

INFINITE GROUP INC  
Form 10QSB  
November 13, 2007

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-QSB**

**QUARTERLY REPORT UNDER SECTION 13 OR 15(D)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2007**

Commission File Number 0-21816

**INFINITE GROUP, INC.**

(Exact name of small business issuer as specified in its charter)

Delaware  
(State or other jurisdiction  
of incorporation or organization)

52-1490422  
(I.R.S. Employer  
Identification No.)

60 Office Park Way  
Pittsford, New York 14534  
(Address of principal executive office)

(585) 385-0610  
(Issuer's telephone number, including area code)

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the issuer 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 issuer is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: As of November 12, 2007, there were 23,524,965 shares of common stock outstanding.

Transitional Small Business Disclosure Format. Yes  No

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INFINITE GROUP, INC.

**FORM 10-QSB REPORT**

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**FORWARD-LOOKING STATEMENTS**

Certain statements made in this Quarterly Report on Form 10-QSB are “forward-looking statements” regarding the plans and objectives of management for future operations and market trends and expectations. Such statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by

such forward-looking statements. The forward-looking statements included herein are based on current expectations that involve numerous risks and uncertainties. Our plans and objectives are based, in part, on assumptions involving the continued expansion of our business. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Although we believe that our assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate and, therefore, there can be no assurance that the forward-looking statements included in this report will prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives and plans will be achieved. We undertake no obligation to revise or update publicly any forward-looking statements for any reason. The terms “we”, “our”, “us”, or any derivative thereof, as used herein refer to Infinite Group, Inc., a Delaware corporation, and its predecessors.

**PART I**  
**FINANCIAL INFORMATION**

**Item 1. Financial Statements****INFINITE GROUP, INC.****Consolidated Balance Sheets**

|   | September 30,<br>2007<br>(Unaudited) | December 31,<br>2006<br>(Audited) |
|---|--------------------------------------|-----------------------------------|
| <b>ASSETS</b>   |                                      |                                   |
| <b>Current assets:</b>  |                                      |                                   |
| Cash  | \$ 8,643                             | \$ 73,786                         |
| Accounts receivable, net of allowance of \$35,000 (\$53,000 – 2006)   | 626,243                              | 487,240                           |
| Notes receivable, current portion   | 953                                  | 4,968                             |
| Prepaid expenses and other current assets   | 74,241                               | 38,600                            |
| <b>Total current assets</b>   | <b>710,080</b>                       | <b>604,594</b>                    |
| <b>Property and equipment, net</b>  | <b>76,790</b>                        | <b>80,612</b>                     |
| <b>Other assets – security deposits</b>   | <b>19,523</b>                        | <b>19,523</b>                     |
| <b>Total assets</b>   | <b>\$ 806,393</b>                    | <b>\$ 704,729</b>                 |
| <b>LIABILITIES AND STOCKHOLDERS' DEFICIENCY</b>   |                                      |                                   |
| <b>Current liabilities:</b>   |                                      |                                   |
| Accounts payable  | 253,503                              | 224,051                           |
| Accrued payroll   | 356,894                              | 216,397                           |
| Accrued interest payable  | 239,460                              | 176,734                           |
| Accrued pension and retirement  | 2,048,887                            | 1,807,524                         |
| Accrued expenses-other  | 81,232                               | 62,042                            |
| Current maturities of long-term obligations-bank  | 3,997                                | 50,354                            |
| Note payable  | 30,000                               | 30,000                            |
| Notes payable-related parties   | 141,660                              | 148,663                           |
| <b>Total current liabilities</b>  | <b>3,155,633</b>                     | <b>2,715,765</b>                  |
| <b>Long-term obligations:</b>   |                                      |                                   |
| Bank notes payable  | 30,787                               | -                                 |
| Notes payable-related parties   | 1,096,124                            | 1,146,124                         |
| Accrued pension obligation  | 703,211                              | 706,196                           |
| <b>Total liabilities</b>  | <b>4,985,755</b>                     | <b>4,568,085</b>                  |
| Commitments and contingencies   |                                      |                                   |
| <b>Stockholders' deficiency:</b>  |                                      |                                   |
| Common stock, \$.001 par value, 60,000,000 shares authorized;<br>23,524,965 (22,414,965 – 2006) shares issued and outstanding | 23,525                               | 22,415                            |
| Additional paid-in capital  | 29,310,505                           | 28,981,059                        |
| Accumulated deficit   | (30,934,753)                         | (30,288,191)                      |
| Accumulated other comprehensive loss  | (2,578,639)                          | (2,578,639)                       |

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|  |  |                    |           |                |
|--|--|--------------------|-----------|----------------|
| Total stockholders' deficiency                 |  | <b>(4,179,362)</b> |           | (3,863,356)    |
| Total liabilities and stockholders' deficiency |  | <b>\$ 806,393</b>  | <b>\$</b> | <b>704,729</b> |

See notes to consolidated financial statements.

**INFINITE GROUP, INC.****Consolidated Statements of Operations (Unaudited)**

|   | Nine Months Ended<br>September 30, |                | Three Months Ended<br>September 30, |              |
|---|------------------------------------|----------------|-------------------------------------|--------------|
|   | 2007                               | 2006           | 2007                                | 2006         |
| <b>Sales</b>  | \$ <b>6,008,314</b>                | \$ 4,391,436   | \$ <b>2,063,644</b>                 | \$ 1,427,434 |
| Cost of services  | <b>4,322,505</b>                   | 3,440,561      | <b>1,570,556</b>                    | 1,085,785    |
| <b>Gross profit</b>   | <b>1,685,809</b>                   | 950,875        | <b>493,088</b>                      | 341,649      |
| Costs and expenses:   |                                    |                |                                     |              |
| General and administrative  | <b>631,370</b>                     | 706,981        | <b>238,890</b>                      | 184,559      |
| Defined benefit pension plan  | <b>273,035</b>                     | 342,370        | <b>84,017</b>                       | 250,587      |
| Selling   | <b>1,118,089</b>                   | 1,243,369      | <b>415,325</b>                      | 427,178      |
| Research and development  | <b>88,807</b>                      | 202,719        | <b>1,553</b>                        | 62,009       |
| Impairment loss   | -                                  | 130,767        | -                                   | 130,767      |
| Depreciation and amortization                                       | <b>26,009</b>                      | 73,988         | <b>7,892</b>                        | 30,361       |
| Total costs and expenses  | <b>2,137,310</b>                   | 2,700,194      | <b>747,677</b>                      | 1,085,461    |
| <b>Operating loss</b>   | <b>(451,501)</b>                   | (1,749,319)    | <b>(254,589)</b>                    | (743,812)    |
| Other income (expense):   |                                    |                |                                     |              |
| Interest income   | <b>255</b>                         | 700            | <b>43</b>                           | 199          |
| Interest expense:   |                                    |                |                                     |              |
| Related parties   | <b>(105,113)</b>                   | (88,164)       | <b>(34,834)</b>                     | (30,129)     |
| Other   | <b>(94,555)</b>                    | (55,777)       | <b>(34,833)</b>                     | (26,621)     |
| Total interest expense  | <b>(199,668)</b>                   | (143,941)      | <b>(69,667)</b>                     | (56,750)     |
| Other income-settlement of litigation                               | -                                  | 498,088        | -                                   | -            |
| Gain (loss) on sale of equipment                                    | <b>4,957</b>                       | -              | <b>(1,634)</b>                      | -            |
| Total other income (expense)  | <b>(194,456)</b>                   | 354,847        | <b>(71,258)</b>                     | (56,551)     |
| Loss before income tax expense                                      | <b>(645,957)</b>                   | (1,394,472)    | <b>(325,847)</b>                    | (800,363)    |
| Income tax expense  | <b>(605)</b>                       | (7,300)        | -                                   | -            |
| <b>Net loss</b>   | \$ <b>(646,562)</b>                | \$ (1,401,772) | \$ <b>(325,847)</b>                 | \$ (800,363) |
| Net loss per share – basic and diluted                              | \$ <b>(.03)</b>                    | \$ (.07)       | \$ <b>(.01)</b>                     | \$ (.04)     |
| Weighted average number of shares<br>outstanding -basic and diluted | <b>23,040,972</b>                  | 20,949,611     | <b>23,514,965</b>                   | 22,034,965   |

See notes to consolidated financial statements.

