SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-KSB

Annual Report pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

For the Fiscal Year Ended December 31, 2001
Commission File No. 0-22405

Information Analysis Incorporated
(Exact name of Registrant as specified in its charter)

| | |
|---|---|
| Virginia | 54-1167364 |
| (State or other jurisdiction of incorporation or organization) | (IRS Employer Identification No.) |

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

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

Securities registered pursuant to Section 12(b) of the Act:
None

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, $0.01 par value
(Title of Class)

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

The issuer's revenue for its most recent fiscal year was $6,086,474.

The aggregate market value of the Registrant's Common Stock held by non-affiliates as of March 27, 2002 was approximately $3,374,940.

As of March 27, 2002 the Registrant had 10,283,515 shares of Common Stock outstanding.



This Form 10-KSB contains forward-looking statements. These statements are based on certain assumptions and involve risks and uncertainties. Actual future results may vary materially from those discussed herein. Any statements that are not historical facts should be forward-looking statements. These forward-looking statements are subject to the safe harbor created by the Private Securities Litigation Reform act of 1995. IAI does not undertake any obligation to publicly release the result of any revision which may be made to any forward-looking statements after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

## PART I

### Item 1. Business Description

#### Overview

Founded in 1979, Information Analysis Incorporated ("IAI" or "the Company") is in the business of modernizing client information systems. Since its inception, IAI has performed software development and conversion projects for over 100 commercial and government clients including Computer Sciences Corporation, IBM, Computer Associates, MCI, Sprint, Citibank, U.S. Customs Service, U.S. Department of Agriculture, U.S. Department of Energy, U.S. Army, U.S. Air Force, Veterans Administration, and the Federal Deposit Insurance Corporation. Today, IAI primarily applies its technology, services and experience to legacy software migration and modernization and to developing web-based solutions.

The migration and modernization market is complex and diverse as to the multiple requirements clients possess to upgrade their older systems. In the early 1990's, many organizations tried to convert or re-engineer their mainframe legacy systems to PC client server environments. Many of these attempts failed because the technology for client servers lacked sufficient hardware performance and capacity. The available software languages and tools were also immature. By the mid 1990's, organizations did establish mid-level server technology (Unix) to off-load and decentralize some of their decision support or departmental systems, and they connected local area networks of PCs to provide better user interfaces. However, many large legacy systems remained 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 NT, rival the traditional mainframe systems. There is a plethora 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 arrival of the internet and intranet technology offers a different approach at collecting and processing large volumes of user transactions, processes which are the forte of older legacy systems.

Companies are being driven for various reasons to address the upgrading of their legacy systems. The Y2K experience has impressed on them the difficulty of finding and retaining staff with outdated technical skills, much of which are practiced by senior programmers in their fifties. Hardware platforms such as Unisys and Honeywell are reaching the horizon of their usefulness, and older programming and data base languages are poorly supported by their providers. Additionally, maintenance costs are skyrocketing 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 their sector rivals. The next ten years should see an upsurge of movement and change as organizations revamp their older legacy systems.

The web solutions market is the fastest growing segment of the computer consulting business as individuals, small companies, large companies, and governmental agencies rush to establish a 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 web-sites and typically have many short duration projects. More complex web applications generally require knowledge of clients' back-end systems based on mainframe or mid-level computers. Few small companies have the expertise to develop these more sophisticated web applications. However, these types of applications will be more prominent in the future as the web is better understood and this will be the area that future expenditures will grow the most.





The commercial and government sectors of the market can be quite different in their requirements on the Internet, as, generally, companies are interested in cataloging and selling items versus government agencies that 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. Accelio (previously known as JetForm), the electronic forms product resold and supported by IAI is the predominant forms software in the federal government.

Description of Business and Strategy

Since the mid-90's IAI has migrated clients from older computer languages generally associated with legacy computer systems to more modern languages used with current-day computer system platforms. In fixing their legacy systems to comply with Y2K dates impacts, many organizations became 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 Internet applications The company's strategy has been to develop and/or acquire tools that will facilitate the modernization process and differentiate the Company's offerings in the marketplace.

The Company has developed a series of workbench tools called ICONS. These tools, used in conjunction with IAI's 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 will facilitate the Company's ability to provide systems modernization services to companies 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.

IAI has structured the company to address the wide range of requirements that it envisions the market will demand. The suite of ICONS tools give IAI, in its opinion, a competitive edge in performing certain conversions and migrations faster and more economically than many other vendors. The diverse capabilities of IAI's staff in mainframe technology and client server implementations help to assure that IAI staff can analyze the original systems properly to conduct accurate and thorough conversions.

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

During the past year and a half IAI has secured contracts to modernize several large legacy systems for a federal agency. These projects are giving IAI staff valuable experience with state of the art web-application products recently released by Oracle Corporation. Personnel with these skills are in great demand and can form the nucleus of a new business division within IAI. It is management's intention to build on these contracts and expand revenues in this area over the next five years.

The Company is also using the experience it has acquired as an Accelio reseller to help secure engagements for web-based applications requiring forms. The Accelio product has evolved over the years into a robust tool that can form the backbone of applications, especially those requiring forms. The company has used this expertise to penetrate a number of federal government clients and build sophisticated web applications. IAI's knowledge of legacy system languages has been instrumental in connecting these web applications to legacy databases residing on mainframe computers. The 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 IAI's relationship with Accelio, the company has developed a cadre of professionals that can quickly and efficiently develop web applications. IAI will focus on federal government clients during 2002 and leverage the company's outstanding reputation with federal clients to penetrate these agencies. IAI will be able to reference





successful projects completed or in development for the Department of Veterans Affairs (VA), Federal Mediation and Conciliation Service (FMCS), U.S. Department of Agriculture (USDA), Immigration and Naturalization Service (INS), General Services Administration (GSA), Army Reserve, and U.S. Air Force Logistics Command (AFLC).

## 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. The Company also faces competition from other companies which purport to substantially automate the process through software tools including Alydaar, Crystal Systems Solutions and Sapiens International. "Off the shelf" software for enterprise resource planning, such as SAP and Baan, 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 the Company's competitors have greater name recognition than the Company, a larger, more established customer base, and significantly greater financial and market resources in comparison to the Company.

