

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

**Form 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2021

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 000-22405

**Information Analysis Incorporated**

(Exact name of registrant as specified in its charter)

Virginia  
(State or other jurisdiction of incorporation or organization)

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

12015 Lee Jackson Memorial Highway  
Suite 210  
Fairfax, Virginia 22033

(Address of principal executive offices, Zip Code)

(703) 383-3000

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Trading Symbol(s) | Name of each exchange on which registered |
|---------------------|-------------------|---|
|                     |                   |   |

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  No

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

Large accelerated filer   
Non-accelerated filer

Accelerated filer   
Smaller reporting company   
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

13,510,690 shares of common stock, par value \$0.01 per share, as of October 28, 2021.

**INFORMATION ANALYSIS INCORPORATED  
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## PART I - FINANCIAL INFORMATION

## Item 1. Financial Statements

INFORMATION ANALYSIS INCORPORATED  
CONSOLIDATED BALANCE SHEETS

|  | September 30, 2021<br>(Unaudited) | December 31, 2020<br>(Note 1) |
|--|-----------------------------------|-------------------------------|
| <b>ASSETS</b>  |                                   |                               |
| Current assets   |                                   |                               |
| Cash and cash equivalents  | \$ 3,682,613                      | \$ 1,858,160                  |
| Accounts receivable  | 2,874,656                         | 1,442,231                     |
| Prepaid expenses   | 283,567                           | 142,770                       |
| Other current assets   | 5,556                             | -                             |
| Total current assets   | <u>6,846,392</u>                  | <u>3,443,161</u>              |
| Intangible assets, net of amortization of \$87,912 and \$0,  | 1,402,088                         | -                             |
| Goodwill   | 785,000                           | -                             |
| Contract assets - non-current  | -                                 | 210,688                       |
| Right-of-use operating lease asset   | 285,667                           | 51,405                        |
| Property and equipment, net of accumulated depreciation and amortization of \$349,300 and \$312,320  | 94,965                            | 62,166                        |
| Other assets   | 5,707                             | 6,281                         |
| Total assets   | <u>\$ 9,419,819</u>               | <u>\$ 3,773,701</u>           |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                                   |                               |
| Current liabilities  |                                   |                               |
| Accounts payable   | \$ 926,643                        | \$ 103,646                    |
| Revolving line of credit   | 402,306                           | -                             |
| Notes payable - current  | 797,295                           | 93,009                        |
| Accrued payroll and related liabilities  | 555,483                           | 375,168                       |
| Commissions payable  | 236,438                           | 181,626                       |
| Other accrued liabilities  | 82,158                            | 54,274                        |
| Contract liabilities   | 78,045                            | 946,884                       |
| Operating lease liability - current  | 35,805                            | 45,595                        |
| Interest payable   | 2,666                             | 3,125                         |
| Total current liabilities  | <u>3,116,839</u>                  | <u>1,803,327</u>              |
| Note payable - non-current   | 400,856                           | 356,991                       |
| Operating lease liability - non-current  | 260,141                           | -                             |
| Total liabilities  | <u>3,777,836</u>                  | <u>2,160,318</u>              |
| Stockholders' equity   |                                   |                               |
| Common stock, \$0.01 par value, 30,000,000 shares authorized, 15,153,306 and 12,904,376 shares issued,<br>13,510,690 and 11,261,760 shares outstanding as of September 30, 2021, and December 31, 2020, respectively | 151,532                           | 129,043                       |
| Additional paid-in capital   | 18,507,731                        | 14,720,065                    |
| Accumulated deficit  | (12,087,069)                      | (12,305,514)                  |
| Treasury stock, 1,642,616 shares at cost   | (930,211)                         | (930,211)                     |
| Total stockholders' equity   | <u>5,641,983</u>                  | <u>1,613,383</u>              |
| Total liabilities and stockholders' equity   | <u>\$ 9,419,819</u>               | <u>\$ 3,773,701</u>           |

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

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

|   | Three months ended September 30, |                   |
|---|----------------------------------|-------------------|
|   | 2021                             | 2020              |
| <b>Revenues</b>                                 |                                  |                   |
| Professional fees                               | \$ 2,798,105                     | \$ 1,580,684      |
| Software sales                                  | 1,501,820                        | 2,342,062         |
| Total revenues                                  | <u>4,299,925</u>                 | <u>3,922,746</u>  |
| <b>Cost of revenues</b>                         |                                  |                   |
| Cost of professional fees                       | 1,832,812                        | 1,051,102         |
| Cost of software sales                          | 1,488,238                        | 2,257,317         |
| Total cost of revenues                          | <u>3,321,050</u>                 | <u>3,308,419</u>  |
| Gross profit                                    | 978,875                          | 614,327           |
| Selling, general and administrative expenses    | 1,000,880                        | 342,778           |
| Commissions expense                             | 23,017                           | 56,643            |
| Acquisition costs                               | <u>39,245</u>                    | <u>-</u>          |
| (Loss) income from operations                   | (84,267)                         | 214,906           |
| Other expense, net                              | <u>(11,260)</u>                  | <u>(203)</u>      |
| (Loss) income before provision for income taxes | (95,527)                         | 214,703           |
| Provision for income taxes                      | <u>-</u>                         | <u>-</u>          |
| Net (loss) income                               | <u>\$ (95,527)</u>               | <u>\$ 214,703</u> |
| Comprehensive (loss) income                     | <u>\$ (95,527)</u>               | <u>\$ 214,703</u> |
| Net (loss) income per common share - basic      | <u>\$ (0.01)</u>                 | <u>\$ 0.02</u>    |
| Net (loss) income per common share - diluted    | <u>\$ (0.01)</u>                 | <u>\$ 0.02</u>    |
| Weighted average common shares outstanding      |                                  |                   |
| Basic   | <u>12,596,126</u>                | <u>11,211,760</u> |
| Diluted   | <u>12,596,126</u>                | <u>11,837,427</u> |

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

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

|  | Nine months ended September 30, |                  |
|--|---------------------------------|------------------|
|  | 2021                            | 2020             |
| <b>Revenues</b>                              |                                 |                  |
| Professional fees                            | \$ 8,565,639                    | \$ 3,353,508     |
| Software sales                               | 3,885,828                       | 7,450,389        |
| Total revenues                               | 12,451,467                      | 10,803,897       |
| <b>Cost of revenues</b>                      |                                 |                  |
| Cost of professional fees                    | 5,698,407                       | 2,232,405        |
| Cost of software sales                       | 3,798,607                       | 7,289,321        |
| Total cost of revenues                       | 9,497,014                       | 9,521,726        |
| Gross profit                                 | 2,954,453                       | 1,282,171        |
| Selling, general and administrative expenses | 2,346,680                       | 1,049,761        |
| Commissions expense                          | 176,660                         | 179,560          |
| Acquisition costs                            | 192,530                         | -                |
| Income from operations                       | 238,583                         | 52,850           |
| Other (expense) income, net                  | (20,138)                        | 894              |
| Income before provision for income taxes     | 218,445                         | 53,744           |
| Provision for income taxes                   | -                               | -                |
| Net income                                   | <u>\$ 218,445</u>               | <u>\$ 53,744</u> |
| Comprehensive income                         | <u>\$ 218,445</u>               | <u>\$ 53,744</u> |
| Net income per common share - basic          | <u>\$ 0.02</u>                  | <u>\$ -</u>      |
| Net income per common share - diluted        | <u>\$ 0.02</u>                  | <u>\$ -</u>      |
| Weighted average common shares outstanding   |                                 |                  |
| Basic  | 11,957,878                      | 11,211,760       |
| Diluted                                      | 12,584,914                      | 11,810,392       |

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

**INFORMATION ANALYSIS INCORPORATED**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)

|   | Nine months ended September 30, |                     |
|---|---------------------------------|---------------------|
|   | 2021                            | 2020                |
| <b>Cash flows from operating activities:</b>  |                                 |                     |
| Net income  | \$ 218,445                      | \$ 53,744           |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities: |                                 |                     |
| Depreciation and amortization   | 111,123                         | 6,821               |
| Stock option compensation   | 220,455                         | 7,171               |
| Changes in operating assets and liabilities:  |                                 |                     |
| Accounts receivable   | (820,954)                       | (931,517)           |
| Prepaid expenses and other current assets   | (140,015)                       | 461,592             |
| Contract assets   | 210,688                         | (89,404)            |
| Other assets  | 16,663                          | -                   |
| Accounts payable  | 508,408                         | 317,048             |
| Contract liabilities  | (868,839)                       | (132,574)           |
| Accrued payroll and related liabilities and other accrued liabilities                       | 63,404                          | 334,325             |
| Commissions payable   | 54,812                          | 11,363              |
| Net cash (used in) provided by operating activities   | <u>(425,810)</u>                | <u>38,569</u>       |
| <b>Cash flows from investing activities</b>   |                                 |                     |
| Acquisition of property and equipment   | (56,010)                        | (58,640)            |
| Acquisition of Tellenger, net of cash acquired  | (2,233,884)                     | -                   |
| Net cash used in investing activities   | <u>(2,289,894)</u>              | <u>(58,640)</u>     |
| <b>Cash flows from financing activities</b>   |                                 |                     |
| Borrowing under revolving line of credit  | 502,306                         | -                   |
| Repayments under revolving line of credit   | (100,000)                       | -                   |
| Proceeds from note payable  | 1,000,000                       | 450,000             |
| Principal payments - long-term note   | (251,849)                       | -                   |
| Net proceeds from issuance of stock   | 3,294,554                       | -                   |
| Proceeds from from exercise of stock options  | 95,146                          | -                   |
| Net cash provided by financing activities   | <u>4,540,157</u>                | <u>450,000</u>      |
| Net increase in cash and cash equivalents   | 1,824,453                       | 429,929             |
| Cash and cash equivalents, beginning of the period  | 1,858,160                       | 1,039,442           |
| Cash and cash equivalents, end of the period  | <u>\$ 3,682,613</u>             | <u>\$ 1,469,371</u> |
| Supplemental cash flow Information  |                                 |                     |
| Interest paid   | <u>\$ 32,197</u>                | <u>\$ -</u>         |
| Non-cash investing and financing activities   |                                 |                     |
| Value of common stock issued in connection with the acquisition of Tellenger, Inc.          | <u>\$ 200,000</u>               | <u>\$ -</u>         |

