

INFINITE GROUP INC
Form 10-Q
May 13, 2011

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: March 31, 2011

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: 0-21816

INFINITE GROUP, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

52-1490422
(IRS Employer
Identification No.)

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

(585) 385-0610
(Registrant's telephone number)

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

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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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 and post such files).
Yes No

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

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Large Accelerated filer
Non-accelerated filer

Accelerated filer
Smaller reporting company

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. There were 26,461,883 shares of the issuer's common stock, par value \$.001 per share, outstanding as of May 13, 2011.

Infinite Group, Inc.
 Quarterly Report on Form 10-Q
 For the Period Ended March 31, 2011

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FORWARD-LOOKING STATEMENTS

Certain statements made in this Quarterly Report on Form 10-Q 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

	March 31, 2011 (Unaudited)	December 31, 2010
ASSETS		
Current assets:		
Cash	\$ 16,246	\$ 33,155
Accounts receivable, net of allowance of \$70,000	511,450	709,302
Prepaid expenses and other current assets	14,108	15,392
Total current assets	541,804	757,849
Property and equipment, net	65,708	68,210
Deposits and other assets	18,424	18,424
Total assets	\$ 625,936	\$ 844,483
LIABILITIES AND STOCKHOLDERS' DEFICIENCY		
Current liabilities:		
Accounts payable	\$ 707,299	\$ 651,976
Accrued payroll	197,182	283,425
Accrued interest payable	335,594	312,945
Accrued retirement and pension	3,262,505	3,129,584
Accrued expenses – other	33,762	54,717
Current maturities of long-term obligations-bank	24,796	25,954
Notes payable	30,000	30,000
Notes payable - related parties	174,000	174,000
Total current liabilities	4,765,138	4,662,601
Long-term obligations:		
Notes payable:		
Banks and other	619,448	624,469
Related parties	501,324	501,324
Accrued pension expense	1,291,119	1,291,119
Total liabilities	7,177,029	7,079,513
Commitments and contingencies (Note 6)	-	-
Stockholders' deficiency:		
Common stock, \$.001 par value, 60,000,000 shares authorized; 26,461,883 (26,461,883 - 2010) shares issued and outstanding	26,461	26,461
Additional paid-in capital	30,015,699	29,999,371
Accumulated deficit	(33,632,106)	(33,299,715)
Accumulated other comprehensive loss	(2,961,147)	(2,961,147)

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Total stockholders' deficiency	(6,551,093)	(6,235,030)
Total liabilities and stockholders' deficiency	\$625,936	\$ 844,483

See notes to unaudited consolidated financial statements.

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

	Three Months Ended March 31,	
	2011	2010
Sales	\$2,009,482	\$2,769,795
Cost of services	1,536,037	2,056,804
Gross profit	473,445	712,991
Costs and expenses:		
General and administrative	247,623	308,299
Defined benefit pension plan	151,863	126,153
Selling	339,544	483,956
Total costs and expenses	739,030	918,408
Operating loss	(265,585)	(205,417)
Interest expense:		
Related parties	(12,864)	(12,010)
Other	(52,762)	(54,136)
Total interest expense	(65,626)	(66,146)
Loss before income tax expense	(331,211)	(271,563)
Income tax expense	(1,180)	(1,230)
Net loss	\$(332,391)	\$(272,793)
Net loss per share - basic and diluted	\$(.01)	\$(.01)
Weighted average number of shares outstanding - basic and diluted	26,461,883	25,661,883

See notes to unaudited consolidated financial statements.

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

	Three Months Ended March 31,	
	2011	2010
Operating activities:		
Net loss	\$(332,391)	\$(272,793)
Adjustments to reconcile net loss to net cash used by operating activities:		
Stock based compensation	16,328	41,011
Depreciation	7,954	8,388
Decrease (increase) in assets:		
Accounts receivable	197,852	12,837
Other assets	1,284	(16,544)
(Decrease) increase in liabilities:		
Accounts payable	55,323	(35,346)
Accrued expenses	(84,549)	143,418
Accrued pension obligations	132,921	105,690
Net cash used by operating activities	(5,278)	(13,339)
Investing activities:		
Purchase of property and equipment	(5,452)	(3,068)
Net cash used by investing activities	(5,452)	(3,068)
Financing activities:		
Repayments of notes payable	(6,179)	(3,746)
Repayments of note payable-related party	-	(25,000)
Net cash used by financing activities	(6,179)	(28,746)
Net decrease in cash	(16,909)	(45,153)
Cash - beginning of period	33,155	196,711
Cash - end of period	\$16,246	\$151,558
Supplemental disclosure:		
Cash paid for:		
Interest	\$41,010	\$50,387
Income taxes	\$1,180	\$1,230

