	-	-
Exercised	(39,696)	\$ 4.10	(54)	\$ 5.50
Canceled	(19,000)	\$ 4.74	(5,561)	\$ 5.01
	-----		-----	
Outstanding, end of year	194,632	\$4.65	37,828	\$ 4.73
	=====		=====	

The board of directors has also granted warrants to directors and employees. During 1996, no warrants to acquire shares of common stock were granted to such persons. The total warrants exercised in 1996 were 10,000 and warrants expired were 5,000. As of December 31, 1996, outstanding warrants are 13,000. The purchase price for shares issued upon exercise of these warrants range from \$5.00 to \$7.50 per share. These warrants are exercisable immediately.

10. RETIREMENT PLANS

The Company adopted a Cash or Deferred Arrangement Agreement (CODA) which satisfies the requirements of section 401(k) of the Internal Revenue Code, on January 1, 1988. This defined contribution retirement plan covers substantially all employees. Each participant can elect to have up to 6% of their salary reduced and contributed to the plan. The Company is required to make a matching contribution of 25% of this salary reduction. The Company can also make additional contributions at its discretion. Amounts expensed under the plan for the years ended December 31, 1996 and 1995, were \$47,029 and \$44,549, respectively.

The Company does not provide post employment benefits and, as a result,

Statement of Financial Accounting Standards No. 106 does not have any impact on these financial statements.

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INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

11. LITIGATION

At December 31, 1996, the Company is involved in litigation with a former inmate at a correctional facility where the Company has provided medical services. The case is a malpractice claim against the Company as well as other related parties. The plaintive seeks \$1,550,000 in damages. The Company has insurance to cover claims of up to \$1 million per occurrence, and there are other defendants who will likely contribute to either a settlement or a judgment, if any. In the opinion of management, there will be no material adverse effect on the Company's financial statements as a result of this litigation. No amounts have been accrued in the financial statements related to this matter.

12. SUBSEQUENT EVENTS

Common Stock

Subsequent to December 31, 1996, the board of directors increased the authorized shares of the Company's common stock from 1,000,000 to 10,000,000 shares and authorized a three for one split of its outstanding common stock.

Private Placement Memorandum

In March 1997, the Company completed a private placement memorandum which raised \$5,000,000 in exchange for 285,714 shares of the Company's common stock. The funds will be utilized for the further development of the Company's CAST software product (see Note 1) and the pursuit of CAST business opportunities during 1997 and 1998.

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