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

**INFORMATION ANALYSIS INCORPORATED**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
(Unaudited)

|  | Nine months ended September 30, 2021 |                                  |                        |                   |              |
|--|--------------------------------------|----------------------------------|------------------------|-------------------|--------------|
|  | Common<br>Stock                      | Additional<br>Paid-In<br>Capital | Accumulated<br>Deficit | Treasury<br>Stock | Total        |
| Balances at December 31, 2020              | \$ 129,043                           | \$ 14,720,065                    | \$ (12,305,514)        | \$ (930,211)      | \$ 1,613,383 |
| Net income                                 | -                                    | -                                | 270,815                | -                 | 270,815      |
| Stock option compensation                  | -                                    | 27,711                           | -                      | -                 | 27,711       |
| Stock issued                               | 3,306                                | 492,693                          | -                      | -                 | 495,999      |
| Issuance of stock from exercise of options | 250                                  | 3,300                            | -                      | -                 | 3,550        |
| Balances at March 31, 2021                 | 132,599                              | 15,243,769                       | (12,034,699)           | (930,211)         | 2,411,458    |
| Net income                                 | -                                    | -                                | 43,157                 | -                 | 43,157       |
| Stock option compensation                  | -                                    | 111,862                          | -                      | -                 | 111,862      |
| Stock issued, net                          | 683                                  | 197,872                          | -                      | -                 | 198,555      |
| Issuance of stock from exercise of options | 3,600                                | 76,395                           | -                      | -                 | 79,995       |
| Balances at June 30, 2021                  | 136,882                              | 15,629,898                       | (11,991,542)           | (930,211)         | 2,845,027    |
| Net loss                                   | -                                    | -                                | (95,527)               | -                 | (95,527)     |
| Stock option compensation                  | -                                    | 80,882                           | -                      | -                 | 80,882       |
| Stock and warrants issued                  | 14,000                               | 2,786,000                        | -                      | -                 | 2,800,000    |
| Issuance of stock from exercise of options | 650                                  | 10,951                           | -                      | -                 | 11,601       |
| Balances at September 30, 2021             | \$ 151,532                           | \$ 18,507,731                    | \$ (12,087,069)        | \$ (930,211)      | \$ 5,641,983 |

|                                | Nine months ended September 30, 2020 |                                  |                        |                   |              |
|--------------------------------|--------------------------------------|----------------------------------|------------------------|-------------------|--------------|
|                                | Common<br>Stock                      | Additional<br>Paid-In<br>Capital | Accumulated<br>Deficit | Treasury<br>Stock | Total        |
| Balances at December 31, 2019  | \$ 128,543                           | \$ 14,682,937                    | \$ (12,718,893)        | \$ (930,211)      | \$ 1,162,376 |
| Net loss                       | -                                    | -                                | (126,339)              | -                 | (126,339)    |
| Stock option compensation      | -                                    | 450                              | -                      | -                 | 450          |
| Balances at March 31, 2020     | 128,543                              | 14,683,387                       | (12,845,232)           | (930,211)         | 1,036,487    |
| Net loss                       | -                                    | -                                | (34,620)               | -                 | (34,620)     |
| Stock option compensation      | -                                    | 356                              | -                      | -                 | 356          |
| Balances at June 30, 2020      | 128,543                              | 14,683,743                       | (12,879,852)           | (930,211)         | 1,002,223    |
| Net income                     | -                                    | -                                | 214,703                | -                 | 214,703      |
| Stock option compensation      | -                                    | 6,365                            | -                      | -                 | 6,365        |
| Balances at September 30, 2020 | \$ 128,543                           | \$ 14,690,108                    | \$ (12,665,149)        | \$ (930,211)      | \$ 1,223,291 |

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

**INFORMATION ANALYSIS INCORPORATED**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Summary of Significant Accounting Policies**

**Organization and Business**

Information Analysis Incorporated (the “Company” or “IAI”), in conjunction with its subsidiary, is primarily serving the U.S. government as a technology integrator. IAI provides information technology (“IT”) services with a specialized set of capabilities. The Company has a long and successful history of over 40 years. IAI has served many branches of the federal civilian market (Department of Agriculture, Department of Education, Department of Homeland Security, Department of the Treasury, U.S. Small Business Administration), the Department of Defense (U.S. Army and Air Force), and several commercial clients. The Company has performed software development and conversion projects for over 100 commercial and government clients, including the most significant application database modernization undertaking to date by the U.S. Small Business Administration. The Company’s long-standing customer relationships and past performance enable it to apply its expertise to meet customers’ mission and provide unique capabilities to the market.

On April 7, 2021, IAI completed the acquisition of Tellenger, Inc. (“Tellenger”), which expands the Company’s capabilities in government priority areas of cyber security, cloud services, complex systems integrations, and data analytics. Tellenger expands and enhances IAI’s portfolio of capabilities through new technology-driven offerings and customers. The expanding customer base includes past and current performance in many branches of the federal civilian market (Department of Homeland Security, Department of Health and Human Services, Department of Commerce, United States Department of Agriculture, National Transportation Safety Administration, and Consumer Product Safety Commission), and the Department of Defense (U.S. Marine Corps). Tellenger advances integrated solid project management solutions with its well-defined metrics-based, Capability Maturity Model Integration/Development (CMMI/DEV) Level 3 independently appraised approach for managing projects (a/k/a Tellenger Integrated Quality [T-IQ]). A proven project management approach to support harnessing a first-class quality system that integrates Information Technology Infrastructure Library (ITIL), CMMI, and Project Management Institute (PMI) best practices. This approach is applied to projects in various customer environments and technology solutions.

**Unaudited Interim Condensed Consolidated Financial Statements**

The accompanying unaudited consolidated financial statements (“financial statements”) have been prepared in conformity with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions for Form 10-Q and Article 8-03 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). In the opinion of management, the financial statements include all adjustments necessary (which are of a normal and recurring nature) for the fair and not misleading presentation of the results of the interim periods presented. These unaudited interim condensed consolidated financial statements should be read in conjunction with the Company’s audited financial statements for the year ended December 31, 2020 included in the Annual Report on Form 10-K filed by the Company with the SEC on March 31, 2021 (the “Annual Report”), as amended. The accompanying December 31, 2020, balance sheet was derived from the audited financial statements included in the Annual Report. The results of operations for any interim periods are not necessarily indicative of the results of operations for any other interim period or for a full fiscal year.

The consolidated financial statements as of September 30, 2021 and for the nine month period ended September 30, 2021 include the accounts of the Company, including the accounts and results of operations of its wholly owned subsidiary, Tellenger, for the period from April 7, 2021 through September 30, 2021. All significant intercompany transactions and balances have been eliminated in consolidation.

The following policies were added to Note 1, “Summary of Significant Accounting Policies,” as a result of activity during the quarter ended June 30, 2021: Business Combinations and Intangibles and Goodwill. There have been no additional changes in the Company’s significant accounting policies as of September 30, 2021, as compared to the significant accounting policies disclosed in Note 1, “Summary of Significant Accounting Policies” in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2020, that was filed with the SEC on March 31, 2021.



**Use of Estimates and Assumptions**

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) requires management to make estimates and assumptions that affect certain reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results can, and in many cases will, differ from those estimates.

**Revenue Recognition**

See Note 2 for a detailed description of revenue recognition under Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* (Topic 606) (“ASU 2014-09”) and its related amendments (collectively known as “ASC 606”).

**Segment Reporting**

The Company has assessed its Tellenger subsidiary and has continued to conclude that it operates in one business segment, providing information technology products and services to modernize, secure, and increase functionality of client information systems.

**Cash and Cash Equivalents**

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

**Accounts Receivable**

Accounts receivable consist of trade accounts receivable and do not bear interest. The Company typically does not require collateral from its customers. The allowance for doubtful accounts is the Company’s best estimate of the amount of probable credit losses in the Company’s existing accounts receivable. The Company reviews its allowance for doubtful accounts monthly. Accounts with receivable balances past due over 90 days are reviewed individually for collectability. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The Company does not have any off-balance sheet credit exposure related to its customers. No allowance for doubtful accounts has been recorded at September 30, 2021 and December 31, 2020.

**Property and Equipment**

Property and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the assets. Furniture and fixtures are depreciated over the lesser of the useful life or five years, off-the-shelf software is depreciated over the lesser of three years or the term of the license, custom software is depreciated over the least of five years, the useful life, or the term of the license, and computer equipment is depreciated over three years. Leasehold improvements are amortized over the estimated 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 operations.

**Stock-Based Compensation**

At December 31, 2020, the Company had the stock-based compensation plans described in Note 6 below. Total compensation expense related to these plans was \$80,882 and \$6,365 for the three months ended September 30, 2021 and 2020, respectively, and \$220,455 and \$7,171 for the nine months ended September 30, 2021 and 2020, respectively. The Company estimates the fair value of options granted using a Black-Scholes valuation model to establish the expense. When stock-based compensation is awarded to employees, the expense is recognized ratably over the vesting period. When stock-based compensation is awarded to non-employees, the expense is recognized over the period of performance.

**Income Taxes**

Deferred tax assets and liabilities are computed based on the difference between the financial statement and tax basis of assets and liabilities and are measured by applying enacted tax rates and laws for the taxable years in which those differences are expected to reverse. In addition, a valuation allowance is required to be recognized if it is believed more likely than not that a deferred tax asset will not be fully realized. Authoritative guidance prescribes a recognition threshold of more likely than not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those positions to be recognized in the financial statements. The Company continually reviews tax laws, regulations and related guidance in order to properly record any uncertain tax liabilities.

The Company has analyzed its income tax positions using the criteria required by GAAP and concluded that as of September 30, 2021, and December 31, 2020, it has no material uncertain tax positions and no interest or penalties have been accrued. The Company has net operating loss carryforwards of approximately \$2.7 million, none of which will expire, if unused, on December 31, 2021. The net operating loss carryforwards are offset by a full valuation allowance.