See notes to unaudited 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-Q. 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 December 31, 2010 balance sheet has been derived from the audited financial statements at that date, but does not include all disclosures required by GAAP. 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-K for the year ended December 31, 2010 filed with the U.S. Securities and Exchange Commission (SEC). Results of consolidated operations for the three months ended March 31, 2011 are not necessarily indicative of the operating results that may be expected for the year ending December 31, 2011. The unaudited 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 the Company believes are significant to the presentation of its consolidated financial statements. These policies require management to make complex or subjective judgments about matters that are inherently uncertain. Note 3 to the Company’s audited consolidated financial statements for the year ended December 31, 2010 presents a summary of significant accounting policies.

Note 3. Warrants

On March 3, 2006, the Company engaged the services of a consultant, an accredited investor, and issued the consultant a warrant to acquire shares of the Company’s common stock exercisable at \$.30 per share. The balance of 320,000 shares under the terms of the warrant expired on March 2, 2011.

On May 1, 2006, the Company engaged the services of a consultant and issued the consultant a warrant to acquire 50,000 shares of the Company’s common stock exercisable at \$.35 per share which warrant expired unvested on April 30, 2011.

Note 4. Stock Option Plans

The Company has approved stock options plans covering up to an aggregate of 9,118,833 shares of common stock. Such options may be designated at the time of grant as either incentive stock options or nonqualified stock options. Stock based compensation includes expense charges related to all stock-based awards to employees, directors and consultants. Such awards include options, warrants and stock grants.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. The following assumptions were used for the three months ended March 31, 2011 and 2010:

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	2011	2010
Risk-free interest rate	2.36% - 2.46%	2.74% - 2.90%
Expected dividend yield	0%	0%
Expected stock price volatility	75%	75%
Expected life of options	5.75 years	5.75 years

The Company recorded expense for options and warrants issued to employees and independent service providers of \$16,328 and \$41,011 for the three months ended March 31, 2011 and 2010, respectively.

A summary of all stock option activity for the three months ended March 31, 2011 follows:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at December 31, 2010	6,414,500	\$.22		
Options granted	60,000	\$.08		
Options expired	(10,000)	\$.20		
Outstanding at March 31, 2011	6,464,500	\$.22	5.8 years	\$ 11,850
Exercisable at March 31, 2011	4,882,500	\$.24	4.7 years	\$ 11,550

The weighted average fair value of options granted during the three months ended March 31, 2011 was approximately \$.05 (\$.11 during the three months ended March 31, 2010). No options were exercised during the three months ended March 31, 2011 and 2010.

At March 31, 2011, there was approximately \$106,400 of total unrecognized compensation cost related to non-vested options. That cost is expected to be recognized over a weighted average period of approximately two years. The total fair value of shares that vested during the three months ended March 31, 2011 was approximately \$24,200.

Note 5. Earnings Per Share

Basic net income (loss) per share is based on the weighted average number of common shares outstanding during the periods presented. Diluted net income (loss) per share is based on the weighted average number of common shares outstanding, as well as dilutive potential common shares which, in the Company's case, comprise shares issuable under convertible notes payable, stock options and stock warrants. 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 options and warrants assumed to be exercised. In a loss period, the calculation for basic and diluted loss per share is considered to be the same, as the impact of potential common shares is anti-dilutive.

For the three months ended March 31, 2011 and 2010, convertible debt, options and warrants to purchase 24,712,064 and 24,367,562 shares of common stock, respectively, that could potentially dilute basic earnings per share in the future were excluded from the calculation of diluted net income (loss) per share because their inclusion would have been anti-dilutive due to the Company's losses in the respective three months.

Note 6. Employee Pension Plan

Prior to December 30, 2002, the Company owned 100% of the common stock of O&W. On December 30, 2002, the Company sold 100% of the O&W common stock to a third party, but continued to act as the sponsor of the Plan. Although the Company continued to act as the sponsor of the Plan after the sale, during 2007 management determined that it had no legal obligation to do so.