**INFINITE GROUP, INC.****Consolidated Statements of Cash Flows (Unaudited)**

|   | <b>For the Nine Months Ended<br/>September 30,</b> |                  |
|---|--|------------------|
|   | <b>2007</b>  | <b>2006</b>      |
| <b>Operating activities:</b>  |  |                  |
| Net loss  | \$ (646,562)                                       | \$ (1,401,772)   |
| Adjustments to reconcile net loss to net cash used in operating activities: |  |                  |
| Stock based compensation  | 255,056  | 191,471          |
| Depreciation and amortization   | 26,009   | 73,988           |
| Gain on sale of equipment   | (4,957)  | -                |
| Impairment loss   | -  | 130,767          |
| (Increase) decrease in:   |  |                  |
| Accounts receivable   | (139,003)  | 516,607          |
| Inventories   | -  | (2,013)          |
| Other assets  | (10,641)   | (9,596)          |
| Increase (decrease) in:   |  |                  |
| Accounts payable  | 29,452   | (174,964)        |
| Accrued expenses  | 222,413  | 165,821          |
| Accrued pension and retirement  | 238,378  | 343,707          |
| <b>Net cash used in operating activities</b>                                | <b>(29,855)</b>                                    | <b>(165,984)</b> |
| <b>Investing activities:</b>  |  |                  |
| Purchase of property and equipment  | (22,686)   | (14,656)         |
| Proceeds from notes receivable  | 4,015  | 3,282            |
| <b>Net cash used in investing activities</b>                                | <b>(18,671)</b>                                    | <b>(11,374)</b>  |
| <b>Financing activities:</b>  |  |                  |
| Repayment of bank notes payable   | (10,114)   | (9,717)          |
| Repayment of notes payable – related parties                                | (7,003)  | (25,450)         |
| Borrowings of notes payable – related parties                               | -  | 120,000          |
| Proceeds from issuance of common stock, net of costs                        | 500  | 420              |
| <b>Net cash provided by (used in) financing activities</b>                  | <b>(16,617)</b>                                    | <b>85,253</b>    |
| Net decrease in cash  | (65,143)   | (92,105)         |
| Cash – beginning of period  | 73,786   | 109,090          |
| Cash – end of period  | \$ 8,643   | \$ 16,985        |
| <b>Supplemental disclosure:</b>   |  |                  |
| Cash paid for:  |  |                  |
| Interest  | \$ 140,890   | \$ 102,440       |
| Income taxes  | \$ 605   | \$ 7,300         |

See notes to consolidated financial statements.

**INFINITE GROUP, INC.**

**Notes to Consolidated Financial Statements (Unaudited)**

**Note 1. Basis of Presentation**

The accompanying unaudited consolidated financial statements of Infinite Group, Inc. (“Infinite Group, Inc.” or the “Company”), included herein have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America (U.S.) for interim financial information and with instructions to Form 10-QSB. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the U.S. for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. All such adjustments are of a normal recurring nature. The accompanying unaudited consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements and the notes thereto included in the Company’s Annual report on Form 10-KSB for the year ended December 31, 2006 filed with the U.S. Securities and Exchange Commission. Results of consolidated operations for the nine months ended September 30, 2007 are not necessarily indicative of the operating results that may be expected for the year ending December 31, 2007. The consolidated financial statements herein include the accounts of the Company and its wholly owned subsidiaries. The subsidiaries are inactive. All material inter-company accounts and transactions have been eliminated.

**Note 2. Summary of Significant Accounting Policies**

There are several accounting policies that we believe are significant to the presentation of our consolidated financial statements. These policies require management to make complex or subjective judgments about matters that are inherently uncertain. Note 3 to our audited consolidated financial statements for the year ended December 31, 2006 presents a summary of significant accounting policies.

**Note 3. Stock Option Plans and Share Based Payments**

Stock based compensation includes expense charges for all stock-based awards to employees, directors and consultants. Such awards include options, warrants and stock grants.

As of September 30, 2007, the Company’s Stock Option Plans (the “Plan”) provided for the grant of incentive (ISO’s) or non-qualified stock options (Non-ISO’s) for the purchase of common stock for up to 5,212,500 shares to employees, directors and consultants. The Plan is administered by the compensation committee established by the Company’s board of directors, which determines the terms of the options including the exercise price, expiration date, number of shares, and vesting provisions.

The Company used volatility of 50% when computing the value of stock options and warrants for the three and nine months ended September 30, 2007, 71% for the six months ended September 30, 2006, and 100% for the three months ended March 31, 2006. This is based on historical volatility, with consideration given to activity subsequent to July 2005, when the Company brought current its public information in filings with the SEC, and the increase in the volume of trading in the Company’s common stock in 2006 and 2007. The Company believes the increase in the volume of trading has provided more liquidity and less volatility than was previously experienced. The expected dividend yield is zero percent and the expected life of the options is ten years. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

The Company recorded expense for options, common stock and warrants issued to employees and independent service providers for the three and nine months ended September 30, 2007 and 2006 as follows:



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|  | <b>Nine Months<br/>ended<br/>September 30,<br/>2007</b> | Nine Months<br>ended<br>September 30,<br>2006 | <b>Three Months<br/>ended<br/>September 30,<br/>2007</b> | Three Months<br>ended<br>September 30,<br>2006 |
|--|---|---|--|--|
| Employee stock options                 | \$ <b>180,068</b>                                       | \$ 174,380                                    | \$ <b>97,009</b>   | \$ 77,853                                      |
| Consultants – stock<br>warrants        | <b>49,988</b>   | 12,578  | <b>13,095</b>  | 4,193  |
| Consultant – shares of<br>common stock | <b>25,000</b>   | -   | <b>12,500</b>  | -  |
| Consultant – stock options             | -   | 4,513   | -  | 1,504  |
| <b>Total expense</b>                   | <b>\$ 255,056</b>                                       | \$ 191,471                                    | <b>\$ 122,604</b>  | \$ 83,550                                      |

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A summary of all stock option activity for nine months ended September 30, 2007 follows:

|                                   | <b>Number of<br/>Options</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Weighted-<br/>Average<br/>Remaining<br/>Contractual<br/>Term</b> | <b>Aggregate<br/>Intrinsic Value</b> |
|-----------------------------------|------------------------------|--|---|--------------------------------------|
| Outstanding at December 31, 2006  | 4,380,000                    | \$ .24   |   |                                      |
| Options granted                   | 536,000                      | \$ .51   |   |                                      |
| Options expired                   | (14,500)                     | \$ .41   |   |                                      |
| Options exercised                 | (10,000)                     | \$ .05   |   |                                      |
| Outstanding at September 30, 2007 | 4,891,500                    | \$ .27   | 7.6 years   | \$ 1,200,000                         |
| Exercisable at September 30, 2007 | 4,049,500                    | \$ .23   | 7.3 years   | \$ 1,147,000                         |

The weighted average fair value of options granted during the nine months ended September 30, 2007 was approximately \$.33 (\$.33 during the nine months ended September 30, 2006). The total intrinsic value of options exercised during the nine months ended September 30, 2007 and 2006 was \$4,700 and \$480, respectively.