**Income (Loss) Per Share**

The Company's income (loss) per share calculations are based upon the weighted average number of shares of common stock outstanding. The dilutive effect of stock options, warrants, and other equity instruments are included for purposes of calculating diluted income per share, except for periods when the Company reports a net loss, in which case the inclusion of such equity instruments would be antidilutive. See Note 10 for more details.

**Business Combinations**

The Company applies the guidance of Accounting Standards Codification ("ASC") Topic 805, *Business Combinations*. The Company recognizes the fair value of assets acquired and liabilities assumed in transactions; establishes the acquisition date fair value as the measurement objective for all assets acquired and liabilities assumed; expenses transaction and restructuring costs; and discloses the information needed to evaluate and understand the nature and financial effect of the business combination. See Note 5 for more details.

**Intangibles and Goodwill**

The Company accounts for goodwill and other intangible assets in accordance with ASC Topic 350, *Goodwill – Intangibles and Other* ("ASC 350"). Goodwill and intangible assets with indefinite useful lives are not amortized but are instead tested for impairment (i) on at least an annual basis and (ii) when changes in circumstances indicate that the fair value of goodwill may be below its carrying value. These circumstances include, but are not limited to, (i) a significant adverse change in the business climate, (ii) unanticipated competition or (iii) an adverse action or assessment by a regulator. The Company performs its annual impairment testing as of October 31. Determining impairment involves estimating the fair value of a reporting unit using a combination of (i) the income or discounted cash flows approach and (ii) the market approach that utilizes comparable companies' data. If the carrying amount of a reporting unit exceeds its fair value, the amount of the impairment loss must be measured. The impairment loss is calculated by comparing the implied fair value of the reporting unit's goodwill to its carrying amount. In calculating the implied fair value of the reporting unit's goodwill, the fair value of the reporting unit is allocated to all of the assets and liabilities of the reporting unit. The excess of the fair value of a reporting unit over the amount assigned to its other assets and liabilities is the implied value of goodwill. See Note 5 for more details.

**COVID-19**

The COVID-19 (coronavirus) outbreak has had a notable impact on general economic conditions, including, but not limited to, the temporary closures of many businesses, “shelter in place” and other governmental regulations, and “work from home” directives. There are many unknowns, and many regional inconsistencies. Notable potential effects on the Company include U.S. government procurements may be delayed or cancelled, work on new or existing contracts that require personal interactions may be suspended, payment processing for customer invoices may be delayed, employees and customers or their families may become infected, and personal business development meetings may not be able to take place. The Company continues to monitor the impact of the COVID-19 outbreak closely.

To date, the COVID-19 impact on the Company’s existing business has been minimal. The Company had previously implemented the necessary infrastructure for its employees to work remotely, so it did not experience material issues supporting its customers. The Company rapidly adapted to the challenges presented to its administration, including challenges to management, accounting, and information technology infrastructure. The extent to which business development efforts have been hampered by the inability to meet with potential customers in person is indeterminable. The full extent to which the COVID-19 outbreak will impact the Company’s business, results of operations, financial condition, and cash flows over time is uncertain.

**2. Revenue from Contracts with Customers**

Revenue is recognized when all of the following steps have been taken and criteria met for each contract:

- **Identification of the contract, or contracts, with a customer** - A contract with a customer exists when (i) the Company enters into an enforceable contract with a customer that defines each party’s rights regarding the goods or services to be transferred and identifies the payment terms related to these goods or services, (ii) the contract has commercial substance and the parties are committed to perform and, (iii) it determines that collection of substantially all consideration to which the Company will be entitled in exchange for goods or services that will be transferred is probable based on the customer’s intent and ability to pay the promised consideration.
- **Identification of the performance obligations in the contract** - Performance obligations promised in a contract are identified based on the goods or services that will be transferred to the customer that are both capable of being distinct, whereby the customer can benefit from the goods or service either on its own or together with other resources that are readily available from third parties or from the Company, and are distinct in the context of the contract, whereby the transfer of the goods or services is separately identifiable from other promises in the contract. To the extent a contract includes multiple promised goods or services, the Company applies judgment to determine whether promised goods or services are capable of being distinct in the context of the contract. If these criteria are not met, the promised goods or services are accounted for as a combined performance obligation.
- **Determination of the transaction price** - The transaction price is determined based on the consideration to which the Company will be entitled in exchange for transferring goods or services to the customer adjusted for estimated variable consideration, if any. The Company typically estimates the transaction price impact of discounts offered to the customers for early payments on receivables or rebates based on sales target achievements. Constraints are applied when estimating variable considerations based on historical experience where applicable.
- **Allocation of the transaction price to the performance obligations in the contract** - If the contract contains a single performance obligation, the entire transaction price is allocated to the single performance obligation. Contracts that contain multiple performance obligations require an allocation of the transaction price to each performance obligation based on a relative standalone selling price basis. The Company determines standalone selling price by taking into account available information such as historical selling prices of the performance obligation, geographic location, overall strategic pricing objective, market conditions and internally approved pricing guidelines related to the performance obligations.
- **Recognition of revenue when, or as, the Company satisfies performance obligations** - The Company satisfies performance obligations either over time or at a point in time as discussed in further detail below. Revenue is recognized at or over the time the related performance obligation is satisfied by transferring a promised good or service to a customer.

**Nature of Products and Services**

The Company generates revenue from the sales of information technology professional services, sales of third-party software licenses and implementation and training services, sales of third-party support and maintenance contracts based on those software products, and incentive payments received from third-party software suppliers for facilitating sales directly between that supplier and a customer introduced by the Company. The Company sells through its direct relationships with end customers and under subcontractor arrangements.

Professional services are offered through several arrangements – through time and materials arrangements, fixed-price-per-unit arrangements, fixed-price arrangements, or combinations of these arrangements within individual contracts. Revenue under time and materials arrangements is recognized over time in the period the hours are worked, or the expenses are incurred, as control of the benefits of the work is deemed to have passed to the customer as the work is performed. Revenue under fixed-price-per-unit arrangements is recognized at a point in time when delivery of units have occurred, and units are accepted by the customer or are reasonably expected to be accepted. Generally, revenue under fixed-price arrangements and mixed arrangements is recognized either over time or at a point in time based on the allocation of transaction pricing to each identified performance obligation as control of each is transferred to the customer. For the periods reported herein, the majority of revenue recognized under fixed price and mixed arrangements occurred over time, and the amounts resulting from additional disaggregation would be immaterial. For fixed-price arrangements for which the Company is paid a fixed fee to make itself available to support a customer, with no predetermined deliverables to which transaction prices can be estimated or allocated, revenue is recognized ratably over time.

Third-party software licenses are classified as enterprise server-based software licenses or desktop software licenses, and desktop licenses are further classified by the type of customer and whether the licenses are bulk licenses or individual licenses. The Company's obligations as the seller for each class differ based on its reseller agreements and whether its customers are government or non-government customers. Revenue from enterprise server-based sales to either government or non-government customers is usually recognized in full at a point in time based on when the customer gains use of the full benefit of the licenses, after the licenses are implemented. If the transaction prices of the performance obligations related to implementation and customer support for the individual contract is material, these obligations are recognized separately over time, as performed. Revenue for desktop software licenses for government customers and for non-government customers is usually recognized on a gross basis at a point in time, based on when the customer's administrative contact gains training in and beneficial use of the administrative portal. For desktop software licenses sold on an individual license basis to non-government customers, where the Company has no obligation to the customer after the third-party makes delivery of the licenses, the Company has determined it is acting as an agent, and the Company recognizes revenue upon delivery of the licenses only for the net of the selling price and its contract costs.

Third-party support and maintenance contracts for enterprise server-based software include a performance obligation under the Company's reseller agreements for it to be the first line of support (direct support) and second line of support (intermediary between customer and manufacturer) to the customer. Because of the support performance obligations, and because the amount of support is not estimable, the Company recognizes revenue ratably over time as it makes itself available to provide the support.

Incentive payments are received under reseller agreements with software manufacturers and suppliers where the Company introduces and courts a customer, but the sale occurs directly between the customer and the supplier or between the customer and the manufacturer. Since the transfer of control of the licenses cannot be measured from outside of these transactions, revenue is recognized when payment from the manufacturer or supplier is received.

Disaggregation of Revenue from Contracts with Customers

| Contract Type                  | Three Months Ended  |         |                     |         | Nine Months Ended    |         |                      |         |
|--------------------------------|---------------------|---------|---------------------|---------|----------------------|---------|----------------------|---------|
|                                | September 30, 2021  |         | September 30, 2020  |         | September 30, 2021   |         | September 30, 2020   |         |
|                                | Amount              | Percent | Amount              | Percent | Amount               | Percent | Amount               | Percent |
| Services Time & Materials      | \$ 2,705,099        | 62.9%   | \$ 1,403,270        | 35.8%   | \$ 7,519,190         | 60.4%   | \$ 2,724,653         | 25.2%   |
| Services Fixed Price           | 19,175              | 0.5%    | 27,150              | 0.7%    | 452,726              | 3.6%    | 177,705              | 1.7%    |
| Services Combination           | 47,060              | 1.1%    | 133,914             | 3.4%    | 506,331              | 4.1%    | 382,860              | 3.5%    |
| Services Fixed Price per Unit  | 26,771              | 0.6%    | 16,350              | 0.4%    | 87,391               | 0.7%    | 68,290               | 0.6%    |
| Third-Party Software           | 1,445,757           | 33.6%   | 2,248,574           | 57.4%   | 3,683,967            | 29.6%   | 6,859,994            | 63.5%   |
| Software Support & Maintenance | 48,421              | 1.1%    | 56,290              | 1.4%    | 150,696              | 1.2%    | 531,983              | 4.9%    |
| Incentive Payments             | 7,642               | 0.2%    | 37,198              | 0.9%    | 51,166               | 0.4%    | 58,412               | 0.6%    |
| <b>Total Revenue</b>           | <b>\$ 4,299,925</b> |         | <b>\$ 3,922,746</b> |         | <b>\$ 12,451,467</b> |         | <b>\$ 10,803,897</b> |         |

Contract Balances*Accounts Receivable*

Trade accounts receivable are recorded at the billable amount where the Company has the unconditional right to bill, net of allowances for doubtful accounts. The allowance for doubtful accounts is based on the Company's assessment of the collectability of accounts. Management regularly reviews the adequacy of the allowance for doubtful accounts by considering the age of each outstanding invoice, each customer's expected ability to pay and collection history, when applicable, to determine whether a specific allowance is appropriate. Accounts receivable deemed uncollectible are charged against the allowance for doubtful accounts when identified. There were no such allowances recognized at September 30, 2021, and December 31, 2020.