During 2007, the Company submitted information to the Department of Treasury (Treasury) advocating that it had no legal obligation to act as the sponsor of the Plan to ascertain whether the Treasury concurred or disagreed with this position. The Company subsequently provided responses to Treasury inquiries related to this determination. In October 2009, the Company received a report from the Treasury that stated that the Treasury staff disagreed with the Company's position and as a result, the Company is responsible for excise taxes attributed to the funding deficiency of

\$1,836,359 for the years 2003 through 2007 which funding deficiency can only be corrected by contributing \$1,836,359 to the Plan. The report also states that proposed 10% excise taxes of \$348,500, penalties for late payment of excise taxes of approximately \$1.2 million and 100% excise taxes of approximately \$3.5 million related to the years ended December 31, 2006 and 2007 may be imposed. Penalties for late payment may be removed if the Company provides reasonable cause for not paying the excise taxes and the Treasury concurs with the Company's position. The Company and its outside legal counsel disagree with significant aspects of both the factual findings and legal conclusions set forth in the report and, in accordance with Treasury procedures, have responded with a detailed analysis of its opposition to their findings. The Company plans to diligently pursue all appropriate steps to perfect its appeal rights and attempt to prevail on the merits of its position, which will include filing a protest, requesting an appeals conference, and, if needed, petitioning the tax court and advocating its position in that forum.

If the Company does not ultimately prevail, it will become obligated for Plan contributions of approximately \$2.2 million as of March 31, 2011 and 10% excise taxes on accumulated unfunded Plan contributions for the Plan years ended December 31, 2006 and 2007 of approximately \$348,500, as stated above, and potentially additional 10% excise taxes of approximately \$440,000 for the years ended December 31, 2009 and 2008, which have not been accrued based upon the Company's determination that it has no legal obligation to act as the Plan sponsor and the Company's belief that the likelihood is not probable that it will be required to pay these excise taxes. Further, if the Company does not ultimately prevail, it may be required to pay interest on these excise taxes and potentially incur penalties for late payment of excise taxes and additional excise taxes up to 100% of each year's required funding deficiency. The Company has accrued amounts related to excise taxes, including late fees and interest, on unfunded contributions for 2003, 2004 and 2005 of approximately \$473,000 as of March 31, 2011 (\$470,000 at December 31, 2010). No excise taxes, late fees or interest for 2006, 2007, 2008, 2009, and 2010 have been accrued at March 31, 2011 or December 31, 2010. The Company does not have the funds available to make required contributions which approximate \$2.2 million and does not intend to make any contributions to the O&W Plan during 2011.

During 2006, the Pension Benefit Guarantee Corporation (PBGC) placed a lien on all of the Company's assets to secure the contributions due to the Plan. This lien is subordinate to liens that secure accounts receivable financing and certain notes payable.

On April 29, 2009, acting for the Plan, the Company sent the Plan participants a notice of intent to terminate the Plan in a distress termination with a proposed termination date of June 30, 2009. The Company also provided additional documentation regarding the Company's status and the status of the Plan. The termination of the Plan is subject to approval by the PBGC. The Company has provided information to the PBGC which Company management believes satisfies the requirements of the PBGC. Recently, the Company discussed terminating the Plan with the PBGC, which included a cap on the Company's potential financial obligation with respect to the Plan and the PBGC, and which may have the effect of reducing the Company's potential Treasury obligations as summarized above. However, there are no assurances that an agreement satisfactory to the PBGC and the Company will be concluded.

At March 31, 2011, the O&W Plan had an accrued pension obligation liability of \$4,435,382 (\$4,314,883 at December 31, 2010), which includes the underfunded amount plus interest on past due payments and excise taxes including penalties and interest of approximately \$473,000 as discussed above. Accumulated other comprehensive loss of \$2,961,147 (\$2,961,147 at December 31, 2010) has been recorded as a reduction of stockholders' deficiency.

The market value of the O&W Plan assets decreased from \$1,601,276 at December 31, 2010 to \$1,559,150 at March 31, 2011. The decrease was comprised of investment returns of \$72,365, offset by benefit payments of \$113,549 and expenses of \$942.

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

	Three Months Ended	
	March 31,	
	2011	2010
Interest cost	\$ 67,878	\$ 72,531
Expected return on plan assets	(30,193)	(39,148)
Service cost	10,500	12,500
Actuarial loss	33,960	31,882
Net periodic pension cost	\$ 82,145	\$ 77,765

There were no holdings of Level 3 investments and there were no purchases, sales, issuances, and settlements of Level 3 investments during the three months ended March 31, 2011 and 2010. Additionally, there were no transfers between

Level 1 and Level 2 assets during the three months ended March 31, 2011.