A summary of the status of nonvested stock option activity for the nine months ended September 30, 2007 follows:

|   | <b>Number of<br/>Nonvested<br/>Options</b> | <b>Weighted Average<br/>Fair Value<br/>at Grant Date</b> |
|---|--|--|
| Nonvested outstanding at December 31, 2006  | 784,000                                    | \$ .30   |
| Options granted                             | 536,000                                    | .33  |
| Options vested                              | (470,000)                                  | .30  |
| Options forfeited                           | (8,000)                                    | .37  |
| Nonvested outstanding at September 30, 2007 | 842,000                                    | \$ .32   |

At September 30, 2007, there was approximately \$179,000 of total unrecognized compensation cost related to non-vested options granted under the plan. That cost is expected to be recognized over a weighted average period of one year. The total fair value of shares vested during the nine months ended September 30, 2006 was approximately \$142,000.

On March 10, 2006 the Company engaged the services of a consultant and issued the consultant a warrant to acquire 500,000 shares of our common stock exercisable at \$.30 per share. The warrant is only exercisable in increments of 100,000 shares as specified performance measures are met. For the nine months ended September 30, 2007 the consultant became vested in 100,000 shares of common stock and we recorded expense of \$37,800 related to this warrant as the consultant satisfied a portion of the performance criteria by assisting us with increasing our sales in 2007. At September 30, 2007, 400,000 common shares issuable pursuant to this warrant are not vested. The Company will record expense when it is probable the consultant will meet the performance measures and therefore vest in these common shares.

On April 5, 2007, the Company engaged the services of a consultant, an accredited investor, to assist with business development for a term of one year through April 4, 2008 and issued it (i) 100,000 restricted shares of common stock and (ii) a warrant to acquire 100,000 shares of common stock, which was fully vested upon issuance, exercisable at \$.50 per share, and which expires on April 4, 2012. Total expense recognized for these equity instruments for the nine months ended September 30, 2007 was \$37,188.

The Company's accounting policy for equity instruments issued to consultants and vendors in exchange for goods and services follows the provisions of EITF 96-18, "Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services" and EITF 00-18, "Accounting Recognition for Certain Transactions Involving Equity Instruments Granted to Other Than Employees." The measurement date for the fair value of the equity instruments issued is determined at the earlier of (i) the date at which a commitment for performance by the consultant or vendor is reached or (ii) the date at which the consultant or vendor's performance is complete. In the case of equity instruments issued to consultants, the fair value of the equity instrument is recognized over the term of the consulting agreement.

**Note 6. Supplemental Cash Flow Information**

Non-cash investing and financing transactions, including non-monetary exchanges, consist of the following:

|   | <b>Nine Months Ended<br/>September 30,</b> |             |
|---|--|-------------|
|   | <b>2007</b>                                | <b>2006</b> |
| Conversion of notes payable to common stock   | \$ 50,000                                  | \$ 100,000  |
| Issuance of 100,000 shares of common stock in exchange for consulting services to be provided over one year | \$ 50,000                                  | \$ -        |

**Note 7. Earnings Per Share**

Basic net loss per share is computed by dividing net loss by the weighted average number of common shares outstanding during the period. Diluted loss per share is computed by dividing net loss by the weighted average number of common shares outstanding including dilutive potential common shares which, in the Company's case, comprise shares issuable under stock options, stock warrants and convertible notes payable. Stock options, warrants and convertible notes payable with exercise prices that exceeded the average fair market value of common stock had an antidilutive effect and therefore, were excluded from the computation of net loss per share. The treasury stock method is used to calculate dilutive shares, which reduces the gross number of dilutive shares by the number of shares purchasable from the proceeds of the equity instruments assumed to be exercised.

If the Company had generated earnings, common stock equivalents would have been added to the weighted average shares outstanding during the three and nine months ended September 30, 2007 and 2006 as follows. These additional shares represent the assumed exercise of common stock options, warrants and convertible notes payable whose exercise price is less than the average of common stock during the period and convertible notes payable. The proceeds of the exercise are assumed to be used to purchase common stock for treasury and the incremental shares are added to the weighted average shares outstanding. In a loss period, the calculation for basic and diluted net loss per share is considered to be the same, as the impact of potential common shares is anti-dilutive.

|   | <b>Nine Months Ended<br/>September 30,</b> |             | <b>Three Months Ended<br/>September 30,</b> |             |
|---|--|-------------|---|-------------|
|   | <b>2007</b>                                | <b>2006</b> | <b>2007</b>                                 | <b>2006</b> |
| Weighted average number of shares outstanding | 23,046,833                                 | 20,949,611  | 23,524,965                                  | 22,034,965  |
| Common stock equivalents                      | 19,381,198                                 | 7,963,802   | 19,399,238                                  | 11,118,008  |

**Note 8. – Employee Pension Plan**

Net periodic pension cost recorded in the accompanying statements of operations includes the following components of expense (benefit) for the periods presented.

|                                | <b>Nine Months<br/>ended<br/>September 30,<br/>2007</b> | <b>Nine Months<br/>ended<br/>September 30,<br/>2006</b> | <b>Three Months<br/>ended<br/>September 30,<br/>2007</b> | <b>Three Months<br/>ended<br/>September 30,<br/>2006</b> |
|--------------------------------|---|---|--|--|
| Interest cost                  | \$ 249,182  | \$ 227,617  | \$ 88,488  | \$ 75,872  |
| Expected return on plan assets | (205,582)   | (205,582)   | (68,527)   | (68,527)   |

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|                           |                   |                   |                  |                  |
|---------------------------|-------------------|-------------------|------------------|------------------|
| Service cost              | <b>97,688</b>     | <b>97,688</b>     | <b>32,563</b>    | <b>32,560</b>    |
| Expected expenses         | <b>48,750</b>     | <b>48,750</b>     | <b>16,250</b>    | <b>16,250</b>    |
| Net periodic pension cost | <b>\$ 190,038</b> | <b>\$ 168,473</b> | <b>\$ 68,774</b> | <b>\$ 56,155</b> |

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## **Note 9. – New Accounting Pronouncements**

Effective January 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48 (“FIN 48”), “Accounting for Uncertainty in Income Taxes — An Interpretation of FASB Statement No. 109.” FIN 48 provides detailed guidance for the financial statement recognition, measurement and disclosure of uncertain tax positions recognized in the financial statements in accordance with SFAS No. 109. Tax positions must meet a “more-likely-than-not” recognition threshold at the effective date to be recognized upon the adoption of FIN 48 and in subsequent periods. Upon the adoption of FIN 48, the Company had no unrecognized tax benefits. During the three and nine months ended September 30, 2007, the Company recognized no adjustments for uncertain tax benefits.

Income taxes are computed using the asset and liability method of accounting. Under the asset and liability method, a deferred tax asset or liability is recognized for estimated future tax effects attributable to temporary differences and carryforwards. The measurement of deferred income tax assets is adjusted by a valuation allowance, if necessary, to recognize future tax benefits only to the extent, based on available evidence, it is more likely than not such benefits will be realized. The Company’s deferred tax assets were fully reserved at September 30, 2007 and December 31, 2006.