*Contract Assets*

Contract assets consist of assets resulting when revenue recognized exceeds the amount billed or billable to the customer due to allocation of transaction price, and of amounts withheld from payment of invoices as a financing component of a contract. Changes in contract assets balances in the three months and nine months ended September 30, 2021 and 2020, are as follows:

**Contract Assets**

|                               |            |
|-------------------------------|------------|
| Balance at December 31, 2020  | \$ 210,688 |
| Contract assets added         | 131,923    |
| Balance at March 31, 2021     | 342,611    |
| Contract assets added         | 134,657    |
| Balance at June 30, 2021      | 477,268    |
| Contract assets added         | 45,895     |
| Reduction in contract assets  | (523,163)  |
| Balance at September 30, 2021 | \$ -       |
| Balance at December 31, 2019  | \$ -       |
| Balance at March 31, 2020     | -          |
| Contract assets added         | 13,918     |
| Balance at June 30, 2020      | 13,918     |
| Contract assets added         | 75,486     |
| Balance at September 30, 2020 | \$ 89,404  |

The contract asset balance was reduced to zero as of September 30, 2021 because the amounts withheld from payment of invoices as a financing component of a subcontract became fully due and billable as the prime contractor met a specific deliverable.

*Contract Liabilities*

Contract liabilities consist of amounts that have been invoiced and for which the Company has the right to bill, but that havenot been recognized as revenue because the related goods or services have not been transferred. Changes in contracts liabilities balances in the three months and nine months ended September 30, 2021 and 2020, are as follows:

| <b>Contract Liabilities</b>   |                   |
|-------------------------------|-------------------|
| Balance at December 31, 2020  | \$ 946,884        |
| Contract liabilities added    | 93,934            |
| Revenue recognized            | <u>(585,322)</u>  |
| Balance at March 31, 2021     | 455,496           |
| Contract liabilities added    | 4,815             |
| Revenue recognized            | <u>(354,427)</u>  |
| Balance at June 30, 2021      | 105,884           |
| Contract liabilities added    | 79,640            |
| Revenue recognized            | <u>(107,479)</u>  |
| Balance at September 30, 2021 | <u>\$ 78,045</u>  |
|                               |                   |
| Balance at December 31, 2019  | \$ 464,223        |
| Contract liabilities added    | 19,136            |
| Revenue recognized            | <u>(212,568)</u>  |
| Balance at March 31, 2020     | 270,791           |
| Contract liabilities added    | 9,906             |
| Revenue recognized            | <u>(216,353)</u>  |
| Balance at June 30, 2020      | 64,344            |
| Contract liabilities added    | 480,024           |
| Revenue recognized            | <u>(212,719)</u>  |
| Balance at September 30, 2020 | <u>\$ 331,649</u> |

Revenues recognized during the nine months ended September 30, 2021, and 2020, from the balances at December 31, 2020 and 2019, were \$946,884 and \$464,223, respectively.

*Costs to Obtain or Fulfill a Contract*

When applicable, the Company recognizes an asset related to the costs incurred to obtain a contract only if it expects to recover those costs and it would not have incurred those costs if the contract had not been obtained. The Company recognizes an asset from the costs incurred to fulfill a contract if the costs (i) are specifically identifiable to a contract, (ii) enhance resources that will be used in satisfying performance obligations in future and (iii) are expected to be recovered. There were no such assets at September 30, 2021, and December 31, 2020. When incurred, these costs are amortized ratably over the periods of the contracts to which those costs apply.

*Financing Components*

In instances where the timing of revenue recognition differs from the timing of invoicing, the Company has determined that one of its subcontracts to a prime contractor includes a significant financing component. The subcontract is invoiced on a time and materials basis, under which 90% of each invoice amount had been paid under regular terms, and the 10% payment balance of each invoice was deferred until the prime contractor met a specific deliverable under its prime contract. The primary purpose of this arrangement was to assist the prime contractor in meeting all of its financial obligations until it could realize the financial benefit of meeting the deliverable. The Company estimated its interest rate of 4.5% based on a small premium over the rate of its revolving line of credit as of the measurement date. The deliverable was met on August 31, 2021, ahead of the original schedule.

*Deferred Costs of Revenue*

Deferred costs of revenue consist of the costs of third-party support and maintenance contracts for enterprise server-based software. These costs are reported under the prepaid expenses and other current assets caption on the Company's balance sheets. The Company recognizes these direct costs ratably over time as it makes itself available to provide its performance obligation for software support, commensurate with its recognition of revenue. Changes in deferred costs of revenue balances in the three months and nine months ended September 30, 2021, and 2020, are as follows:

**Deferred Costs of Revenue**

|                               |    |                  |
|-------------------------------|----|------------------|
| Balance at December 31, 2020  | \$ | 89,068           |
| Deferred costs added          |    | 17,406           |
| Deferred costs expensed       |    | <u>(75,223)</u>  |
| Balance at March 31, 2021     |    | 31,251           |
| Deferred costs added          |    | 11,188           |
| Deferred costs expensed       |    | <u>(16,681)</u>  |
| Balance at June 30, 2021      |    | 25,758           |
| Deferred costs added          |    | 194,686          |
| Deferred costs expensed       |    | <u>(33,118)</u>  |
| Balance at September 30, 2021 | \$ | <u>187,326</u>   |
|                               |    |                  |
| Balance at December 31, 2019  | \$ | 453,607          |
| Deferred costs added          |    | 181              |
| Deferred costs expensed       |    | <u>(207,437)</u> |
| Balance at March 31, 2020     |    | 246,351          |
| Deferred costs added          |    | 2,472            |
| Deferred costs expensed       |    | <u>(192,548)</u> |
| Balance at June 30, 2020      |    | 56,275           |
| Deferred costs added          |    | -                |
| Deferred costs expensed       |    | <u>(54,477)</u>  |
| Balance at September 30, 2020 | \$ | <u>1,798</u>     |

**3. Leases**

The Company has a primary operating lease which is a real estate lease for its headquarters in Fairfax, Virginia. This lease has a fixed lease term of 66 months and commenced July 1, 2021. The Company determines if an arrangement is a lease at inception. Operating leases are included in right-of-use operating lease assets and operating lease liabilities in the Company's balance sheets as of September 30, 2021, and December 31, 2020. As of September 30, 2021, and December 31, 2020, the Company does not have any sales-type or direct financing leases.

The Company's primary operating lease asset represents its right to use an underlying asset for the lease term and lease liabilities represent its obligation to make lease payments arising from the lease. Operating lease assets and liabilities are recognized at the commencement date based on the present value of lease payments over the lease term. Since the lease does not provide an implicit rate, the Company uses its incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. The operating lease asset also includes any lease payments made and excludes lease incentives. Lease expense for lease payments is recognized on a straight-line basis over the lease term. The Company's lease agreement includes rental payments escalating annually for inflation at a fixed rate. These payments are included in the initial measurement of the operating lease liability and operating lease asset. The Company does not have any rental payments which are based on a change in an index or a rate that can be considered variable lease payments, which would be expensed as incurred.

The Company also has an operating lease which is a real estate lease for its Tellenger subsidiary. The original term of the lease expired, and it continues on a month-to-month basis at a fixed rate of \$900 per month. Neither a lease asset nor a lease liability is recognized for this lease.

The Company's lease agreements do not contain any material residual value guarantees or material restrictions or covenants.

The Company does not sublease any real estate to third parties.

The following table provides supplemental balance sheet information related to the Company's operating lease:

| Balance Sheet<br>Classification         | As of<br>September 30,<br>2021 | As of<br>December 31,<br>2020 |
|---|--------------------------------|-------------------------------|
| <b>Assets:</b>                          |                                |                               |
| Right-to-use operating lease asset      | \$ 285,667                     | \$ 51,405                     |
| <b>Liabilities:</b>                     |                                |                               |
| Operating lease liability - current     | \$ 35,805                      | \$ 45,595                     |
| Operating lease liability - non-current | 260,141                        | -                             |
| Total lease liabilities                 | <u>\$ 295,946</u>              | <u>\$ 45,595</u>              |

The following table reconciles the undiscounted cash flows to the operating lease liabilities recorded in the Company's consolidated balance sheet:

|                                    | As of<br>September 30,<br>2021 |
|------------------------------------|--------------------------------|
| Remainder of 2021                  | \$ -                           |
| 2022                               | 69,334                         |
| 2023                               | 71,210                         |
| 2024                               | 54,699                         |
| 2025                               | 75,111                         |
| 2026                               | 51,327                         |
| Total lease payments               | 321,681                        |
| Less: discount                     | (25,735)                       |
| Present value of lease liabilities | <u>\$ 295,946</u>              |

As of September 30, 2021, the Company's primary operating lease had a lease term of 66 months. The discount rate of the lease is equal to IAI's estimated incremental borrowing rate at the measurement date of the lease agreement. The weighted average discount rate of the Company's operating lease is approximately 5.5%. For the three months ended September 30, 2021, and 2020, the Company incurred \$15,985 and \$26,122 of expense related to its operating leases, and for the nine months ended September 30, 2021 and 2020, the Company incurred \$68,229 and \$78,365 of expense related to its operating leases.

#### 4. Accounts Receivable

Accounts receivable at September 30, 2021 and December 31, 2020, consist of the following:

|                           | September 30,<br>2021 | December 31,<br>2020 |
|---------------------------|-----------------------|----------------------|
| Billed federal government | \$ 2,832,906          | \$ 1,425,217         |
| Unbilled receivables      | 41,750                | 17,014               |
| Accounts receivable       | <u>\$ 2,874,656</u>   | <u>\$ 1,442,231</u>  |

Billed receivables from the federal government include amounts due from both prime contracts and subcontracts where the federal government is the end customer.