Note 7. Supplemental Cash Flow Information

Non-cash investing and financing transactions, including non-monetary exchanges, consisted of the acquisition of computer equipment of \$38,675 under the terms of a capital lease during the three months ended March 31, 2010.

Note 8. Management Plans – Capital Resources

The Company reported net losses for the three months ended March 31, 2011 and 2010, respectively, and a stockholders' deficit at March 31, 2011 and December 31, 2010, and a decline in the Company's 2011 and 2010 sales as compared to prior periods in 2010 and 2009, respectively. The Company's capital resources are summarized as follows.

The Company believes the capital resources available under its factoring line of credit, cash from additional related party loans and cash generated by improving the results of its operations provide sources to fund its ongoing operations and to support the internal growth it expects to achieve for at least the next 12 months. The Company will continue to implement expense reductions if it does not realize improved sales or improved gross profit margins. If the Company does not improve the results of its operations in future periods, it expects that additional working capital will be required to fund its business. Although the Company has no assurances, it believes that related parties, who have previously provided working capital to the Company, will continue to provide working capital loans on similar terms, as in the past, as may be necessary to fund the on-going operations for at least the next 12 months. If the Company experiences significant growth in its sales, it believes that this may require it to increase its financing line or obtain additional working capital from other sources to support its sales growth. There is no assurance that in the event it needs additional funds that adequate additional working capital will be available or, if available, will be offered on acceptable terms.

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

IT Consulting

We are a provider of information technology (IT) services to federal, state and local governments and commercial clients. Our expertise includes managing leading edge operations and implementing complex programs in advanced server management, virtualization (server, desktop, application, and storage), cloud computing, network services, information security, wireless technology, human capital services, enterprise architecture, and program and project management. We focus on aligning business processes with technology for delivery of solutions meeting our clients' exact needs and providing expert management services to the lifecycle of technology-based projects.

We have a business development office with close proximity to the Washington, D.C. metropolitan area and operate in various locations in the United States. In December 2009, we opened an office in Colorado Springs, Colorado to serve as a business development and client service office for the Rocky Mountain region. We increased our focus to include providing IT consulting services to small and medium sized businesses in Upstate New York and recently started our marketing efforts through our newly formed KeyITSupport division.

We have several contract vehicles that enable us to deliver a broad range of our services and solutions to the U.S. Government and state governments. The quality and consistency of our services and IT expertise allow us to maintain long-term relationships with the U.S. Government and other major clients. We have entered into various subcontract agreements with prime contractors to the U.S. Government, state and local governments and commercial customers.

Results of Operations

Comparison of the Three Months Ended March 31, 2011 and 2010

The following table compares our statements of operations data for the three months ended March 31, 2011 and 2010. The trends suggested by this table are not indicative of future operating results.

	Three Months Ended March 31,						2011 vs. 2010	
	2011	As a % of Sales		2010	As a % of Sales	Amount of Change	% Increase (Decrease)	
Sales	\$2,009,482	100.0	%	\$2,769,795	100.0	\$(760,313)	(27.5)	%
Cost of services	1,536,037	76.4		2,056,804	74.3	(520,767)	(25.3)	
Gross profit	473,445	23.6		712,991	25.7	(239,546)	(33.6)	
General and administrative	247,623	12.3		308,299	11.1	(60,676)	(19.7)	
Defined benefit pension plan	151,863	7.6		126,153	4.6	25,710	20.4	
Selling	339,544	16.9		483,956	17.5	(144,412)	(29.8)	
Total operating expenses	739,030	36.8		918,408	33.2	(179,378)	(19.5)	
Operating loss	(265,585)	(13.2)		(205,417)	(7.4)	60,168	29.3	
Interest expense	(65,626)	(3.3)		(66,146)	(2.4)	(520)	(0.8)	
Income tax expense	(1,180)	(.1)		(1,230)	(.0)	(50)	(4.1)	
Net loss	\$(332,391)	(16.5)	%	\$(272,793)	(9.8)	\$59,598	21.8	%
Net loss per share - basic and diluted	\$(.01)			\$(.01)				

Sales

The current economic downturn has led to economic contraction in certain areas of business where we operate. It is also impacting the needs of our clients. These changing demand patterns have had and will likely continue to have an adverse effect on our new project bookings and sales.