## Patents and Proprietary Rights

The Company depends upon a combination of trade secret and copyright laws, nondisclosure and other contractual provisions and technical measures to protect its proprietary rights in its methodologies, databases and software. The Company has not filed any patent applications covering its methodologies and software. The Company distributes ICONS under agreements that grant customers non-exclusive licenses and contain terms and conditions restricting the disclosure and use of the Company's databases or software and prohibiting the unauthorized reproduction or transfer of its products. In addition, IAI attempts to protect the secrecy of its proprietary databases and other trade secrets and proprietary information through agreements with employees and consultants.

The Company also seeks 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. The Company believes, however, that the creation of competing databases would be very time consuming and costly.

Backlog

As of December 31, 2001, the Company estimated its backlog at approximately $4 million. Of the entire backlog, the Company believes approximately 95% will be completed by December 31, 2002. This backlog consists of outstanding contracts and general commitments from current clients. The Company regularly provides services to certain clients on an as-needed basis without regard to a specific contract. General commitments represent those services which the Company anticipates providing to such clients during a twelve-month period.

Employees

As of December 31, 2001, the Company employed 43 full-time and part-time individuals. In addition, the Company maintained independent contractor relationships with 20 individuals for computer services. Approximately 80% of the Company's professional employees have at least four years of related experience. For computer related services, the Company believes that the diverse professional opportunities and interaction among its employees contribute to maintaining a stable professional staff with limited turnover.





Item 2. Properties

The Company's offices are located at 11240 Waples Mill Road, Suite 400, Fairfax, VA. 22030. IAI holds a lease for 12,345 square feet. This lease expires on February 29, 2004.

Item 3. Legal Proceedings

The Company is not aware of any legal proceedings against it at this time.

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

No matter was submitted during the fourth quarter of fiscal 2001 to a vote of security holders, either through the solicitation of proxies or otherwise.

PART II

Item 5. Market for the Company's Common Stock and Related Stockholder Matters

The Company's Common Stock (symbol: IAIC) has been traded on over the counter 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:

<TABLE>
<CAPTION>

| | Fiscal Year Ended December 31, 2000 | | | | Fiscal Year Ended December 31, 2001 | | | |
|---|---|---|---|---|---|---|---|---|
| | Quarter Ended: | | | | Quarter Ended: | | | |
| | 3/31/00 | 6/30/00 | 9/30/00 | 12/31/00 | 3/31/01 | 6/30/01 | 9/30/01 | 12/31/01 |
| <S> | <C> | <C> | <C> | <C> | <C> | <C> | <C> | <C> |
| High | $2.156 | $1.063 | $0.594 | $0.438 | $0.300 | $0.740 | $0.410 | $0.590 |
| Low | $0.531 | $0.375 | $0.260 | $0.040 | $0.090 | $0.200 | $0.120 | $0.130 |

</TABLE>

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

As of December 31,2001, the Company had 119 stockholders of record. The Company has never paid a cash dividend on its Common Stock. The Company does not anticipate the payment of cash dividends to the holders of Common Stock in the foreseeable future.

The Company issued to six accredited investors a total of $125,000 of three year 12% convertible notes, having a conversion price of $0.25 per share. The Company relied upon section 4(2) in issuing these notes without registration under the Securities Act of 1933.

Item 6. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

During 2001 IAI sales and marketing organizations were focused to capitalize on its services and tools to address the legacy modernization and conversion market. Additional resources were added to support Web-based solutions and staff augmentation.

IAI was profitable in 2001after considering an extraordinary gain. The Company's expenses related to sales, marketing, and administrative infrastructure were reduced and revenue increased during 2001. As we continue to build backlog, we believe the Company's economic prospects will improve.

Results of Operations

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

| | Years Ended | |
|---|---|---|
| | December 31, 2001 | December 31, 2000 |
| Revenue | 100.0% | 100.0% |
| Cost of Goods Sold | 75.3% | 74.1% |
| Gross Profit | 24.7% | 25.9% |
| Operating Expenses | | |
| Selling, general and administrative | 27.6% | 38.7% |
| Loss from operations | (2.9%) | (12.8%) |
| Non recurring item | 0.0% | 0.0% |
| Other (expense) income | (0.5%) | (0.7%) |
| Loss before income taxes | (3.4%) | (13.5%) |
| Net income (loss) | 1.6% | (13.5%) |
| Extraordinary Gain | 5.0% | 0 |

2001 Compared to 2000

Revenue. Fiscal 2001 revenue increased $0.3 million, or 5.5%, to $6.1 million from $5.8 million in fiscal year 2000. Revenue from software sales decreased $0.4 million, or 43.6%, to $0.4 million in fiscal year 2001 from $0.8 million in fiscal year 2000. Revenue from professional services increased $0.7 million, or 13.9%, to $5.6 million in fiscal year 2001 from $4.9 million in fiscal year 2000.

Gross Profit. Gross profit was $1.5 million in fiscal 2001 versus $1.4 million in 2000,or 24.7% of revenue in 2001 compared to 25.9% of revenue in 2000. Professional services gross margin was 29.8% of revenue in 2001, compared to 25.8% in 2000. The increase in professional services gross margin was primarily attributable to new contracts in 2001, which generated a higher gross margin for the year. Software sales gross margin was (35.0%) of revenue in 2001, down from 26.5% in 2000. The decrease in software sales gross margin was do to lower software sales and the amortization for capitalized software during fiscal year 2001.

Selling, General and Administrative (SG&A). Fiscal 2001 SG&A expense decreased to $1.7 million, or 27.6% of revenue, from $2.2 million, or 38.7% of revenue in 2000, a decrease in expenses of 24.6%. The decrease is due to a continued effort by management to scale back expenses as the Company positions itself to meet its current needs.