The Company recognizes interest and penalties, if any, related to uncertain tax positions in selling, general and administrative expenses or to defined benefit pension plan expense if they are associated with the Osley & Whitney, Inc. Retirement Plan (O&W Plan). The Company has accrued \$380,000 of excise taxes and interest associated with the unfunded contributions to the O&W Plan through the Plan year ended December 31, 2005. Although the Company continued to act as the sponsor of the O&W Plan after the sale of all of the common stock of Osley & Whitney, Inc. (O&W) on December 30, 2002, during 2007 it was determined that, as a matter of law, the Company had no legal obligations to continue as the O&W Plan Sponsor. During the nine months ended September 30, 2007, the Company submitted information advocating this position to the Department of Treasury (“DOT”) to ascertain whether they concur or disagree with this determination. The DOT is presently reviewing this information. If the DOT does not concur, the additional estimated excise taxes on accumulated unfunded O&W Plan contributions for the Plan year ended December 31, 2006 would approximate \$135,000, which amount has not been accrued at September 30, 2007. Further, if the DOT does not concur, the Company could potentially incur additional excise taxes up to 100% of all required plan contributions. Such 100% excise taxes have not been assessed and no portion of this amount has been accrued at September 30, 2007.

No interest and penalties related to other uncertain tax positions were accrued at September 30, 2007.

The tax years 2002 through 2006 remain open to examination by the taxing jurisdictions in which the Company operates. The Company expects no material changes to unrecognized tax positions within the next twelve months.

## **Item 2. Management’s Discussion and Analysis or Plan of Operations**

### **Our Business**

With offices in Pittsford, New York, Vienna, Virginia and Jackson, Mississippi, we provide business, program management and information technology (IT) services and systems support to federal, state and local government and commercial clients through our IT Services Group. Our work includes leading edge operations supporting complex programs in advanced computing environments (network services), server and desktop virtualization technology, wireless technology, human capital services, financial services, enterprise architecture, and earned value management. We focus on aligning business processes with technology for delivery of solutions meeting our clients’ exact needs.

In December 2003, we were awarded a Federal Supply Schedule Contract by the U.S. General Services Administration (GSA) for IT consulting services. As a GSA contractor we can compete for and secure prime contracts

with all executive agencies of the U.S. Government, as well as state and local governments and other national and international organizations. As of September 30, 2007, we have one prime contract under our GSA schedule with the U.S. Department of Homeland Security.

During 2007, we were approved as a VMware Authorized Consultant (VAC) by VMware, Inc. (NYSE:VMW) a subsidiary of EMC Corporation (NYSE:EMC). VMware is recognized as the industry leader in virtualization technology. As a VAC, we are trained and certified to deliver consulting services and solutions leveraging VMware technology. We are also certified as a VMware Enterprise VIP Reseller authorized to resell VMware's full product line. We are actively working with a number of potential customers in that regard. These certifications are examples of our concerted effort to grow and expand our server virtualization practice. Server virtualization involves the creation, allocation, and management of "virtual machines," which entails the virtual representation of hardware by a software system. What this means is that traditional "physical servers," which typically run at only 5% to 15% of their capacity, can now be consolidated with the use of specialized software such as VMware to increase server utilization by a factor of ten to one or even greater. Reducing the number of physical machines required in a typical environment provides numerous and obvious benefits, including equipment cost savings, reduced operational maintenance costs, easier backup, improved availability, and better security. Due to the substantial energy savings resulting from reduced infrastructure, virtualization is also a "green" technology.

In July 2007, we were accepted into the Hewlett Packard (NYSE:HPQ) Developer and Solutions Partner Program (DSPP). DSPP provides us with a mechanism to work with HP and our joint customers and prospects to provide solutions and services that complement HP's broad portfolio of products and services. HP has many tools and resources to help us generate new sales streams, and improve our mutual profitability, while at the same time adding unique value for our joint customers. The program comprises practical tools and services that we hope will help us in the key areas of marketing and selling our solutions, optimizing the technology, and collaborating with other organizations within our industry.

In August 2007, we were notified that we were part of a team led by a large systems integrator that was awarded a Government Wide Acquisition Contract (GWAC) under GSA's \$50 billion Alliant program.

We are a member of a team led by CACI International Inc (NYSE:CAI) that was awarded a \$36 million task order by the U.S. Navy in October 2007 to support its Navy Enterprise Maintenance Automated Information System (NEMAIS) data center operations. The task order, awarded under the Seaport II Enhanced contract vehicle (Seaport-e), provides for one base year and three one-year options. The CACI team will perform the work at the Naval Sea Systems Command (NAVSEA) site in Norfolk, Virginia and the Puget Sound Naval Shipyard in Washington State. As a result of the award CACI was able to maintain the same level of support it has been providing to the Navy for the NEMAIS data center which in turn enhances CACI's and our core lines of business in engineering services, network services and business systems integration.

The acquisition of these contract vehicles allows us additional opportunities to bid on new projects.

#### **Osley & Whitney, Inc. Retirement Plan**

Prior to December 30, 2002, we owned 100% of the common stock of Osley & Whitney, Inc. (O&W). On December 30, 2002, we sold all of the O&W common stock to a third party, but mistakenly continued to act as the sponsor of the O&W Retirement Plan (O&W Plan), a defined benefit pension plan. In 2007 it was determined that we had no legal obligations to continue as the O&W Plan Sponsor. During the nine months ended September 30, 2007, we submitted information advocating this position to the Department of Treasury to ascertain whether they concur or disagree with this determination. The Department of Treasury is presently reviewing this information. If they do not concur with our position, we intend to pursue all appropriate further avenues to prevail on our position. Depending upon the ultimate outcome regarding our obligations as sponsor of the O&W Plan, adjustments to our financial statements may be necessary. At September 30, 2007 we have accrued liabilities of \$2,677,979 related to the O&W Plan and an accumulated other comprehensive loss of \$2,578,639 which we have recorded as a reduction of stockholders' equity.

The market value of plan assets decreased by \$79,353 from \$3,497,115 at December 31, 2006 to \$3,417,763 at September 30, 2007. The decrease was comprised of investment returns of \$258,634 which were offset by benefit payments of \$320,552 and expenses paid of \$17,434.

Whether or not we ultimately will be responsible to fund any O&W Plan deficiencies is largely dependent upon the ultimate outcome regarding our obligations as sponsor of the O&W Plan, as described above. If it is determined that we are responsible for such deficiencies, then we will be required to make contributions for deficiencies in 2004, 2005, 2006, 2007, and in future years to fund any O&W Plan deficiencies. We did not make any contributions in 2004, 2006 or 2007. During 2005, we made contributions of \$6,439 and 500,000 shares of our common stock, which were valued on the contribution date at \$175,000 using that day's closing market price. We currently do not have the funds available to make the required contributions which currently approximate \$1.6 million, which includes the minimum required plan contributions. We recorded defined benefit pension expense (including professional services, excise taxes and interest costs) of \$273,035 and \$342,370 for the nine months ended September 30, 2007 and 2006, respectively. In 2006, we recorded excise taxes of \$200,000. We may be required to pay interest on these excise taxes and potentially could incur additional excise taxes up to 100% of required plan contributions that were not made.



During 2006, the Pension Benefit Guarantee Corporation placed a lien on all of our assets to secure the contributions due to the O&W Plan. This lien is subordinate to liens that secure accounts receivable financing and certain notes payable.

**Future Trends**

We believe that our operations, as currently structured, together with our current financial resources, will result in improved financial performance in future years. Although our future prospects appear promising, the lengthy government financing and procurement processes may result in operating losses until sales increase to support our infrastructure and provide consistent cash flow to support profitability.

In the future, we may issue additional debt or equity securities to satisfy our cash needs. Any debt incurred or issued may be secured or unsecured, at fixed or variable interest rates and may contain other terms and conditions that our board of directors deems prudent. Any sales of equity securities may be at or below current market prices. We cannot assure you that we will be successful in generating sufficient capital to adequately fund our working capital needs.