#### 5. Acquisition

On April 7, 2021, the Company executed and closed a stock purchase agreement to purchase all of the issued and outstanding shares of stock of Tellenger, Inc. The adjusted purchase price was approximately \$2.3 million in cash and 68,264 unregistered shares of the Company's stock, valued at \$200,000. Legal fees and other costs specifically related to the Tellenger acquisition in the amounts of \$18,575 and \$171,860 were incurred during the three-month and nine-month periods ended September 30, 2021, respectively, and were classified as acquisition costs in the Company's consolidated statement of operations. The Company also incurred other acquisition types of costs unrelated to Tellenger. Included in the cash consideration is \$272,000 in amounts held in escrow at Citizens Bank, N.A. Institutional Services Group (as escrow agent) to satisfy any potential post-closing claims.

Tellenger is primarily engaged in the businesses of cyber security, cloud services, and data analytics services. Tellenger has access to a range of federal government contract vehicles and subcontracts under federal government agencies which include the Department of Homeland Security, the U.S. Department of Agriculture, the Department of Health and Human Services, the U.S. Marine Corps, and the U.S. Census Bureau, among others. Tellenger also performs cloud services for several national not-for-profits. Tellenger's processes are appraised at CMMI Level3, providing assurance to customers of consistency and quality in their efforts.

Following the April 7, 2021, Tellenger acquisition, the Company engaged an independent valuation firm to aid in the application of ASC805 inclusive of the initial measurement of any intangible assets acquired by the Company. The Company's intangible assets subject to amortization consist of acquired customer relationships and non-compete agreements. The Company amortizes intangible assets over their respective estimate useful lives. Identifiable intangible assets that are subject to amortization are evaluated for impairment and the Company will periodically reassess the carrying value, useful lives, and classifications of all identifiable intangible assets.

The purchase price allocation has been prepared on a preliminary basis and changes to the preliminary purchase price allocations may occur as additional information concerning asset and liability valuations is finalized. Under the acquisition method of accounting, the total consideration was first allocated to net tangible assets and identifiable intangible assets based upon their fair values as of the date of completion of the acquisition. As a result of the acquisition, the Company recorded net tangible assets of \$240,357, and intangible assets in the form of \$1,090,000 for customer relationships with an amortizable useful life of eight years, \$280,000 for



Tellenger's trade name / trademarks with an indefinite life, and \$120,000 for executed non-compete agreements with a useful life of three years. In accordance with ASC 350, the excess of the total consideration over the fair values of the net tangible and intangible assets of \$785,000 was recorded as goodwill on the transaction.

The components of the Company's identifiable intangible assets are as follows:

|  | <b>September 30, 2021</b> |                              |
|--|---------------------------|------------------------------|
|  | Useful<br>Lives (years)   | Gross<br>Carrying<br>Amounts |
| <b>Intangible assets with estimated useful lives</b> |                           |                              |
| Customer relationships                               | 8                         | \$ 1,090,000                 |
| Non-compete agreements                               | 3                         | 120,000                      |
| <b>Intangible assets with indefinite lives</b>       |                           |                              |
| Trade names  |                           | 280,000                      |
| <b>Gross identified intangible assets</b>            |                           | 1,490,000                    |
| <b>Accumulated amortization</b>                      |                           | (87,912)                     |
| <b>Net identifiable intangible assets</b>            |                           | 1,402,088                    |
| Goodwill   |                           | 785,000                      |
| <b>Intangible assets</b>                             |                           | <u>\$ 2,187,088</u>          |

Amortization expense related to the amortizable intangible assets was \$44,061 and \$87,912 for the three months and nine months ended September 30, 2021, respectively. Amortization expense for the remaining three months of 2021 and the five years after 2021 is estimated to be:

|                   |    |                  |
|-------------------|----|------------------|
| Remainder of 2021 | \$ | 44,061           |
| 2022              |    | 176,244          |
| 2023              |    | 176,244          |
| 2024              |    | 146,259          |
| 2025              |    | 136,248          |
| 2026              |    | 136,248          |
| Thereafter        |    | 306,784          |
| Total             | \$ | <u>1,122,088</u> |

#### Supplemental Pro Forma Information

The following unaudited pro forma financial information presents combined results of operations for the periods presented as if the acquisition of Tellenger had been completed on January 1, 2020. The pro forma information includes adjustments to amortization expense for the intangible assets acquired and interest expense for the additional debt used to partially fund the acquisition price.

The pro forma data are for informational purposes only and are not necessarily indicative of the consolidated results of operations of the combined business had the acquisition of Tellenger occurred on January 1, 2020, or the results of future operations of the combined business. For instance, planned or expected operational synergies following the acquisition are not reflected in the pro forma information. Consequently, actual results will differ from the unaudited pro forma information presented below.

|                               | Three Months Ended September 30, |              | Nine Months Ended September 30, |               |
|-------------------------------|----------------------------------|--------------|---------------------------------|---------------|
|                               | 2021                             | 2020         | 2021                            | 2020          |
| Revenue                       | \$ 4,299,925                     | \$ 5,061,260 | \$ 13,677,430                   | \$ 14,058,930 |
| Income (loss) from operations | \$ (84,267)                      | \$ 252,947   | \$ 291,508                      | \$ (9,425)    |

## 6. Stock-Based Compensation

The Company has two shareholder-approved stock-based compensation plans. The 2006 Stock Incentive Plan was adopted in 2006 ("2006 Plan") and had options granted under it through April 12, 2016. On June 1, 2016, the shareholders ratified the IAI 2016 Stock Incentive Plan ("2016 Plan"), which had been approved by the Board of Directors on April 4, 2016.

The Company recognizes compensation costs only for those shares expected to vest on a straight-line basis over the requisite service period of the awards. Such options generally vest over periods of six months to two years. Fair values of option awards granted in the three months and nine months ended September 30, 2021 and 2020, were estimated using the Black-Scholes option pricing model under the following assumptions:

|                          | Three Months Ended September 30, |       | Nine Months Ended September 30, |   |       |       |   |       |
|--------------------------|----------------------------------|-------|---------------------------------|---|-------|-------|---|-------|
|                          | 2021                             | 2020  | 2021                            |   | 2020  |       |   |       |
| Risk-free interest rate  | 0.84%                            | 0.26% | 0.46%                           | - | 0.92% | 0.26% | - | 0.33% |
| Dividend yield           | 0%                               | 0%    | 0%                              |   |       | 0%    |   |       |
| Expected term (in years) | 5                                | 5%    | 5                               |   |       | 5     |   |       |
| Expected volatility      | 46.8%                            | 69.6% | 47.1%                           | - | 92.6% | 65.8% | - | 69.6% |

Given the limited public market for the Company's stock, the Company has elected to estimate its expected volatility by benchmarking its volatility against the calculated volatility of several public company issuers that operate within its market segment. The first issuance for which this benchmarking was applied was effective with options granted on March 31, 2021.

#### 2016 Stock Incentive Plan

The 2016 Plan became effective June 1, 2016 and expires April 4, 2026. The 2016 Plan provides for the granting of equity awards to key employees, including officers and directors. The maximum number of shares for which equity awards may be granted under the 2016 Plan is 1,000,000. Options under the 2016 Plan expire no later than ten years from the date of grant or within prescribed periods following cessation of employment, whichever comes first, and vest over periods determined by the Board of Directors. The minimum exercise price of each option is the quoted market price of the Company's stock on the date of grant. At September 30, 2021, there were unexpired options for 853,500 shares issued under the 2016 Plan, of which 556,000 were exercisable.

## 2006 Stock Incentive Plan

The 2006 Plan became effective May 18, 2006, and expired April 12, 2016. The 2006 Plan provides for the granting of equity awards to key employees, including officers and directors. Options under the 2006 Plan were generally granted at-the-money or above, expire no later than ten years from the date of grant or within three months of within prescribed periods following cessation of employment, whichever comes first, and vest over periods determined by the Board of Directors. The number of shares subject to options available for issuance under the 2006 Plan could not exceed 1,950,000. There were 374,000 unexpired options remaining from the 2006 Plan at September 30, 2021, all of which were exercisable.

The status of the options issued under the foregoing option plans as of September 30, 2021 and 2020, and changes during the three months and nine months ended September 30, 2021 and 2020, were as follows:

| <b>Options outstanding</b>        |                  |  |  |  |
|-----------------------------------|------------------|--|--|--|
| <b>Incentive Options</b>          | <b>Shares</b>    | <b>Weighted average<br/>exercise price<br/>per share</b> | <b>Weighted average<br/>remaining<br/>contractual term</b> | <b>Aggregate<br/>intrinsic<br/>value</b> |
| Outstanding at December 31, 2020  | 1,395,000        | \$ 0.31  |  |  |
| Options granted                   | 145,000          | 2.62   |  |  |
| Options exercised                 | (25,000)         | 0.14   |  |  |
| Options expired                   | -                | -  |  |  |
| Options forfeited                 | -                | -  |  |  |
| Outstanding at March 31, 2021     | 1,515,000        | \$ 0.53  |  |  |
| Options granted                   | 127,500          | 2.85   |  |  |
| Options exercised                 | (360,000)        | 0.22   |  |  |
| Options expired                   | (20,000)         | 0.17   |  |  |
| Options forfeited                 | -                | -  |  |  |
| Outstanding at June 30, 2021      | 1,262,500        | \$ 0.86  |  |  |
| Options granted                   | 30,000           | 2.80   |  |  |
| Options exercised                 | (65,000)         | 0.18   |  |  |
| Options expired                   | -                | -  |  |  |
| Options forfeited                 | -                | -  |  |  |
| Outstanding at September 30, 2021 | <u>1,227,500</u> | <u>\$ 0.94</u>   | <u>5 years, 1 month</u>                                    | <u>\$ 2,450,068</u>                      |
| Exercisable at September 30, 2021 | <u>930,000</u>   | <u>\$ 0.44</u>   | <u>4 years, 5 months</u>                                   | <u>\$ 2,326,943</u>                      |
| Outstanding at December 31, 2019  | 1,349,000        | \$ 0.23  |  |  |
| Options granted                   | -                | -  |  |  |
| Options exercised                 | -                | -  |  |  |
| Options expired                   | (129,000)        | 0.17   |  |  |
| Options forfeited                 | -                | -  |  |  |
| Outstanding at March 31, 2020     | 1,220,000        | 0.24   |  |  |
| Options granted                   | 10,000           | 0.15   |  |  |
| Options exercised                 | -                | -  |  |  |
| Options expired                   | (10,000)         | 0.19   |  |  |
| Options forfeited                 | -                | -  |  |  |
| Outstanding at June 30, 2020      | 1,220,000        | 0.24   |  |  |
| Options granted                   | 210,000          | 0.66   |  |  |
| Options exercised                 | -                | -  |  |  |
| Options expired                   | -                | -  |  |  |
| Options forfeited                 | -                | -  |  |  |
| Outstanding at September 30, 2020 | <u>1,430,000</u> | <u>\$ 0.30</u>   | <u>4 years, 5 months</u>                                   | <u>\$ 487,773</u>                        |
| Exercisable at September 30, 2020 | <u>1,208,500</u> | <u>\$ 0.24</u>   | <u>3 years, 5 months</u>                                   | <u>\$ 482,268</u>                        |