Liquidity and Capital Resources

The proceeds derived from the $125,000 convertible notes issued in 2001, along with current collections and net borrowing of $(2,591) from the Company's bank provided financing for the Company's operations in 2001. Certain creditors accepted 582,042 shares of common stock and two creditors





accepted warrants for 47,636 shares of common stock in satisfaction of their claims in the amount of $519,057. For fiscal year 2001, net cash provided by operating, investing and financing activities of $5,000 along with net income of $96,953 resulted in cash and cash equivalents of $102,640 at year end. The Company's line of credit of $2,000,000 with First Virginia Bank expired on June 19, 1999. First Virginia Bank has executed forbearance agreements with the Company, which effectively extends a line of credit of $800,000 until April 23, 2002. The Company is in negotiations with First Virginia Bank and expects to have the line of credit extended.

The Company cannot be certain that there will not be a need for additional cash resources at some point in fiscal 2002. Accordingly, the Company may from time to time consider additional equity offerings to finance business expansion. The Company is uncertain that it will be able to raise additional capital.

Item 7. Financial Statements and Supplementary Data

See Consolidated Financial Statements included herein beginning on page F-1.

Item 8. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None





PART III

Item 9. Directors and Executive Officers of the Registrant

The executive officers and directors of the Company are:

| NAME | DIRECTOR SINCE | OFFICE HELD WITH COMPANY |
|---|---|---|
| Sandor Rosenberg | 1979 | Chairman of the Board, Chief Executive Officer |
| Richard S. DeRose | 1991 | Executive Vice President, Chief Financial Officer, Secretary |
| Stanley A. Reese | 1993 | Senior Vice President, Chief Operating Officer |
| Charles A. May, Jr. | 1997 | Director |
| Bonnie K. Wachtel | 1992 | Director |
| James D. Wester | 1985 | Director |

Directors serve until the next annual meeting of shareholders or until successors have been elected and qualified. Officers serve at the discretion of the Board of Directors.

Sandor Rosenberg, 55, is the founder of the Company and has been Chairman of the Board and Chief Executive Officer of the Company since 1979. Mr. Rosenberg holds a BS degree in Aerospace Engineering from Rensselaer Polytechnic Institute, and has done graduate studies in Operations Research at George Washington University.

Richard S. DeRose, 63, has been Executive Vice President since 1991. From 1979 to 1991 he served as the President and CEO of DHD, Inc. and was a founder of the company. Prior to DHD, Mr. DeRose held several management positions in the information technology and telecommunications industries at RCA, Burroughs, and MCI. Mr. DeRose holds a BS degree in Science from the US Naval Academy and an MS degree in Computer Systems Management from the US Naval Postgraduate School, Monterey.

Stanley A. Reese, 45, joined the Company in 1993. Mr. Reese has been Senior Vice President since 1997 and Chief Operating Officer since March 1999. From 1992 to 1993, he served as Vice President, Technical Services at Tomco Systems, Inc. Prior to Tomco Systems, he served as Senior Program manager at ICF Information Technology, Inc. Mr. Reese has over 17 years experience managing and marketing large scale mainframe and PC-based applications. Mr. Reese holds a BA in History from George Mason University

Charles A. May, Jr., 64, is a consultant focusing on national security and defense conversion issues. In 1992, he retired as a Lt. General from the Air Force where he last served as Assistant Vice Chief of Staff, Headquarters US Air Force, Washington, D.C. He is a graduate of the US Air Force Academy, where he once served as an Associate Professor of Political Science. General May has also graduated from the NATO Defense College and has completed the University of Pittsburgh's Management Program for Executives.

Bonnie Wachtel, 46, has served as vice president and general counsel of Wachtel & Co., Inc., a Washington, D.C.-based brokerage and investment banking firm, since 1984. Ms. Wachtel holds BA and MBA degrees from the University of Chicago and a JD from the University of Virginia. She is a director of Integral Systems, Inc., a provider of computer systems and software for the satellite communications market; and VSE Corporation, a provider of technical services to the federal government.

James Wester, 63, has been a computer services marketing consultant for more than 15 years. Since 1984, he has been president of Results, Inc., a computer services marketing firm. Mr. Wester holds a BME degree from Auburn University and an MBA from George Washington University.

There are no family relationships between any directors or executive officers of IAI.





Compliance with Section 16(a) of the Exchange Act

Section 16(a) ("Section 16(a)") of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), requires executive officers and Directors and persons who beneficially own more than ten percent (10%) of the Company's Common Stock to file initial reports of ownership and reports of changes in ownership with the Securities and Exchange Commission (the "Commission") and any national securities exchange on which the Company's securities are registered. Executive officers, Directors and greater than ten percent (10%) beneficial owners are required by the Commission's regulations to furnish the Company with copies of all Section 16(a) forms they file.

Based solely on a review of the copies of such forms furnished to the Company and written representations from the executive officers and Directors, the Company believes that all Section 16(a) filing requirements applicable to its executive officers, Directors and greater than ten percent (10%) beneficial owners were satisfied, except for Traditions LP and any filing required in connection with option grants.

Item 10. Executive Compensation

The Summary Compensation Table below sets forth individual compensation information for the Chief Executive Officer and the other executive officers serving as executive officers as of December 31, 2001 (collectively "Named Executive Officers"):

Summary Compensation Table

<TABLE>
<CAPTION>

| Name and Principal Position | Year | Annual Compensation Salary | Bonus | Securities Underlying Options (#) |
|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> |
| Sandor Rosenberg | 2001 | $85,165 | -- | -- |
| Chairman of the Board and | 2000 | $76,904 | -- | -- |
| Chief Executive Officer | 1999 | $76,457 | -- | -- |
| Richard S. DeRose | 2001 | $87,017 | -- | -- |
| Executive Vice President | 2000 | $75,000 | -- | 50,000 |
| Chief Financial Officer | 1999 | $97,617 | -- | 20,000 |
| Stanley A. Reese | 2001 | $82,742 | -- | 50,000 |
| Senior Vice President and | 2000 | $75,000 | -- | -- |
| Chief Operating Officer | 1999 | $97,867 | -- | 20,000 |

</TABLE>

No Named Executive Officer has received any perquisite or benefit, securities, or property that exceeded the lesser of $50,000 or 10% of the total annual salary and bonus reported for such executive officer.

The following table sets forth all option grants during 2001 to all executive officers.