## Results of Operations

### Comparison of Three and Nine Month Periods ended September 30, 2007 and 2006

The trends suggested by the following tables are not indicative of future operating results due to the relatively short track record that we have in focusing on providing IT consulting services.

The following table compares our statements of operations data for the three months ended September 30, 2007 and 2006.

|  | Three Months Ended September 30, |                 |              |                 | 2007 vs. 2006    |                       |
|--|----------------------------------|-----------------|--------------|-----------------|------------------|-----------------------|
|  | 2007                             | As a % of Sales | 2006         | As a % of Sales | Amount of Change | % Increase (Decrease) |
| Sales                                  | \$ 2,063,644                     | 100.0%          | \$ 1,427,434 | 100.0%          | \$ 636,210       | 44.6%                 |
| Cost of services                       | 1,570,556                        | 76.1            | 1,085,785    | 76.1            | 484,771          | 44.6                  |
| Gross profit                           | 493,088                          | 23.9            | 341,649      | 23.9            | 151,439          | 44.3                  |
| General and administrative             | 238,890                          | 11.6            | 184,559      | 12.9            | 54,331           | 29.4                  |
| Defined benefit pension plan           | 84,017                           | 4.1             | 250,587      | 17.6            | (166,570)        | (66.5)                |
| Selling                                | 415,325                          | 20.1            | 427,178      | 29.9            | (11,853)         | (2.8)                 |
| Research and development               | 1,553                            | .1              | 62,009       | 4.3             | (60,456)         | (97.5)                |
| Impairment loss                        | -                                | .0              | 130,767      | 9.2             | (130,767)        |                       |
| Depreciation and amortization          | 7,892                            | .4              | 30,361       | 2.1             | (22,469)         | (74.0)                |
| Total costs and expenses               | 747,677                          | 36.2            | 1,085,461    | 76.0            | (337,784)        | (31.1)                |
| Operating loss                         | (254,589)                        | (12.3)          | (743,812)    | (52.1)          | 489,223          |                       |
| Interest expense, net                  | (69,624)                         | (3.4)           | (56,551)     | (4.0)           | (13,073)         | 23.1%                 |
| Other (loss)                           | (1,634)                          | (.1)            | -            | .0              | (1,634)          |                       |
| Net loss                               | \$ (325,847)                     | (15.8)%         | \$ (800,363) | (56.1)%         | \$ 474,516       |                       |
| Net loss per share - basic and diluted | \$ (.01)                         |                 | \$ (.04)     |                 | \$ .03           |                       |

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The following table compares our statements of operations data for the nine months ended September 30, 2007 and 2006.

|  | Nine Months Ended September 30, |                 |                |                 |                  |                                     |
|--|---------------------------------|-----------------|----------------|-----------------|------------------|-------------------------------------|
|  | 2007                            | As a % of Sales | 2006           | As a % of Sales | Amount of Change | 2007 vs. 2006 % Increase (Decrease) |
| Sales                                  | \$ 6,008,314                    | 100.0%          | \$ 4,391,436   | 100.0%          | \$ 1,616,878     | 36.8%                               |
| Cost of services                       | 4,322,505                       | 71.9            | 3,440,561      | 78.3            | 881,944          | 25.6                                |
| Gross profit                           | 1,685,809                       | 28.1            | 950,875        | 21.7            | 734,934          | 77.3                                |
| General and administrative             | 631,370                         | 10.5            | 706,981        | 16.1            | (75,611)         | (10.7)                              |
| Defined benefit pension plan           | 273,035                         | 4.5             | 342,370        | 7.8             | (69,335)         | (20.3)                              |
| Selling                                | 1,118,089                       | 18.6            | 1,243,369      | 28.3            | (125,280)        | (10.1)                              |
| Research and development               | 88,807                          | 1.5             | 202,719        | 4.6             | (113,912)        | (56.2)                              |
| Impairment loss                        | -                               | .0              | 130,767        | 3.0             | (130,767)        |                                     |
| Depreciation and amortization          | 26,009                          | .4              | 73,988         | 1.7             | (47,979)         | (64.8)                              |
| Total costs and expenses               | 2,137,310                       | 35.6            | 2,700,194      | 61.5            | (562,884)        | (20.8)                              |
| Operating loss                         | (451,501)                       | (7.5)           | (1,749,319)    | (39.8)          | 1,297,818        |                                     |
| Interest expense, net                  | (199,413)                       | (3.3)           | (143,241)      | (3.3)           | (56,172)         | 39.2                                |
| Other income                           | 4,957                           | .1              | 498,088        | 11.3            | (493,131)        | (99.0)                              |
| Income tax expense                     | (605)                           | (.0)            | (7,300)        | (.2)            | 6,695            | (91.7)%                             |
| Net loss                               | \$ (646,562)                    | (10.8)          | \$ (1,401,772) | (31.9)          | \$ 755,210       |                                     |
| Net loss per share - basic and diluted | \$ (.03)                        |                 | \$ (.07)       |                 | \$ .04           |                                     |

### Sales

Sales for the three months ended September 30, 2007 were \$2,063,644, an increase of \$636,210 or 44.6% as compared to sales for the three months ended September 30, 2006 of \$1,427,434. Sales for the nine months ended September 30, 2007 were \$6,008,314, an increase of \$1,616,878 or 36.8% as compared to sales for the nine months ended September 30, 2006 of \$4,391,436. A significant portion of this increase was a result of sales from new projects including significant server virtualization projects for a major establishment of the U.S. Government.

Server virtualization involves the creation, allocation, and management of “virtual machines,” which entails the virtual representation of hardware by a software system. Traditional “physical servers,” which typically run at only 5% to 15% of their capacity, can now be consolidated with the use of specialized software such as VMware to increase server utilization by a factor of ten to one or even greater. Reducing the number of physical machines required in a typical environment provides numerous and obvious benefits, including equipment cost savings, reduced operational maintenance costs, easier backup, improved availability, and better security. Due to the substantial energy savings resulting from reduced infrastructure, virtualization is also a “green” technology. We continue to devote substantial resources to support our expanding server and desktop virtualization practice.

In March 2006, one of our subcontracts for services to the U.S. Department of Homeland Security ended when the project ended. Most of our government contracts have a lifecycle; there is a beginning, middle and an end. Contracts end naturally when projects are completed or when appropriations of funds have been fully depleted and new appropriations have not been approved. Our ongoing business development efforts entail the submission of numerous contract proposals and the identification of opportunities for other new contracts to replace sales that do not continue in the ordinary course of business and to increase our sales.

We are actively pursuing opportunities to develop additional sales from new and existing target markets. In March 2006, we opened a regional office in Jackson, Mississippi, and hired a new business development employee and retained a lobbying firm to pursue state and local government business opportunities within the Gulf Coast region. We have made inroads within the state and local government market in Mississippi, although the sales cycle has been longer than we anticipated. Nevertheless, we remain committed to developing the state and local government market and are optimistic about our prospects in Mississippi and several other states. Moreover, we are also channeling energies towards forming alliances with large systems integrators, who are mandated by federal policy to direct defined percentages of their work to small business subcontractors. In addition, we are currently working on proposals for contract awards that we believe will enhance our position as a government contractor.

Early successes in our recent initiatives are evident in the preferred relationships we have earned with several large systems integrators and one major product house. In August 2007, we were notified that we were part of a team led by a large systems integrator that was awarded a Government Wide Acquisition Contract (GWAC) under GSA's \$50 billion Alliant program. In addition, we are a member of a team that won the U.S. State Department's recent Hybrid Information Technology Support Services (HITSS) contract and a member of a team that won a \$36 million contract to support the Navy's Enterprise Maintenance Automated Information System (NEMAIS) data center operations in Norfolk, Virginia and Puget Sound, Washington State. The acquisition of these contract vehicles allows us additional opportunities to bid on new projects. Although we believe our future prospects are robust, the lengthy government financing and procurement processes may result in continuing operating losses until sales increase to support our infrastructure.