There were 30,000 options and 210,000 options granted during the three months ended September 30, 2021, and 2020, respectively, and there were 302,500 options and 220,000 options granted during the nine months ended September 30, 2021 and 2020, respectively. There were 65,000 options and no options exercised during the three months ended September 30, 2021, and 2020, respectively, and there were 450,000 options and no options exercised during the nine months ended September 30, 2021, and 2020, respectively. As of September 30, 2021, there was \$163,847 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the stock incentive plans; that cost is expected to be recognized over a weighted-average period of seven months.

Total compensation expense related to these plans was \$80,882 and \$6,365 for the three months ended September 30, 2021, and 2020, respectively, and \$220,455 and \$7,171 for the nine months ended September 30, 2021, and 2020, respectively.

Nonvested option awards as of September 30, 2021, and 2020, and changes during the three months and nine months ended September 30, 2021 and 2020, were as follows:

|                                 | Nonvested      |  |
|---------------------------------|----------------|--|
|                                 | Shares         | Weighted average<br>grant date<br>fair value |
| Nonvested at December 31, 2020  | 235,000        | \$ 0.36                                      |
| Granted                         | 145,000        | 1.22   |
| Vested                          | -              | -  |
| Forfeited                       | -              | -  |
| Nonvested at March 31, 2021     | 380,000        | \$ 0.94                                      |
| Granted                         | 127,500        | 1.19   |
| Vested                          | (25,000)       | 1.01   |
| Forfeited                       | -              | -  |
| Nonvested at June 30, 2021      | 482,500        | \$ 0.81                                      |
| Granted                         | 30,000         | 1.15   |
| Vested                          | (215,000)      | 0.41   |
| Forfeited                       | -              | -  |
| Nonvested at September 30, 2021 | <u>297,500</u> | <u>\$ 1.13</u>                               |
| Nonvested at December 31, 2019  | 23,500         | \$ 0.17                                      |
| Granted                         | -              | -  |
| Vested                          | (5,000)        | 0.21   |
| Forfeited                       | -              | -  |
| Nonvested at March 31, 2020     | 18,500         | \$ 0.15                                      |
| Granted                         | 10,000         | 0.08   |
| Vested                          | (15,500)       | 0.16   |
| Forfeited                       | -              | -  |
| Nonvested at June 30, 2020      | 13,000         | \$ 0.09                                      |
| Granted                         | 210,000        | 0.37   |
| Vested                          | (1,500)        | 0.12   |
| Forfeited                       | -              | -  |
| Nonvested at September 30, 2020 | <u>221,500</u> | <u>\$ 0.36</u>                               |

## 7. Revolving Line of Credit

At September 30, 2021, the Company had a revolving line of credit with Summit Community Bank ("Summit") providing for on-demand or short-term borrowings of up to \$1,000,000, subject to a borrowing base calculated using outstanding accounts receivable, in which the bank has a collateral interest. The line expires on April 16, 2022. As of September 30, 2021, \$402,306 was outstanding under this line of credit at a variable interest rate of 3.25% (Wall Street Journal prime plus 0% with a floor of 3.25%), and there was no outstanding balance at December 31, 2020.

The Company previously had a revolving line of credit with another bank ("prior LOC") providing for demand or short-term borrowings of up to \$1,000,000. The prior LOC originally was due to expire on July 31, 2021. The new Summit line of credit was used to pay off the prior LOC and it was closed on May 3, 2021.

## 8. Notes Payable

Due to the coronavirus uncertainty and staffing and payroll cuts that were being considered in early 2020 due to liquidity constraints, the Company applied for a Paycheck Protection Program loan, guaranteed by the SBA. The Company was funded by its lender on April 20, 2020, in the amount of \$450,000. The loan accrues interest at a fixed rate of 1% and has a term of two years. The first payment is deferred until the date the SBA remits the Company's loan forgiveness amount to the lender, though interest accrues during the deferral period. The loan has been used exclusively to support maintaining employee payroll and benefits. The Company began making principal and interest payments in August 2021 while also continuing to pursue its application for loan forgiveness. On October 6, 2021, the Company was notified that its lender had approved the full amount of \$450,000 for forgiveness, and the forgiveness package had been submitted to the SBA for final approval. The SBA may take up to 90 days to complete their review of the submission. The Company expects its application for loan forgiveness to be resolved during the fourth quarter of 2021.

In conjunction with the Tellenger acquisition, on April 16, 2021, the Company and Tellenger jointly procured a \$1 million term loan ("Term Loan") with Summit Community Bank to assist with post-acquisition cash flow and integration costs. The loan is payable in monthly installments consisting of a fixed principal amount plus accrued interest over the course of two years at a fixed interest rate of 4.89%. The loan is collateralized by a security interest in substantially all the assets of both companies.

To provide additional net working capital support, the Company borrowed \$150,000 from the sellers of Tellenger for a period of 90 days from the closing date of April 7, 2021, without interest accumulation. The sellers were repaid in July 2021.

The following table represents note payable balances at September 30, 2021 and December 31, 2020:

|           | September 30,<br>2021 | December 30,<br>2020 |
|-----------|-----------------------|----------------------|
| PPP loan  | \$ 406,484            | \$ 450,000           |
| Term loan | 791,667               | -                    |

|                      |            |            |
|----------------------|------------|------------|
| Total                | 1,198,151  | 450,000    |
| Less current portion | (797,295)  | (93,009)   |
| Non-current portion  | \$ 400,856 | \$ 356,991 |

|                   | Notes Payable Payment Schedule |            |              |
|-------------------|--------------------------------|------------|--------------|
|                   | Term Loan                      | PPP Loan   | Total        |
| Remainder of 2021 | \$ 125,000                     | \$ 74,045  | \$ 199,045   |
| 2022              | 500,000                        | 298,039    | 798,039      |
| 2023              | 166,667                        | 34,400     | 201,067      |
| Total payments    | \$ 791,667                     | \$ 406,484 | \$ 1,198,151 |

## 9. Private Placement

On August 26, 2021, the Company completed a private offering of 1,400,000 units at a price of \$2.00 per unit, each unit consisting of one share of common stock and one warrant exercisable at \$3.00 for one share of common stock. No commissions were payable in connection with this offering. The warrants expire on August 31, 2026. 1,400,000 shares of common stock issuable upon exercise of warrants in connection with the offering have been reserved for issuance. The net proceeds of the transaction of \$2,800,000 will be used for general corporate purposes.

The shares are unregistered and are subject to a six-month holding period under SEC Rule 144 before the securities can be sold in the public market. The warrants are also exercisable for unregistered shares and are freely transferable after six months from their issuance. The shares underlying the warrants must be held for a period of at least six months if exercised for cash. If exercised on a cashless basis, the shares can be freely traded once the holding period of the warrants and the shares is at least six months combined. The warrants are freestanding securities that are separately exercisable and legally detachable from the common shares and have been classified as equity in accordance with ASC Topic 480, *Distinguishing Liabilities from Equity*. The proceeds from the offering were allocated using the relative fair value method as follows:

|                     | Common<br>Stock | Additional<br>Paid-In<br>Capital | Total        |
|---------------------|-----------------|----------------------------------|--------------|
| Unregistered shares | \$ 14,000       | \$ 2,142,000                     | \$ 2,156,000 |
| Warrants            | -               | 644,000                          | 644,000      |
| Total               | \$ 14,000       | \$ 2,786,000                     | \$ 2,800,000 |

**10. Earnings (Loss) Per Share**

Basic loss per share excludes dilution and is computed by dividing loss available to common shareholders by the weighted-average number of shares outstanding for the period. Diluted earnings (loss) per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock, except for periods when the Company reports a net loss because the inclusion of such items would be antidilutive. The antidilutive effect of 672,373 shares from stock options were excluded from diluted shares for the three months ended September 30, 2021.

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

|  | Net income<br>(loss) | Shares            | Per share<br>amount |
|--|----------------------|-------------------|---------------------|
| Basic net loss per common share for the three months ended September 30, 2021:     |                      |                   |                     |
| Loss available to common shareholders  | \$ (95,527)          | 12,596,126        | \$ (0.01)           |
| Effect of dilutive stock options   | -                    | -                 | -                   |
| Diluted net loss per common share for the three months ended September 30, 2021    | <u>\$ (95,527)</u>   | <u>12,596,126</u> | <u>\$ (0.01)</u>    |
| Basic net income per common share for the three months ended September 30, 2020:   |                      |                   |                     |
| Income available to common shareholders  | \$ 214,703           | 11,211,760        | \$ 0.02             |
| Effect of dilutive stock options   | -                    | 625,667           | -                   |
| Diluted net income per common share for the three months ended September 30, 2020: | <u>\$ 214,703</u>    | <u>11,837,427</u> | <u>\$ 0.02</u>      |
| Basic net income per common share for the nine months ended September 30, 2021:    |                      |                   |                     |
| Income available to common shareholders  | \$ 218,445           | 11,957,878        | \$ 0.02             |
| Effect of dilutive stock options   | -                    | 627,036           | -                   |
| Diluted net income per common share for the nine months ended September 30, 2021   | <u>\$ 218,445</u>    | <u>12,584,914</u> | <u>\$ 0.02</u>      |
| Basic net income per common share for the nine months ended September 30, 2020:    |                      |                   |                     |
| Income available to common shareholders  | \$ 53,745            | 11,211,760        | \$ -                |
| Effect of dilutive stock options   | -                    | 598,632           | -                   |
| Diluted net income per common share for the nine months ended September 30, 2020   | <u>\$ 53,745</u>     | <u>11,810,392</u> | <u>\$ -</u>         |

**11. Subsequent Events****Lease Agreement**

In October 2021, the Company executed a lease of office space in Annapolis, MD. The lease's effective date was October 1, 2021. The lease term is 36 months with no renewal options and initial monthly rent of \$12,713. Rent for the first three months of the lease term will be abated by 50% and the lease contains 2.5% rent escalations in its second and third years.