<TABLE>
<CAPTION>

Option Grants in Last Fiscal Year

| Name | Number of Securities Underlying Options Granted | % of Total Options Granted To Employees in Fiscal Year | Exercise Price | Expiration Date |
|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> |
| Stanley A. Reese | 50,000 | 37.5% | $0.200 | 09/07/11 |

</TABLE>

The following table depicts option exercise activity in the last fiscal year and fiscal year-end option values with respect to each of the Named Executive Officers. The value of unexercised in-the-money options at December 31, 2001 equals the market value of the underlying common stock at December 31, 2001 minus the option exercise price. The fair market value of the Company's common stock at December 31, 2001 was $0.55.





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

<TABLE>
<CAPTION>

| Name | Shares Acquired on Exercise | Value Realized | Number of Securities Underlying Unexercised Options at 12/31/01 Exercisable | Unexercisable | Value of Unexercised In-the-Money Options at 12/31/01 Exercisable | Unexercisable |
|---|---|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| Richard S. DeRose | -- | -- | 167,900 | -- | $15,285 | -- |
| Stanley A. Reese | -- | -- | 178,750 | -- | $18,428 | -- |

</TABLE>

Directors of the Company who are not executive officers of the Company receive a stipend of $500 per quarter plus reimbursement of reasonable expenses incurred in attending meetings.





Item 11. Security Ownership of Certain Beneficial Owners and Managers

The following table sets forth, as of March 27, 2002, the number of shares and percentage of the Company's Common Stock owned by all persons known by the Company to own beneficially more than 5% of the Company's Common Stock, by each director, by each executive officer named in the Summary Compensation Table, and by all directors and executive officers as a group. This information has been obtained in part from such persons and in part from the Company's records. Each person has sole voting and investment power with respect to the shares indicated except for shares which may be acquired upon exercise of options and as otherwise noted.

<TABLE>
<CAPTION>

| NAME AND ADDRESS OF BENEFICIAL OWNER (1) | SHARES BENEFICIALLY OWNED (2) | | % OF CLASS |
|---|---|---|---|
| <S> | <C> | | <C> |
| Sandor Rosenberg, Chairman, CEO, and Director | 1,752,800 | | 17.0% |
| Richard S. DeRose, Executive Vice President | 365,900 | (3) | 3.5% |
| Stanley A. Reese, Senior Vice President | 200,750 | (4) | 1.9% |
| Charles A. May, Jr., Director | 16,000 | (5) | * |
| Bonnie K. Wachtel, Director | 112,800 | (6) | 1.1% |
| James D. Wester, Director | 427,355 | (7) | 4.0% |
| Kenneth Parsons | 712,500 | (8) | 6.5% |
| Traditions LP | 1,500,000 | (9) | 13.9% |
| All directors and executive officers as a group | 2,875,605 | (10) | 26.4% |

</TABLE>

*less than 1%

(1) The address of all beneficial holders is care of the Company, except Ms. Wachtel, whose address of record is 1101 14/th/ St. NW, Washington, DC 20001.
(2) All shares are held outright by the individuals listed. References to options and warrants include all options and warrants exercisable within 60 days of March 27, 2002.
(3) Includes options on 167,900 shares.
(4) Includes options on 178,750 shares.
(5) Includes options on 16,000 shares.
(6) Includes options on 13,000 shares.
(7) Includes warrants on 108,000 shares and options for 190,000 shares.
(8) Includes options on 712,500 shares.

(9) Includes warrants on 500,000 shares.
(10) Includes options on 565,650 shares and warrants for 108,000 shares.

Item 13. Exhibits, Financial Statements Schedules, and Reports on Form 8-K

(a) (1) Financial Statements:



(a) (2) Exhibits:
See Exhibit Index on page 12.

(b) No reports were filed on Form 8-K during the last quarter of 2001.





Signatures

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

INFORMATION ANALYSIS INCORPORATED

By:

Sandor Rosenberg, President
April 12, 2002

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

| Signature | Title | Date |
|---|---|---|
| /s/ Sandor Rosenberg<br>Sandor Rosenberg | Chairman of the Board and President | April 12, 2002 |
| /s/ Charles A. May, Jr.<br>Charles A. May | Director | April 12, 2002 |
| /s/ Bonnie K. Wachtel<br>Bonnie K. Wachtel | Director | April 12, 2002 |
| /s/ James D. Wester<br>James D. Wester | Director | April 12, 2002 |
| /s/ Richard S. DeRose<br>Richard S. DeRose | Treasurer | April 12, 2002 |





Exhibit Index

<TABLE>
<CAPTION>

| Exhibit No. | Description | Location |
|---|---|---|
| <S> | <C> | <C> |
| 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 |
| 4.2 | Form of Warrant issued in December 1999 and January 2000 | Incorporated by reference from the Registrant's Form 10-KSB for the fiscal year ending December 31, 2000 and filed on March 29, 2000 |
| 4.3 | Common Stock and Warrant Purchase Agreement dated December 1999 | Incorporated by reference from the Registrant's Form 10-KSB for the fiscal year ending December 31, 2000 and filed on March 29, 2000 |
| 4.4 | Form of 12% 3 year convertible note | Incorporated by reference from the Registrant's Form 10-QSB for the period ending September 30, 2001 and filed on November 12, 2001. |
| 4.5 | Form of Warrant issued to trade creditors who exchanged claims for warrants. | Incorporated by reference from the Registrant's Form 10-QSB for the period ending September 30, 2001 and filed on November 12, 2001. |
| 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. | 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 | 1986 Stock Option Plan | Incorporated by reference from the Registrant's Form S-8 filed on December 20, 1988 |
| 10.4 | 1996 Stock Option Plan | Incorporated by reference from the Registrant's Form S-8 filed on June 25, 1996 |
| 10.5 | Line of Credit Agreement with First Virginia Bank | Incorporated by reference the Registrant's Form 10-KSB for the fiscal year ending December 31, 1995 and filed April 15, 1996 |