### **Cost of Services and Gross Profit**

Cost of services represents the cost of employee services related to the IT Services Group. Cost of services for the three months ended September 30, 2007 was \$1,570,556 or 76.1% of sales as compared to \$1,085,785 or 76.1% of sales for the three months ended September 30, 2006. Gross profit was \$493,088 or 23.9% of sales for the three months ended September 30, 2007 compared to \$341,649 or 23.9% of sales for the three months ended September 30, 2006. Cost of services for the nine months ended September 30, 2007 was \$4,322,505 or 71.9% of sales as compared to \$3,440,561 or 78.3% of sales for the nine months ended September 30, 2006. Gross profit was \$1,685,809 or 28.1% of sales for the nine months ended September 30, 2007 compared to \$950,875 or 21.7% of sales for the nine months ended September 30, 2006.

The increase in gross profit in 2007 is due to a change in the mix of our business resulting from new projects at improved profit margins and a reduction in the costs of employees who did not generate billable sales after contract reductions.

Although our objective is to maintain an overall gross margin of approximately 30%, in the future we may submit bids on new work with lower gross profit margins to generate opportunities for long-term, larger volume contracts and more stable sales.

### **General and Administrative Expenses**

General and administrative expenses include corporate overhead such as compensation and benefits for administrative and finance personnel, rent, insurance, professional fees, travel, and office expenses. General and administrative expenses for the three months ended September 30, 2007 were \$238,890 which was an increase of \$54,331 or 29.4% as compared to \$184,559 for the three months ended September 30, 2006 due to slight increases in a variety of general and administrative expense categories and the reassignment of an independent consultant from research and development when the TouchThru™ development activities ended. As a percentage of sales, general and administrative expenses were 11.6% for the three months ended September 30, 2007 as compared to 12.9% for the three months ended September 30, 2006.

General and administrative expenses for the nine months ended September 30, 2007 decreased by \$75,611 or 10.7%. As a percentage of sales, general and administrative expenses were 10.5% for the nine months ended September 30, 2007 and 16.1% for the nine months ended September 30, 2006. This change was due in part to an increase in sales for the nine months ended September 30, 2007 compared to 2006. In 2007, we experienced a decrease in compensation expense of \$41,200 from consolidating certain administrative functions, which were offset by the expenses associated with the reassignment of an independent consultant from research and development when the TouchThru™ development activities ended. In addition, we incurred certain non-recurring expenses in 2006 including legal fees of \$25,000 due to administering our contracts and annual stockholder meeting proxy expenses of approximately \$18,400.

We anticipate that general and administrative expenses will increase as we continue to grow our business and incur travel and other expenses associated with managing a larger business, however, we anticipate that general and administrative expenses will decline as a percentage of sales as our sales increase.

### **Defined Benefit Pension Plan Expenses**

Defined benefit pension plan expenses are expenses (including pension expense, excise taxes, professional services, and interest costs) associated with the O&W Plan. These expenses were \$84,017 for the three months ended September 30, 2007 and \$250,587 for the three months ended September 30, 2006, a decrease of \$166,570, and \$273,035 for the nine months ended September 30, 2007 and \$342,370 for the nine months ended September 30,

2006, a decrease of \$69,335. The decrease in expense is due to recording excise taxes of \$200,000 during the three months ended September 30, 2006 which are offset by accruing additional interest on unfunded contributions and increases in legal and professional fees during 2007.

During 2006, the Pension Benefit Guarantee Corporation placed a lien on all of our assets to secure pension payments due under the O&W Plan. This lien is subordinate to liens that secure accounts receivable financing and certain notes payable.

Although we have acted as the sponsor of the O&W Plan since we acquired O&W, recently it was determined that we may not have had, or currently have, a legal obligation to do so since December 30, 2002 when we sold all of the common stock of O&W to a third party. During the nine months ended September 30, 2007, we incurred additional legal and professional fees in connection with advocating this position with the appropriate regulatory authorities to ascertain whether they concur or disagree with this determination. We are seeking the concurrence of the Department of Treasury and have recently provided to them the information related to our determination. They are presently reviewing this information.

If our current efforts do not result in a concurrence with our position, we intend to pursue all appropriate further avenues to prevail in our position. Depending upon the ultimate outcome regarding our obligations as sponsor of the O&W Plan, adjustments to our financial statements may be necessary.

### **Selling Expenses**

For the three months ended September 30, 2007, we incurred selling expenses of \$415,325 associated with growing the business in our IT Services Group as compared to \$427,178 for the three months ended September 30, 2006, a decrease of 11,853 or 2.8%. For the nine months ended September 30, 2007 we incurred selling expenses of \$1,118,089 associated with growing business in our IT Services Group compared to \$1,243,369 for the nine months ended September 30, 2006, a decrease of \$125,280 or 10.1%.

Selling expenses consist of our business development staff including salaries, benefits, sales consultants, travel expenses, and occupancy expenses. As a result of the completion of one subcontract during the first quarter of 2006, we reduced certain salaried selling positions. During the second quarter of 2006, we hired new business development personnel, including a new business development director. In June 2007, we hired a new business development employee to focus efforts toward increasing sales of physical to virtual server consolidation projects. In August 2007, we hired two additional employees to focus more effort in generating business opportunity leads and writing proposals for new projects.

We experienced a decrease in consulting expense of \$9,525 and \$103,982 for the three and nine months ended September 30, 2007, respectively, as a result of our hiring of a consultant as an employee in the third quarter of 2006 and our reduction of the use and rate of compensation to other independent consultants.

We continued to incur expenses during the three and nine months ended September 30, 2007 associated with our business development efforts in the Gulf Coast region.

### **Research and Development Expenses and Impairment Loss**

For the three months ended September 30, 2007, we recorded \$1,553 of research and development expenses, a decrease of \$60,456 compared to \$62,009 for the three months ended September 30, 2006. For the nine months ended September 30, 2007, we recorded \$88,807 of research and development expenses compared to \$202,719 for the nine months ended September 30, 2006, a decrease of \$113,912. In 2007, these expenses were principally related to the development of an access control terminal and related software called TouchThru™. During the three months ended September 30, 2007, we ended development activities and related expenses for TouchThru™ and reassigned an independent consultant from these development efforts to other business activities. TouchThru™ is a self-contained terminal enabling physical access control using biometric identification. It incorporates fingerprint matching technology licensed from Ultra-Scan Corporation, a private technology company headquartered in Buffalo, New York.

During the three months ended September 30, 2006, we recorded an impairment loss of \$130,767 related to the carrying costs of TouchThru™ capitalized software development costs, tooling costs and inventory. Our TouchThru™ unit was designed around Ultra-Scan's unique ultrasonic scanner. We anticipate that Ultra-Scan will improve the technology by designing a next generation scanner that will be smaller, lighter and less costly. We expect this will result in a substantial reduction in the costs of components to build our TouchThru™ unit and accordingly a substantial reduction in our sales price. As a result of the evolution of our business strategy, during the three months ended September 30, 2006, we recorded an impairment loss for a portion of capitalized software development costs, all of the capitalized tooling costs and the related inventory.

We believe that significant resources will be required to market and sell a newly designed TouchThru™ product that is based on Ultra-Scan's next generation scanner. For example, we will be required to re-design our TouchThru™ unit based on the next generation of this technology and offer for sale a newly designed unit when it is completed. Given our limited financial resources at this time and other business priorities, this will be deferred until the market is better established and we have the necessary working capital to support this product. We will continue to monitor the market and determine the appropriate time to enter this market.