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

### Cautionary Statement Regarding Forward-Looking Statements

This Form 10-Q contains forward-looking statements regarding our business, customer prospects, or other factors that may affect future earnings or financial results that are subject to the safe harbor created by the Private Securities Litigation Reform Act of 1995. Such statements involve risks and uncertainties which could cause actual results to vary materially from those expressed in the forward-looking statements. Investors should read and understand the risk factors detailed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2020 ("2020 10-K") and in other filings with the Securities and Exchange Commission.

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

- our failure to generate a sufficient level of professional fees;
- the loss of one or more material subcontracts under which a material portion of our revenue and income is concentrated;
- our inability to integrate businesses, products, or technologies we may acquire;
- the limited public market for our common stock;
- inaccuracy in our estimates of the cost of services and the timeline for completion of contracts;
- our inability to hire, retain, and utilize qualified personnel;
- our failure to protect our information technology from disruptions, failures, and security breaches;
- changes in the funding priorities of the U.S. federal government;
- intense competition from other companies;
- our inability to raise additional capital when needed;
- fluctuations in our results of operations and the resulting impact on our stock price;
- efforts to gain entry into new markets may be unsuccessful;
- investments in developing new services offerings may take time to recover;
- health epidemics, pandemics, and other natural disasters and national emergencies;
- our inability to reach investors and gain shareholder approval when needed; and
- our forward-looking statements and projections may prove to be inaccurate.

In some cases, you can identify forward-looking statements by terms such as "may," "will," "should," "could," "would," "expect," "plans," "anticipates," "believes," "estimates," "projects," "predicts," "intends," "potential" and similar expressions intended to identify forward-looking statements. These statements reflect our current views with respect to future events and are based on assumptions and subject to risks and uncertainties. Given these uncertainties, you should not place undue reliance on these forward-looking statements. We discuss many of these risks in greater detail under the heading "Risk Factors" in Item 1A of our 2020 10-K. Also, these forward-looking statements represent our estimates and assumptions only as of the date of this report. Except as required by law, we assume no obligation to update any forward-looking statements after the date of this report.

### Our Business

Information Analysis Incorporated, which we refer to as IAI, the Company, we or our, is an information technology, or IT, provider primarily for the benefit of federal government agencies. Our focus is on enterprise IT solutions primarily relating to system modernization, cloud-based solutions and cyber security protection. Modernization has been a core competency of IAI for over 20 years. We have modernized over 100 million lines of COBOL code for over 35 governmental and commercial customers. We maintain a pool of skilled COBOL programmers. This provides us with competitive advantage as the labor pool of such programmers is shrinking as aging software professionals retire. Our business has also historically relied upon the reselling of applications, primarily for forms development.

Through our recent acquisition of Tellenger, Inc., we acquired competencies in web-based solutions and cyber security. We believe combining web-based solutions with system modernization will provide us with the skill sets that are needed to migrate legacy systems to the cloud. We foresee this as a key component of our growth since there are billions of lines of code, in both the governmental and commercial sectors, that eventually must be modernized. We see this as an expanding market since users eventually will need to substantially update their systems.

Our acquisition of Tellenger was also premised upon gaining access to its professionals and service engagements in cyber security. Cyber security opportunities continue to grow. Given recent hacking incidents, it is increasingly clear, that every enterprise and governmental agency must devote resources to protect themselves. It is our intention to better leverage our resources to take advantage of the growth in this market.

### **Our Strategy**

Our strategy is to grow our business organically and through acquisitions. Over the last two decades, IAI had been resistant to investing in business development activities. Instead, it was inclined to rely upon a limited number of professional service engagements to sustain itself and not risk capital to grow the business. With changes in our executive management team and in the composition of our board of directors, we are now focused on growing our business. As a public company, we are positioned to raise capital to support our growth. We have also made our initial hires in business development personnel to help grow our business. We also intend to become more proactive in bidding as a prime contractor on government proposals and expanding our outreach to larger prime contractors for subcontract and teaming opportunities.

As for acquisitions, we believe there are numerous small government contractors, such as IAI and Tellenger, who recognize that unless they undertake fundamental changes in their business and invest the necessary capital, their business prospects stall. The founders of these companies who are resistant to change and investment are often inclined to sell their businesses, but given their modest size, their ability to attract suitable buyers is limited. We believe we can be a potential buyer for these companies. As in the Tellenger transaction, the currency of our publicly traded shares allows us to provide sellers with a means of participating in the anticipated future growth of the combined companies. These acquisitions can also serve as a talent acquisition vehicle to better enable us to compete for engagements in our focus areas.

We have been taking steps to make it easier for investors to trade in our stock. In January, we upgraded IAI's listing from the OTC pink sheets to the OTCQB. We currently have a pending application to list our shares on the NASDAQ Capital Market.

### **Concentration of Risk**

Our greatest concentration of risk for us is that a material portion of our gross profits and our income is derived from a few material subcontracts for professional services. For the three months ended September 30, 2021, three subcontracts under government procurements represented 54.4% of our revenue and 87.9% of our gross profit, respectively. For the nine months ended September 30, 2021, these same subcontracts represented 50.4% of our revenue and 78.7% of our gross profit, respectively.

Fluctuations in our revenue and concentrations of prime U.S. government contracts have ceased to be a material risk compared to our gross profits on professional fees contracts, as a large percentage of our sales under prime U.S. government contracts are software sales. The amount of such revenue does not have a material effect on gross profit.

At September 30, 2021, accounts receivable balances related to two professional services subcontracts under one prime contractor for projects at one federal agency collectively represented 63% of our outstanding accounts receivable. One other subcontract under federal procurements represented 12.3% outstanding accounts receivable.

We sold third-party software and maintenance contracts under multiple agreements with one major supplier. These sales accounted for 34.8% and 55.6% of total revenue in the three months ended September 30, 2021 and 2020, respectively, and 30.8% and 67.3% of revenue in the nine months ended September 30, 2021 and 2020, respectively.



**Results of Operations***Three Months Ended September 30, 2021 versus Three Months Ended September 30, 2020**Revenue*

Total revenue was \$4,299,925 for the three months ended September 30, 2021, compared with \$3,922,746 in the prior year quarter, an increase of \$377,179, or 9.6%. Professional fees increased \$1,217,421, or 77.0%, while software sales revenue decreased by \$840,242, or 35.9%. Our acquisition of Tellenger represents approximately two-thirds of the increase in professional fees. The decrease in software revenue in 2021 versus the same period in 2020 is due to the non-recurring nature of software sales transactions, as well as the timing of recurring orders.

*Gross Profit*

Gross profit increased by \$364,548, or 59.3%, to \$978,875, in the third quarter of 2021 over the third quarter of 2020, due to the increase in the revenue generated from professional fees. Overall gross profit margin was 22.8% in 2021, up from 15.7% in 2020, due to the increase in professional fees revenue relative to software sales revenue. Gross profit percentage for professional fees in the third quarter of 2021 was 34.5%, while software sales generated a gross profit percentage of 0.9%. In 2021, we have added several new partnerships for software product lines that are expected to improve our gross profit margin.

*Selling, General and Administrative Expenses*

Selling, general and administrative expenses (SG&A) increased by \$658,102 in the third quarter of 2021 over the prior year. Incorporating Tellenger's administrative structure added \$66,062 to our SG&A, and amortization of intangible assets (a non-cash expense) related to the Tellenger acquisition added another \$44,061. Our efforts to attract and retain quality new members of our board of directors, the addition of an additional independent director, the increased use of share-based compensation (a non-cash expense) to attract and retain key employees and directors, management changes and administrative salaries, investor relations, a post-employment transition agreement with a retiring executive, increased legal expenses, and investment in our business resources, including our business development program and our accounting department, contributed to the increase in SG&A. Much of the increase in SG&A is associated with putting the resources in place necessary to position the Company for growth.

*Acquisition Costs*

We incurred legal, accounting, and other acquisition related expenses totaling \$39,245 in the third quarter of 2021.

*Income (Loss) from Operations*

Loss from operations was \$84,267 in the third quarter of 2021 compared to income from operations of \$214,906 in 2020, a difference of \$299,173. The decrease in income from operations is the net effect of increased gross profit of \$364,548 being more than offset by increased SG&A costs of \$658,102, as discussed above.

*Nine Months Ended September 30, 2021 versus Nine Months Ended September 30, 2020**Revenue*

Total revenue was \$12,451,467 for the nine months ended September 30, 2021, compared with \$10,803,897 in the prior year period, an increase of \$1,647,570, or 15.2%. Professional fees increased \$5,212,131, or 155.4%, while software sales revenue decreased by \$3,564,561, or 47.8%. Our acquisition of Tellenger represents approximately one-third of the increase in professional fees. The decrease in our software revenue in the first nine months of 2021 versus the same period in 2020 is due to the non-recurring nature of many of our software sales transactions, including one software sales contract that expired after 2020 that contributed \$1,931,692 to revenue each year, as well as the timing of recurring orders. Software sales are subject to considerable fluctuation from period to period, based on the product mix sold and referral fees earned.