</TABLE>





<TABLE>
<CAPTION>

| <S> | <C> | <C> |
|---|---|---|
| | | (Commission File No. 33-9390). |
| 10.6 | Warrant Agreement between James D. Wester, a director, and the Company dated February 24, 1993 | 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 |
| 10.7 | Office lease for 19,357 square feet at 3877 Fairfax Ridge Road, Fairfax, Virginia | Incorporated by reference from the Registrant's Form 10-QSB for the period ending March 31, 1998 and filed on May 15, 1998. |
| 10.8 | 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 ending March 31, 2001 and filed on May 11, 2001. |

| | | |
|---|---|---|
| 21.1 | List of Subsidiaries. | Filed with this Form 10-KSB |
| 23.1 | Consent of independent auditors, Rubino & McGeehin, Chartered | Filed with this Form 10-KSB |

</TABLE>





Exhibit 21.1

SUBSIDIARIES OF
INFORMATION ANALYSIS INCORPORATED

| Name | State of Incorporation | Name under which Subsidiary Does Business |
|---|---|---|
| Allied Health & Information Systems, Inc. | VA | N/A |
| International Software Services Corporation | VA | N/A |



Exhibit 23.1

Consent of Independent Auditors

We consent to the incorporation by reference in the Registration Form SB-2 No. 333-95775 dated September 4, 2000 and Registration Statements (Form S-8 No. 33-26249 and No. 33-305136) pertaining to the 1986 Stock Option Plan and 1996 Stock Option Plan of Information Analysis Incorporated and in the related prospectus' of our report dated March 29, 2002 with respect to the consolidated financial statements and schedule of Information Analysis Incorporated included in the Annual Report (Form 10-KSB) for the year ended December 31, 2001.

/s/ Rubino & McGeehin, Chartered

Bethesda, Maryland
April 15, 2002



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, 2001, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for the years ended December 31, 2001 and 2000. 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 auditing standards generally accepted in the 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles 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, 2001, and their consolidated results of operations and cash flows for the years ended December 31, 2001 and 2000, in conformity with accounting principles generally accepted in the United States.

The accompanying consolidated financial statements have been prepared assuming Information Analysis Incorporated and subsidiaries will continue as a going concern. As discussed in Note 16, the Company has suffered recurring losses from operations and has cash flows problems and financing requirements that raise substantial doubt about its ability to continue as a going concern. Management's plans in regards to these matters are described in Note 16. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

March 29, 2002
Bethesda, MD /S/ Rubino & McGeehin, Chartered





INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET

<TABLE>
<CAPTION>

| | December 31, 2001 |
|---|---|
| ASSETS | |
| <S> | <C> |
| Current assets | |
| Cash and cash equivalents | $ 102,640 |
| Accounts receivable, net of allowance of $469,957 | 1,526,372 |
| Prepaid expenses | 22,255 |
| Note receivable | 75,000 |
| Other receivables | 22,203 |
| Total current assets | 1,748,470 |
| Fixed assets, net of accumulated depreciation and amortization of $2,237,780 | 34,654 |
| Capitalized software, net of accumulated amortization of $472,045 | 292,065 |
| Other receivables | 31,865 |
| Other assets | 58,275 |
| Total assets | $ 2,165,329 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | |
| Current liabilities | |
| Revolving line of credit | $ 596,000 |
| Accounts payable | 1,024,717 |
| Accrued payroll and related liabilities | 294,489 |
| Other accrued liabilities | 175,158 |
| Deferred revenue | 157,882 |
| Total current liabilities | 2,248,246 |
| Long-term liabilities | |
| Notes payable | 125,001 |
| Total liabilities | 2,373,247 |
| Stockholders' equity | |
| Common stock, $0.01 par value, 30,000,000 shares authorized, 11,788,126 shares issued, 10,283,515 shares outstanding | 117,881 |
| Additional paid-in capital | 14,122,019 |
| Accumulated deficit | (13,593,505) |
| Less treasury stock, 1,504,611 shares, at cost | (854,313) |
| Total stockholders' equity (deficit) | (207,918) |
| Total liabilities and stockholders' equity | $ 2,165,329 |

</TABLE>

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

INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

<TABLE>
<CAPTION>

| | For the years ended December 31, 2001 | 2000 |
|---|---|---|
| Sales | | |
| <S> | <C> | <C> |
| Professional fees | $ 5,606,815 | $ 4,920,931 |
| Software sales | 479,659 | 849,710 |
| Total sales | 6,086,474 | 5,770,641 |
| Cost of sales | | |
| Cost of professional fees | 3,936,288 | 3,653,333 |
| Cost of software sales | 647,643 | 624,654 |
| Total cost of sales | 4,583,931 | 4,277,987 |
| Gross profit | 1,502,543 | 1,492,654 |
| Selling, general and administrative expenses | 1,681,479 | 2,231,056 |
| Loss from operations | (178,936) | (738,402) |
| Other expenses | (31,031) | (42,338) |
| Loss before provision for income taxes and extraordinary item | (209,967) | (780,740) |
| Provision for income taxes | - | - |
| Net loss before extraordinary item | (209,967) | (780,740) |
| Extraordinary gain-settlement of debt with equity | 306,920 | - |
| Net income (loss) | $ 96,953 | $ (780,740) |
| Earnings per common share - Basic and Diluted | | |
| Net loss before extraordinary item | $ (0.02) | $ (0.08) |
| Extraordinary gain | 0.03 | - |
| Net income (loss) | $ 0.01 | $ (0.08) |
| Weighted average common shares outstanding | | |
| Basic | 9,970,133 | 9,576,981 |
| Diluted | 9,970,133 | 9,576,981 |

</TABLE>

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





INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

<TABLE>
<CAPTION>

Shares of Common                    Additional

| | Stock Issued | Common Stock | Paid-in Capital | Accumulated Deficit | Treasury Stock | Total |
|---|---|---|---|---|---|---|
| Balances, December 31, 1999 | 10,723,284 | $ 107,233 | $ 13,763,904 | $ (12,909,718) | $ (854,313) | $ 107,106 |
| Exercise of stock options and warrants | 112,800 | 1,128 | 30,498 | - | - | 31,626 |
| Stock issued for private placement | 250,000 | 2,500 | 122,500 | - | - | 125,000 |
| Stock issued as contingent payment of debt | 120,000 | 1,200 | (1,200) | - | - | - |
| Net loss | - | - | - | (780,740) | - | (780,740) |
| Balances, December 31, 2000 | 11,206,084 | 112,061 | 13,915,702 | (13,690,458) | (854,313) | (517,008) |
| Stock issued as settlement of debt | 582,042 | 5,820 | 206,317 | - | - | 212,137 |
| Net Income | - | - | - | 96,953 | - | 96,953 |
| Balances, December 31, 2001 | 11,788,126 | $ 117,881 | $ 14,122,019 | $ (13,593,505) | $ (854,313) | $ (207,918) |