### **Depreciation and Amortization Expenses**

Depreciation and amortization expense decreased by \$22,649 to \$7,892 for the three months ended September 30, 2007 compared to \$30,361 for the three months ended September 30, 2006. For the nine months ended September 30, 2007, depreciation and amortization expense decreased by \$47,979 to \$26,009 compared to \$73,988 for the nine months ended September 30, 2006. The decrease is due to less depreciation and amortization of assets related to the TouchThru™ product, which was considered impaired and written off during the last two quarters of 2006.



### **Operating Loss**

For the three months ended September 30, 2007 our operating loss was \$(254,589) compared to an operating loss of \$(743,812) for the three months ended September 30, 2006; an improvement of \$489,223. This is principally attributable to the following factors: first, our sales increased by \$636,210 from \$1,427,434 in 2006 to \$2,063,644 in 2007; second, our gross profit increased by \$151,439 from \$341,649 in 2006 to \$493,088 in 2007; and third, we realized a decrease in total operating expenses of \$337,784 from \$1,085,461 in 2006 to \$747,677 in 2007.

For the nine months ended September 30, 2007 our operating loss was \$(451,501) compared to an operating loss of \$(1,749,319) for the nine months ended September 30, 2006; an improvement of \$1,297,818. This is principally attributable to the following factors: first, our sales increased by \$1,616,878 from \$4,391,436 in 2006 to \$6,008,314 in 2007; second, our gross profit increased by \$734,934 from \$950,875 in 2006 to \$1,685,809 in 2007; and third, we realized a decrease in total operating expenses of \$562,884 from \$2,700,194 in 2006 to \$2,137,310 in 2007.

### **Net Interest Expense**

Net interest expense consists of interest income offset by interest expense on indebtedness and fees for financing accounts receivable invoices. Net interest expense was \$69,624 for the three months ended September 30, 2007 compared to net interest expense of \$56,551 for the three months ended September 30, 2006. Net interest expense was \$199,413 for the nine months ended September 30, 2007 compared to net interest expense of \$143,241 for the nine months ended September 30, 2006. The increase in net interest expense of \$13,073 and \$56,172, for the three and nine months ended September 30, 2007, respectively, was principally due to an increase in the length of term and volume of accounts receivable invoices that were financed in 2007.

### **Other Income (Loss)**

For the three months ended September 30, 2007, we had a loss of \$1,634 compared to \$0 for the three months ended September 30, 2006. For the nine months ended September 30, 2007, we had other income of \$4,957 compared to \$498,088 for the nine months ended September 30, 2006.

We received and recorded other income of \$498,088, net of legal fees and expenses of \$164,412, in the first quarter of 2006. We were the plaintiff in a lawsuit filed in the Superior Court, State of Rhode Island on August 13, 1999 captioned Infinite Group, Inc. vs. Spectra Science Corporation and Nabil Lawandy. In the action, we asserted that by fraud and in breach of fiduciary duties owed, Spectra and its president, Nabil Lawandy, caused us to sell to Spectra shares of Spectra's Series A Preferred stock at a substantial discount to fair market value. We alleged that in entering into the transaction it relied on various representations made by Spectra and Mr. Lawandy, which were untrue at the time they were made. The trial was completed in February 2005, and the jury returned a verdict in our favor in the amount of approximately \$600,000. We appealed the amount of the verdict and entered into a settlement with the defendants in January 2006 and recorded other income of \$498,088.

### **Income Taxes**

Income tax expense was \$0 for the three months ended September 30, 2007 and 2006, respectively. Income tax expense was \$605 and \$7,300 for the nine months ended September 30, 2007 and 2006, respectively, consisting of state taxes.

### **Net Loss**

For the three months ended September 30, 2007, we recorded a net loss in the amount of \$(325,847) or \$(.01) per share compared to a net loss of \$(800,363) or \$(.04) per share for the three months ended September 30, 2006. The

improvement in net loss of \$474,516 is principally attributable to an increase in gross profit of \$151,439 and a decrease in operating costs and expenses of \$337,784. For the three months ended September 30, 2007 and 2006, we recorded expense of \$97,009 and \$77,853, respectively, for employee stock options expense under SFAS 123R and \$25,595 and \$5,697, respectively, for equity instruments issued to consultants.

For the nine months ended September 30, 2007, we recorded a net loss in the amount of \$(646,562) or \$(.03) per share compared to a net loss of \$(1,401,772) or \$(.07) per share for the nine months ended September 30, 2006. The improvement in net loss of \$755,210 is principally attributable to an increase in gross profit of \$734,934 and a decrease in operating costs and expenses of \$562,884, which were offset in part by an increase in net interest expense of \$56,172, a decreases in other income of \$493,131 and state income taxes of \$6,695.

## Stock-Based Compensation

In the following table, we present adjustments and pro forma amounts to reflect the impact that the adoption of SFAS 123R related to employee stock options had on our financial statements including net loss for the nine months ended September 30, 2007 and 2006. Such expenses are allocated in the same manner as employee salary expense. We believe that these non-generally accepted accounting principles (GAAP) financial measures provide investors useful information to facilitate the comparison of current performance to prior performance. These non-GAAP measures should not be considered in isolation or as a substitute for performance measures in accordance with GAAP.

|                               | Nine Months Ended September 30, |                     |                   |                     |                     |                   |
|-------------------------------|---------------------------------|---------------------|-------------------|---------------------|---------------------|-------------------|
|                               | 2007<br>As Reported             | 2007<br>Adjustments | 2007<br>Pro Forma | 2006<br>As Reported | 2006<br>Adjustments | 2006<br>Pro Forma |
| Sales                         | \$ 6,008,314                    | \$ -                | \$ 6,008,314      | \$ 4,391,436        | \$ -                | \$ 4,391,436      |
| Cost of services              | 4,322,505                       | (67,702)            | 4,254,803         | 3,440,561           | (20,372)            | 3,420,189         |
| Gross profit                  | 1,685,809                       | 67,702              | 1,753,511         | 950,875             | 20,372              | 971,247           |
| General and administrative    | 631,370                         | (12,636)            | 618,734           | 706,981             | (8,485)             | 698,496           |
| Defined benefit pension plan  | 273,035                         | -                   | 273,035           | 342,370             | -                   | 342,370           |
| Selling                       | 1,118,089                       | (99,730)            | 1,018,359         | 1,243,369           | (145,523)           | 1,097,846         |
| Research and development      | 88,807                          | -                   | 88,807            | 202,719             | -                   | 202,719           |
| Impairment loss               | -                               | -                   | -                 | 130,767             | -                   | 130,767           |
| Depreciation and amortization | 26,009                          | -                   | 26,009            | 73,988              | -                   | 73,988            |
| Total costs and expenses      | 2,137,310                       | (112,366)           | 2,024,944         | 2,700,194           | (154,008)           | 2,546,186         |
| Operating loss                | (451,501)                       | 180,068             | (271,433)         | (1,749,319)         | 174,380             | (1,574,939)       |
| Interest expense, net         | (199,413)                       | -                   | (199,413)         | (143,241)           | -                   | (143,241)         |
| Other income                  | 4,957                           | -                   | 4,957             | 498,088             | -                   | 498,088           |
| Income tax expense            | (605)                           | -                   | (605)             | (7,300)             | -                   | (7,300)           |
| Net loss                      | \$ (646,562)                    | \$ 180,068          | \$ (466,494)      | \$ (1,401,772)      | \$ 174,380          | \$ (1,227,392)    |
| Net loss per share - basic    | \$ (.03)                        | \$ .01              | \$ (.02)          | \$ (.07)            | \$ .01              | \$ (.06)          |

We recorded expense of \$74,488 and \$17,091 for equity instruments issued to consultants for the nine months ended September 30, 2007 and 2006, respectively.