*Gross Profit*

Gross profit increased by \$1,672,282, or 130.4%, to \$2,954,453, for the nine months ended September 30, 2021 over the comparable period of 2020, due to the increase in the revenue generated from professional fees. Maintaining a certain level of professional fees revenue is necessary to generate sufficient gross profit to cover the cost of our operations. Overall gross profit margin was 23.7% in 2021, up from 11.9% in 2020, due to the increase in professional fees revenue relative to software sales revenue. Gross profit percentage for professional fees for the nine months ended September 30, 2021 was 33.5%, while software sales generated a gross profit percentage of 2.2%. In 2021, we have added several new partnerships for software product lines that are expected to improve our gross profit margin. Our first sale under one of these new product lines, while a modest sale, produced a gross profit percentage of 19.3%.

*Selling, General and Administrative Expenses*

SG&A increased by \$1,296,919 for the nine months ended September 30, 2021 over the prior year. Incorporating Tellenger's administrative structure added \$146,807 to our SG&A, and amortization of intangible assets (a non-cash expense) related to the Tellenger acquisition added another \$87,912. Our efforts to attract and retain quality new members of our board of directors, the addition of an additional independent director, the increased use of share-based compensation (a non-cash expense) to attract and retain key employees and directors, management changes and administrative salaries, investor relations, a post-employment transition agreement with a retiring executive, increased legal expenses, and investment in our business resources, including our business development program and our accounting department, contributed to the increase in SG&A. Much of the increase in SG&A is associated with putting the resources in place necessary to position the Company for growth.

*Acquisition Costs*

We incurred legal, accounting, and other expenses totaling \$192,530 for the nine months ended September 30, 2021, primarily related to the acquisition of Tellenger.

*Income (Loss) from Operations*

Income from operations was \$238,583 for the nine months ended September 30, 2021 as compared to \$52,850 for the comparable period of 2020, an increase of \$185,733, or 351.4%. The increase in income from operations is the net effect of increased gross profit of \$1,672,282 being partially offset by increased SG&A expenses of \$1,296,919, as discussed above.

**Liquidity and Capital Resources**

Our beginning cash and cash equivalents balance, when combined with our cash flow from operations and proceeds from sales of common stock and exercise of stock options, was sufficient to provide financing for our operations. Our cash balance at September 30, 2021, was \$3,682,613.

On August 26, 2021 we completed a private offering of 1,400,000 units at a price of \$2.00 per unit, each unit consisting of one share of common stock and one warrant exercisable at \$3.00 for one share of common stock. The warrants expire on August 31, 2026.

On April 16, 2021, we secured financing for a \$1 million 24-month term loan and a \$1 million revolving line of credit as joint borrowings of IAI and our subsidiary, Tellenger, Inc. The purpose of the term loan was to provide financing for the Tellenger acquisition, and the balance at September 30, 2021, was \$791,667. The line of credit has a current balance of \$402,306 and is limited to a borrowing base calculated based on our accounts receivable and expires on April 16, 2022. As of September 30, 2021, we had borrowing availability of \$597,694 under this line of credit. In addition, we borrowed \$150,000 from the sellers of Tellenger to provide additional net working capital support for the first ninety days following the transaction. The seller loan was repaid in July 2021.

In March 2021 we raised \$495,999 in a private placement, and payments received from exercised stock options have added an additional \$95,145 in 2021 through September 30.

Due to the coronavirus uncertainty, and pending staffing and payroll cuts due to liquidity constraints, the Company applied for a Paycheck Protection Program loan, guaranteed by the SBA. The Company was funded by its lender on April 20, 2020, in the amount of \$450,000. The loan accrues interest at a fixed rate of 1% and has a term of two years. The first payment is deferred until the date the SBA remits the Company's loan forgiveness amount to the lender, though interest accrues during the deferral period. The loan has been used exclusively to support maintaining employee payroll and benefits. We began making principal and interest payments in August 2021 while also continuing to pursue our application for loan forgiveness. On, October 6, 2021, we were notified that the bank had approved the full amount of \$450,000 for forgiveness, and the forgiveness package had been submitted to the SBA for final approval. The SBA may take up to 90 days to complete their review of the submission. The Company expects its application for loan forgiveness to be fully resolved during the fourth quarter of 2021.

There was a financing component to one of our subcontracts under which we had accrued \$545,152 through July 31, 2021. The full amount of the accrual was invoiced on September 8, 2021.

Based on our current cash position and operating plan, we anticipate that we will be able to meet our cash requirements for at least one year from the filing date of this Quarterly Report on Form 10-Q.

We have no material commitments for capital expenditures.

**Item 4. Controls and Procedures*****Disclosure Controls and Procedures***

Our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, and people performing similar functions, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act), as of September 30, 2021 (the "Evaluation Date"). Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the Evaluation Date, our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and (ii) is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

***Changes in Internal Controls over Financial Reporting***

In September 2021 the Company created the position of Senior Vice President & Corporate Controller which created an additional level of review for the Company's financial reporting. There were no other changes in the Company's internal control over financial reporting during the quarter ended September 30, 2021, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Tellenger, Inc. had been privately held and utilized non-U.S.-GAAP financial reporting prior to being acquired. It had written procedures but insufficient and limited controls. The IAI accounting department reconstructed Tellenger's prior years' financial statements and assumed full control of Tellenger's books. As such, Tellenger has now been fully integrated into the IAI systems of internal controls over financial reporting. Tellenger's will be migrated into IAI's primary accounting system by the start of the 2022 calendar year.

***Inherent Limitations on Effectiveness of Controls***

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

**PART II - OTHER INFORMATION****Item 1. Legal Proceedings**

None.

**Item 1A. Risk Factors**

“Item 1A. Risk Factors” of our annual report on Form 10-K for the year ended December 31, 2020, as amended, includes a discussion of our risk factors. There have been no material changes from the risk factors described in our annual report on Form 10-K for the year ended December 31, 2020.

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

Previously furnished in our Form 8-K dated August 26, 2021 and filed with the SEC on August 30, 2021.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

|         |   |  |
|---------|---|--|
| 3.2     | <a href="#">Amended Article III, Section 2 of the Company's Bylaws</a>  | Incorporated by reference from the Registrant's Form 8-K filed August 26, 2021                           |
| 4.1     | <a href="#">Form of Warrant issued in connection with the offering of August 26, 2021</a>   | Incorporated by reference from the Registrant's Form 8-K filed August 26, 2021                           |
| 10.1    | <a href="#">Executive employment agreement for G. James Benoit, Jr. dated August 24, 2021</a>   | Incorporated by reference from the Registrant's Form 8-K dated August 24, 2021 and filed August 26, 2021 |
| 31.1    | <a href="#">Certification of Chief Executive Officer Pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934</a>     | Filed with this Form 10-Q  |
| 31.2    | <a href="#">Certification of Principal Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934</a> | Filed with this Form 10-Q  |
| 32.1    | <a href="#">Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</a>        | Filed with this Form 10-Q  |
| 32.2    | <a href="#">Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</a>        | Filed with this Form 10-Q  |
| 101.INS | Inline XBRL Instance Document   | Filed with this Form 10-Q  |
| 101.SCH | Inline XBRL Taxonomy Extension Schema   |  |
| 101.CAL | Inline XBRL Taxonomy Extension Calculation Linkbase   |  |
| 101.DEF | Inline XBRL Taxonomy Extension Definition Linkbase  |  |
| 101.LAB | Inline XBRL Taxonomy Extension Label Linkbase   |  |
| 101.PRE | Inline XBRL Taxonomy Extension Presentation Linkbase  |  |
| 104     | Cover Page Interactive Data File (formatted in Inline XBRL and contained in Exhibit 101)  |  |

**SIGNATURES**

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

Information Analysis Incorporated  
(Registrant)

Date: November 1, 2021

By: /s/ G. James Benoit  
G. James Benoit,  
Chief Executive Officer

Date: November 1, 2021

By: /s/ Timothy G. Hannon  
Timothy G. Hannon, Interim Chief Financial Officer

**CERTIFICATION of Chief Executive Officer Pursuant to Rules 13a-14(a)  
and 15d-14(a) of the Securities Exchange Act of 1934**

I, G. James Benoit, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Information Analysis Incorporated;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 2, 2021

By: /s/ G. James Benoit  
G. James Benoit  
Chief Executive Officer

A signed original of this written statement required by Section 302 has been provided to Information Analysis Incorporated and will be retained by Information Analysis Incorporated and furnished to the Securities and Exchange Commission or its staff upon request.



**CERTIFICATION of Interim Chief Financial Officer Pursuant to Rules 13a-14(a)  
and 15d-14(a) of the Securities Exchange Act of 1934**

I, Timothy G. Hannon, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Information Analysis Incorporated;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 2, 2021

By: /s/ Timothy G. Hannon  
Timothy G. Hannon  
Interim Chief Financial Officer

A signed original of this written statement required by Section 302 has been provided to Information Analysis Incorporated and will be retained by Information Analysis Incorporated and furnished to the Securities and Exchange Commission or its staff upon request.

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO SECTION 906  
OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code), I, G. James Benoit, Chief Executive Officer of Information Analysis Incorporated, a Virginia corporation (the "Company"), do hereby certify, to the best of my knowledge, that:

- 1 the Company's Quarterly Report on Form 10-Q for the period ended September 30, 2021, as filed with the Securities and Exchange Commission on the date hereof, (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- 2 the information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company for the periods presented therein.

Date: November 2, 2021

By: /s/ G. James Benoit  
G. James Benoit  
Chief Executive Officer

A signed original of this written statement required by Section 906 has been provided to Information Analysis Incorporated and will be retained by Information Analysis Incorporated and furnished to the Securities and Exchange Commission or its staff upon request.

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO SECTION 906  
OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code), I, Timothy G. Hannon, Interim Chief Financial Officer of Information Analysis Incorporated, a Virginia corporation (the "Company"), do hereby certify, to the best of my knowledge, that:

- 1 the Company's Quarterly Report on Form 10-Q for the period ended September 30, 2021, as filed with the Securities and Exchange Commission on the date hereof, (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- 2 the information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company for the periods presented therein.

Date: November 2, 2021

By: /s/ Timothy G. Hannon  
Timothy G. Hannon  
Interim Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided to Information Analysis Incorporated and will be retained by Information Analysis Incorporated and furnished to the Securities and Exchange Commission or its staff upon request.