</TABLE>

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





INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

<TABLE>
<CAPTION>

| | For the years ended December 31, 2001 | 2000 |
|---|---|---|
| Net income (loss) | $ 96,953 | $(780,740) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Extraordinary gain | (306,920) | |
| Depreciation and amortization | 73,822 | 188,484 |
| Amortization of capitalized software | 199,487 | 154,548 |
| Gain on sale of fixed assets | (9,537) | - |
| Changes in operating assets and liabilities | | |
| Accounts receivable | (452,431) | 828,303 |
| Other receivables and prepaid expenses | 99,494 | 11,699 |
| Accounts payable and accrued expenses | 74,683 | (557,215) |
| Deferred revenue | 157,882 | - |
| Net cash used by operating activities | (66,567) | (154,921) |
| Cash flows from investing activities: | | |
| Acquisition of furniture and equipment | (5,630) | - |
| Proceeds from sale of fixed assets | 9,547 | - |
| Increase in capitalized software | - | (182,447) |
| Net cash provided (used) by investing activities | 3,917 | (182,447) |

| | | |
|---|---|---|
| Cash flows from financing activities: | | |
| Net (payments) borrowings under bank revolving line of credit | (2,591) | 97,091 |
| Net received on long-term note payable | 125,000 | - |
| Principal payments on capital leases | - | (6,936) |
| Proceeds from private placement of common stock | - | 125,000 |
| Proceeds from exercise of stock options and warrants | - | 31,626 |
| Net cash provided by financing activities | 122,409 | 246,781 |
| Net increase (decrease) in cash and cash equivalents | 59,759 | (90,587) |
| Cash and cash equivalents, beginning of the year | 42,881 | 133,468 |
| Cash and cash equivalents, end of the year | $ 102,640 | $ 42,881 |
| Supplemental cash flow information | | |
| Interest paid | $ 48,219 | $ 60,999 |
| Non-cash financing activity | | |
| Issuance of common stock to settle debt | $ 212,137 | |
| Non-cash operating activity | | |
| Reduction of accounts payable through issuance of equity | $ 519,057 | |

</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, International Software System Corporation (ISSC) and Allied Health & Information Systems, Inc. (AHISI). Upon consolidation, all material intercompany accounts, transactions and profits are eliminated.

Accounting Estimates

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

Revenue Recognition

The Company provides services under various pricing arrangements. Revenue from "cost-plus-fixed-fee" contracts is recognized on the basis of reimbursable contract costs incurred during the period, plus a percentage of the fixed fee. Revenue from "firm-fixed-price" contracts is recognized on the percentage-of-completion method. Under this method, individual contract revenues are recorded based on the percentage relationship that contract costs incurred bear to management's estimate of total contract costs. Revenue from "time and material" contracts is recognized on the basis of hours utilized, plus other reimbursable contract costs incurred during the period. Contract losses, if any, are accrued when their occurrence becomes known and the amount of the loss is reasonably determinable. 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.

Revenue from software sales is recognized upon delivery, when collection of the receivable is probable. Maintenance revenue is recognized ratably over the maintenance period.





INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (continued)

Segment Reporting

The Company adopted Statement No. 131, "Disclosures about Segments of an Enterprise and Related Information," in 1998, and concluded that it operates in one business segment, providing products and services to modernize client information systems.

Government Contracts

Company 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 renegotiating 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. Management is of the opinion that any disallowance of costs for subsequent fiscal years by the government auditors, other than amounts already provided, will not materially affect the Company's financial statements.

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 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.

Advertising

All costs related to advertising the Company's products are expensed in the period incurred.





INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (continued)

Software Development Costs

The Company has capitalized costs related to the development of the ICONS software product. 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 is computed and recognized for the product when available for general release to customers based on the greater of (a) the ratio that current gross revenues for the product bear to the total of current and anticipated future gross revenues for that product or, (b) the straight-line method over the economic life of the product. Capitalized costs and amortization periods are management's estimates and may have to be modified due to inherent technological changes in software development.

Stock-Based Compensation

The Company records compensation expense for all stock-based compensation plans using the intrinsic value method prescribed by APB Opinion No. 25, "Accounting for Stock Issued to Employees." The Company's annual financial statements disclose the required pro forma information as if the fair value method prescribed by Financial Accounting Standards Board's Statement No. 123, "Accounting for Stock-Based Compensation," had been adopted.

Earnings Per Share

The Company's earnings per share calculations are based upon the weighted average of shares of common stock outstanding. The dilutive effect of stock options, warrants and, for 2001, convertible notes, are included for purposes of calculating diluted earnings per share, except for periods when the Company reports a net loss before extraordinary item, in which case the inclusion of such equity instruments would be antidilutive.

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.





INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (continued)

Fair Market Value of Financial Instruments

The Company's financial instruments include trade receivables, other receivables, 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.

2. Receivables

Accounts receivable at December 31, 2001, consist of the following:

| | |
|---|---|
| Billed-federal government | $ 1,921,565 |
| Billed-commercial and other | 18,750 |
| Total billed | 1,940,315 |
| Unbilled | 56,015 |
| Less: allowance of doubtful accounts | (469,958) |
| Accounts receivable, net | $ 1,526,372 |

Billed receivables from the federal government includes 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 which are expected to be billed and collected within one year.

At December 31, 2001, there is a note receivable of $75,000 from a customer. The note bears interest of 7% and is due September 30, 2002.