## Liquidity and Capital Resources

At September 30, 2007, we had cash of \$8,643 available for our working capital needs and planned capital asset expenditures, a working capital deficit of approximately \$2,445,000 and a current ratio of .22. The O&W Plan current liabilities have a significant impact on our working capital. Without the current liabilities of the O&W Plan of approximately \$1,975,000, working capital would be a deficit of approximately \$470,000. Our objective is to improve our working capital position from profitable operations. If we continue to incur operating losses or net losses, we may continue to experience working capital shortages that impair our business operations and growth strategy. Presently, we have sufficient cash flow and short-term financing sources, including sales with recourse of accounts receivable, to pay our payrolls and recurring invoices on a timely basis.

We have financed the activity of our IT Services Group through the issuance of notes payable to third parties, including related parties, private placements of common stock and financing through sales with recourse of our accounts receivable.

We have available a financing line of up to \$800,000 with a financial institution that allows us to sell selected accounts receivable invoices to the financial institution with full recourse against us. We pay fees based on the length of time that the invoice remains unpaid. At September 30, 2007, we had approximately \$200,000 of availability under this line and could finance up to another approximately \$200,000 based on eligible accounts receivable at September 30, 2007.

We have used our common stock to provide compensation to certain employees and consultants and to fund liabilities. For the nine months ended September 30, 2007 we recorded expense of \$37,800 related to a warrant issued to a consultant who has met a portion of his performance criteria by assisting us with increasing our sales in 2007. During this period we also recorded expense of \$37,188 related to a warrant for 100,000 shares of our common stock and 100,000 shares of our common stock issued to another consultant for services to be performed over one year.

During the nine months ended September 30, 2006, we issued non-qualified stock options and warrants to other service providers and recorded \$17,091 of expense related to these issuances.

Successes in our 2006 and 2007 initiatives are evident in the preferred relationships we have earned with several large systems integrators and one major product house. In addition, we are a member of a team that won the U.S. State Department's recent Hybrid Information Technology Support Services (HITSS) contract and a member of a team that won a \$36 million contract in October 2007 to support the U.S. Navy's Enterprise Maintenance Automated Information System (NEMAIS) data center operations in Norfolk, Virginia and Puget Sound, Washington. In June 2006, we were awarded a prime contract under the Department of the Navy's SeaPort-Enhanced (SeaPort-e) program. This contract allows us to compete for and perform service requirements solicited by various Navy commands, the Marine Corps, other organizations within the Department of Defense (DoD), non-DoD agencies, and certain joint agency organizations for work that is integrally related to the scope and mission of the contract. This work involves professional services in all phases of naval ship and weapon systems acquisition and life-cycle support, including research and development support, prototyping, technology analysis, acquisition logistics, project management support, modeling, test and evaluation trials, crisis and consequence management, and engineering support. (The NEMAIS Data Center contract referenced above was procured using the SeaPort-e contract vehicle.)

During 2007, we were approved as a VMware Authorized Consultant (VAC) by VMware, Inc. (NYSE:VMW), a subsidiary of EMC Corporation (NYSE:EMC). VMware is recognized as the industry leader in virtualization technology. As a VAC, we are trained and certified to deliver consulting services and solutions leveraging VMware technology. We are also certified as a VMware Enterprise VIP Reseller authorized to resell VMware's full product line. We are actively working with a number of potential customers in that regard. These certifications are examples of our concerted effort to grow and expand our server virtualization practice. Server virtualization involves the creation, allocation, and management of "virtual machines," which entails the virtual representation of hardware by a software system. What this means is that traditional "physical servers," which typically run at only 5% to 15% of their capacity, can now be consolidated with the use of specialized software such as VMware to increase server utilization by a factor of ten to one or even greater. Reducing the number of physical machines required in a typical environment provides numerous and obvious benefits, including equipment cost savings, reduced operational maintenance costs, easier backup, improved availability, and better security. Due to the substantial energy savings resulting from reduced infrastructure, virtualization is also a "green" technology.

In July 2007, we were accepted into the Hewlett Packard (NYSE:HPQ) Developer and Solutions Partner Program (DSPP). DSPP provides us with a mechanism to work with HP and our joint customers and prospects to provide solutions and services that complement HP's broad portfolio of products and services. HP has many tools and resources to help us generate new revenue streams, and improve our mutual profitability, while at the same time adding unique value for our joint customers. The program comprises practical tools and services that we hope will help us in the key areas of marketing and selling our solutions, optimizing the technology, and collaborating with other organizations within our industry.

In August 2007, we were notified that we were part of a team led by a large systems integrator that was awarded a Government Wide Acquisition Contract (GWAC) under GSA's \$50 billion Alliant program. The competitively awarded GSA Alliant contract is a multiple-award, indefinite-delivery, indefinite-quantity (IDIQ) contract with a ceiling value of \$50 Billion. The GSA's Alliant Government-wide Acquisition Contract is for ten years and can be utilized by all federal and Department of Defense agencies. The lead systems integrator and its team was one of 29 companies to receive awards for the contract which will support national security in areas such as infrastructure protection, anti-terrorism and emerging technologies.

The acquisition of these contract vehicles allows us additional opportunities to bid on new projects.

Although our future prospects appear promising, the lengthy government financing and procurement processes may result in continuing operating losses until sales increase to support our infrastructure.

In the future, we may issue additional debt or equity securities to satisfy our cash needs. Any debt incurred or issued may be secured or unsecured, at a fixed or variable interest rates and may contain other terms and conditions that our board of directors deems prudent. Any sales of equity securities may be at or below current market prices. We cannot assure you that we will be successful in generating sufficient capital to adequately fund our working capital needs.

### **Risk Factors**

You should consider the risk factors included in our Annual Report on Form 10-KSB for the year ended December 31, 2006 in evaluating our business and us. Additional risks and uncertainties not presently known to us, which we currently deem immaterial or that are similar to those faced by other companies in our industry or business in general, such as competitive conditions, may also impair our business operations. If any of the results of the risks occur, our business, financial condition, or results of operations could be materially adversely affected.

### **Item 3. Controls and Procedures**

Evaluation of Disclosure Controls and Procedures. Our management, with the participation of the chief executive officer and chief financial officer, carried out an evaluation of the effectiveness of our “disclosure controls and procedures” (as defined in the Securities Exchange Act of 1934, as amended (the “Exchange Act”) Rules 13a-15(e) and 15-d-15(e)) as of the end of the period covered by this report (the “Evaluation Date”). Based upon that evaluation, the chief executive officer and chief financial officer 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 U.S. Securities and Exchange Commission’s rules and forms and (ii) is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting. There were no changes in our internal controls over financial reporting that occurred during our fiscal third quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II**

### **OTHER INFORMATION**

#### **Item 1. Legal Proceedings.**

We are not presently involved in any material legal proceedings.

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

None.

#### **Item 3. Defaults Upon Senior Securities.**

None.

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

None.

#### **Item 5. Other Information.**

None.

#### **Item 6. Exhibits.**

| Exhibit No. | Description  |
|-------------|--|
| 31.1        | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*                             |
| 31.2        | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*                             |
| 32.1        | Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.* |

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\* Filed herewith

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**SIGNATURES**

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

Infinite Group, Inc.  
(Registrant)

Date: November 12, 2007

/s/ Michael S. Smith  
Chief Executive Officer  
(Principal Executive Officer)

Date: November 12, 2007

/s/ Michael S. Smith  
Chief Financial Officer  
(Principal Financial Officer)