3. Fixed Assets

A summary of fixed assets and equipment at December 31, 2001, consist of the following:

| | | |
|---|---|---|
| Furniture and equipment | $ | 341,055 |
| Leasehold improvements and other | | 204,634 |
| Computer equipment and software | | 1,726,745 |
| | | 2,272,434 |
| Less: accumulated depreciation and amortization | | (2,237,780) |
| Total | $ | 34,654 |

Depreciation expense for the years ended December 31, 2001 and 2000, was $73,822 and $188,484 respectively.





INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4. Software Development Costs

Software development costs as of December 31, 2001, consist of the following:

| | | |
|---|---|---|
| Cumulative costs incurred | $ | 764,110 |
| Accumulated amortization | | (472,045) |
| Net software development costs | $ | 292,065 |

Amortization expense for the years ended December 31, 2001 and 2000, was $199,487 and $154,548, respectively.

At December 31, 2001, capitalized software development cost is for the ICONS software tool. All costs related to other products have been fully amortized or written off.

5. Other Assets

Other assets at December 31, 2001, consist of the following:

| | | |
|---|---|---|
| Security deposits | $ | 48,275 |
| Other | | 10,000 |
| Total other assets | $ | 58,275 |

6. Other Accrued Liabilities

Other accrued liabilities at December 31, 2001, consist of the following:

| | | |
|---|---|---|
| Royalties payable | $ | 18,558 |
| Accrued payables | | 146,489 |
| Other | | 10,111 |
| Total other accrued liabilities | $ | 175,158 |





INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

7. Revolving Line of Credit

At December 31, 2001, the Company had a revolving line of credit with a bank providing for demand or short-term borrowings up to $1,000,000. The bank has executed a forbearance agreement with the Company for demand or short-term borrowings up to $800,000, which effectively extends the line of credit until April 23, 2002. Draws against this line are limited by varying percentages of the Company's accounts receivable balances depending on the source of the receivables and their age. The bank is granted a security interest in certain assets if there are borrowings under the line of credit. Interest on outstanding amounts is payable monthly at the bank's prime rate plus 2.5% (7.25% at December 31, 2001). The lender has a first priority security interest in the Company's receivables and a direct assignment of its U.S. Government contracts. The revolving line of credit, among other covenants, requires the Company to comply with certain financial ratios. The Company was not in compliance with any of the financial ratios at December 31, 2001, when there was an outstanding balance of $596,000 on the line.

The Company is in negotiations with various organizations to obtain a new line of credit. The current line of credit, coupled with funds generated from operations, assuming the operations are cash flow positive, should be sufficient to meet the Company's operating cash requirements. The Company, however, may be required from time to time to delay timely payments of its accounts payable. The Company cannot be certain that there will not be a need for additional working capital in the near future. It is uncertain whether the Company will be able to obtain such additional working capital.

8. Commitments and Contingencies

Operating Leases

The Company leases facilities and equipment under long-term operating lease agreements. Rent expense was $141,936 and $212,756 for the years ended December 31, 2001 and 2000, net of sublease income of $288,398 and $301,306, respectively. During 2001, the Company renegotiated its lease without penalty to lease less space in the current building. The future minimum rental payments to be made under long-term operating leases principally for facilities, and giving effect to the aforementioned reduction in space, are as follows:

| | | |
|---|---|---|
| Year ending December 31, 2002 | $ | 369,100 |
| 2003 | | 361,000 |
| 2004 | | 82,300 |
| Total minimum rent payments | $ | 812,400 |





INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

8. Commitments and Contingencies (continued)

The above minimum lease payments reflect the base rent under the lease agreements. However, these base rents can 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 leases are secured by security deposits in the amount of $48,275.

The aggregate future minimum rentals to be received under non-cancelable subleases as of December 31, 2001, is $531,200 of which $239,400 is receivable in 2002, $230,200 is receivable in 2003, and $61,600 is receivable in 2004.

9. Income Taxes

The tax effect of significant temporary differences representing deferred tax assets and deferred tax liabilities at December 31, 2001, are as follows:

| | | |
|---|---|---|
| Deferred tax assets: | | |
| Net operating loss carry forward | $ | 6,264,700 |
| Accrued vacation | | 59,800 |
| Allowance for bad debts | | 178,600 |
| Intangibles | | 41,100 |
| Fixed assets | | 87,900 |
| Other | | 1,600 |
| Subtotal | | 6,633,700 |
| Valuation allowance | | (6,633,700) |
| Total | | - |

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





INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

9. Income Taxes (continued)

<TABLE>
<CAPTION>

| | December 31, 2001 | | December 31, 2000 | |
|---|---|---|---|---|
| Income (loss) before taxes, including extraordinary item for 2001 | $ | 96,953 | $ | (780,740) |
| Income taxes (benefit) on above amount at federal statutory rate | | 23,200 | | (265,500) |
| State income taxes, net of federal benefit | | 4,900 | | (31,200) |
| (Decrease) increase in valuation allowance | | (29,600) | | 295,000 |
| Effect of change in estimates and non-deductible items | | 1,500 | | 1,700 |
| Provision for income taxes | $ | - | $ | - |

</TABLE>

The Company has recognized a valuation allowance to the full extent of its net deferred tax assets since the likelihood of realization of the benefit cannot be determined.

The Company has net operating loss carryforwards of approximately $16.5 million, which expire, if unused, in the year 2020. The tax benefits of approximately $2.3 million of net operating losses related to stock options will be credited to equity when the benefit is realized through utilization of the net operating loss carryover.

10. Major Customers

Traditionally, the Company's clients have spanned a wide range of enterprises in the private sector along with government agencies. The Company's prime contracts and subcontracts with agencies of the federal government accounted for 98% of the Company's 2001 revenues and 73% of the 2000 revenues. The Company's subcontracts with two prime contractors accounted for 38% of the Company's 2001 revenue.

11. 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. Participants can elect to have up to 15% of their salary reduced and contributed to the plan. The Company is required to make a matching contribution of 25% of the first 6% of this salary reduction. The Company can also make additional contributions at its discretion. There was no expense under the plan for the years ended December 31, 2001 and 2000. Payments for 2001 and 2000 were paid from the Company's forfeiture account, which offset any matching expenses incurred in both years.

INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

12. Stock Options and Warrants

The Company has an incentive stock option plan, which became effective June 25, 1996. The plan provides for the granting of stock options to certain employees and directors. The maximum number of shares for which options may be granted under the plans is 2,575,000. 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 in 2001 was eight months. 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 date consistent with the method of Statement of Financial Accounting Standards (SFAS) No. 123, the Company's net income and earnings would have been:

| | | 2001 | 2000 |
|---|---|---|---|
| Net income (loss) | As reported | $ 96,953 | $ (780,740) |
| | Pro forma | $ 71,958 | $ (812,440) |
| Net income (loss) | As reported | $ 0.01 | $ (0.08) |
| per share | Pro forma | $ 0.01 | $ (0.08) |

The fair value of the options granted in 2001 and 2000 is estimated on the date of the grant using the Black-Scholes options-pricing model assuming the following:

| | 2001 | 2000 |
|---|---|---|
| Dividend yield | None | None |
| Risk-free interest rate | 4.59% | 5.5% |
| Expected volatility | 163.7% | 135.7% |
| Expected term of options | 3 years | 3 years |

The effects on 2001 and 2000 pro forma net income and earnings per share of expensing the estimated fair value of stock options are not necessarily representative of the effects on reported net income for future years due to such things as the vesting period of the stock options and the potential for issuance of additional stock options in future years. The weighted average fair value per option granted in 2001 and 2000, was $0.18 and $0.43, respectively.





INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

12. Stock Options and Warrants (continued)

The following table summarizes information about stock options outstanding at December 31, 2001:

| | Options Outstanding | | Options Exercisable |
|---|---|---|---|
| | Weighted | Weighted Average | |

| Range of Exercise Prices | Number of Options | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life | Number of Options | Weighted Average Exercise Price |
|---|---|---|---|---|---|
| Less than $1.00 | 1,473,650 | $ 0.40 | 6.0 years | 1,294,150 | $ 0.43 |
| $1.00 and more | 178,300 | $ 5.76 | 5.7 years | 178,300 | $ 5.76 |
| Total | 1,651,950 | $ 0.98 | 5.9 years | 1,472,450 | $ 1.07 |

</TABLE>

Unexercisable options are as follows: 1,000 at $0.51 per share; 3,500 options at $0.36 per share; 4,000 options at $0.35 per share; 7,000 options at $0.30 per share; 2,000 options at $0.24 per share; 41,500 options at $0.21 per share; 119,000 options at $0.20 per share; 1,500 options at $0.15 per share. Transactions involving the plan were as follows:

<TABLE>
<CAPTION>

| | December 31, 2001 Shares | 2001 Weighted Average Price | 2000 Shares | 2000 Weighted Average Price |
|---|---|---|---|---|
| Outstanding, beginning of year | 1,455,950 | $ 1.14 | 1,505,550 | $ 1.11 |
| Granted | 239,000 | 0.21 | 94,000 | 0.43 |
| Exercised | 0 | | (112,800) | 0.28 |
| Canceled | (43,000) | 2.07 | (30,800) | 0.90 |
| Outstanding, end of year | 1,651,950 | $ 0.98 | 1,455,950 | $ 1.14 |

</TABLE>





INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

12. Stock Options and Warrants (continued)

The Board of Directors has also granted warrants to directors, employees and others. No warrants were issued to directors or employees in 2001 and 2000. In 2001, the Company issued 47,636 warrants to certain creditors in satisfaction of their claims totaling $38,109. There were no warrants exercised in 2001 or 2000. As of December 31, 2001, outstanding warrants are 1,717,975 of which 1,633,000 expire within 3 years and 84,975 expire thereafter. The purchase price for shares issued upon exercise of these warrants range from $0.01 to $6.42 per share. These warrants are exercisable immediately.

13. Convertible Notes Payable

During 2001, the Company issued to accredited investors $125,000 of 3-year 12% convertible notes, having a conversion price of $0.25 per share. Notes totaling $80,000 were issued to stockholders, officers and directors.

14. Extraordinary Gain

During 2001, the Company issued 582,042 shares of stock and 47,636 warrants to certain creditors in satisfaction of claims totaling $519,057. The stock was recorded at its market value based upon quoted trade prices, and the transactions resulted in an extraordinary gain of $306,920.

15. Computation Of Earnings (Loss) Per Share

<TABLE>
<CAPTION>

| <S> | For the years ended December 31, 2001 <C> | 2000 <C> |
|---|---|---|
| Numerator for basic and diluted earnings (loss) per share - net income (loss) | $ 96,953 | $ (780,740) |
| Denominator for basic earnings per share - weighted average shares | 9,970,133 | 9,576,981 |
| Effect of dilutive securities: Stock options, warrants, and convertible notes payable assumed conversions | - | - |
| Denominator for diluted earnings per share - adjusted weighted average shares and assumed conversions | 9,970,133 | 9,576,981 |
| Basic net earnings (loss) per share | $ 0.01 | $ (0.08) |
| Diluted net earnings (loss) per share | $ 0.01 | $ (0.08) |

</TABLE>





INFORMATION ANALYSIS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

16. Going Concern Evaluation

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company has realized approximately $97,000 in net income after extraordinary items for the year ended December 31, 2001 but incurred losses of approximately $210,000 and $800,000 before extraordinary items for the years ended December 31, 2001 and 2000, respectively. The gain in 2001 contributed to improved cash flow and financial position. The Company, however, remains in violation of loan covenants with its bank and has negotiated a forbearance agreement through April 23, 2002 (see Note 7).

A breach of any of the terms and conditions of the forbearance agreement, or subsequent breaches of the financial covenants under the credit facility, could result in acceleration of the Company's indebtedness, in which case the debt would become immediately due and payable. Based upon current projections, management does not believe the Company will comply with the existing financial covenants unless they are modified. If the forbearance agreement is not extended after April 23, 2002, the Company may not be able to repay the credit facility or borrow sufficient funds from another financial institution to refinance it. Management expects that the forbearance agreement will be extended under its existing terms.

Management is seeking alternative financing and capital sources to replace the existing credit facility. The Company's ability to continue operations, however, is contingent upon obtaining new financing and capital, returning to profitable operations, and continuing to reduce overhead and general administrative costs. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.