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Sales for the three months ended March 31, 2011 were \$2,009,482 as compared to sales for the three months ended March 31, 2010 of \$2,769,795, a decrease of \$760,313 or 27.5%. The sales decrease in 2011 was principally a result of reduced sales to U.S. Government agencies and an establishment of the U.S. Government. Certain projects, including a Microsoft Stimulus360 project (used to help public sector agencies track, measure, and share information about federal stimulus programs through easy-to-use graphical dashboards and maps) for a state government client, were completed in 2010 and were not replaced by the same volume of new projects. In addition, during the second half of 2010, certain consulting services performed by our employees were in-sourced by the U.S. Government and certain employees were converted to U.S. Government employees. In the second half of 2010, we worked more closely with certain of our partners to increase opportunities for sales to commercial clients. We continue to pursue opportunities to develop additional sales from new and existing target markets.

We continue to use one consultant and one employee on a part time basis to focus on business development in the Gulf Coast region. During 2010, we completed a virtualization assessment project that studied, architected, and designed a program to consolidate and virtualize executive agency servers for a State Government datacenter. During the second half of 2011, we expect to begin implementing the second phase of a virtualization project with work extending into 2012.

We have several contract vehicles that enable us to deliver a broad range of our services and solutions to the U.S. Government. The acquisition of these contract vehicles allows us additional opportunities to bid on new projects. Although we believe we have opportunities for sales growth with government and commercial clients, the lengthy procurement processes may result in continuing operating losses until sales increase to support our infrastructure. We understand that the U.S. Government has expressed its intention to reduce its budgets related to technical services contracts in the coming years, which may impact our ability to increase our sales to certain U.S. Government agencies.

Cost of Services and Gross Profit

Cost of services represents the cost of employee services related to our IT Services Group. Cost of services for the three months ended March 31, 2011 was \$1,536,037 or 76.4% of sales as compared to \$2,056,804 or 74.3% for the three months ended March 31, 2010. Gross profit was \$473,445 or 23.6% of sales for the three months ended March 31, 2011 compared to \$712,991 or 25.7% of sales for the three months ended March 31, 2010. The decrease in gross profit margin is due to a change in the mix of our business resulting from new projects in 2010 which carried higher profit margins than work completed in 2011. Additionally, gross profit margins in the first quarter of 2011 were adversely affected by a decrease in certain personnel utilization rates when certain project commencement dates were delayed or deferred.

General and Administrative Expenses

General and administrative expenses include corporate overhead such as compensation and benefits for executive, administrative and finance personnel, rent, insurance, professional fees, travel, and office expenses. General and administrative expenses for the three months ended March 31, 2011 decreased by \$60,676 or 19.7% to \$247,623 as compared to \$308,299 for the same period in 2010. The decrease in general and administrative expenses in 2011 was a result of decreased salaries from a personnel reduction.

We anticipate that general and administrative expenses will increase as we continue to grow our business and incur travel and other expenses associated with recruiting additional personnel and managing a larger business.

Defined Benefit Pension Plan Expenses

Defined benefit pension plan expenses include expenses (including pension expense, professional services, and interest costs) associated with the Osley & Whitney, Inc. Retirement Plan (O&W Plan) of \$151,863 for the three months ended March 31, 2011 and \$126,153 for the three months ended March 31, 2010, an increase of \$25,710. During the three months ended March 31, 2011, we incurred legal and professional fees of approximately \$31,000 in connection with compliance requirements and advocating our legal position in response to recent communication with the appropriate regulatory authorities as compared to approximately \$13,000 for the three months ended March 31, 2010. Net periodic pension cost decreased by \$4,380 to \$82,145 for the three months ended March 31, 2011. We continue to accrue interest and fees on unpaid excise taxes for plan years 2003, 2004 and 2005, as well as interest on unfunded contributions, which amounted to additional expense of approximately \$38,400 and \$35,300 for the three months ended March 31, 2011 and 2010, respectively.

Selling Expenses

For the three months ended March 31, 2011 we incurred selling expenses of \$339,544 associated with the development of our IT Services Group business compared to \$483,956 for the three months ended March 31, 2010, a decrease of \$144,412. This decrease is primarily attributable to the reduction of our business development work force since April 2010. We also realized expense reductions associated with less travel and other selling expenses due to maintaining fewer business development positions.

Operating Loss

For the three months ended March 31, 2011, we had an operating loss of \$265,585 compared to an operating loss of \$205,417 for the three months ended March 31, 2010. The \$60,168 increase is principally attributable to a decrease in gross profit of \$239,546 offset by a decrease in total operating expenses of \$179,378 for the three months ended March 31, 2011 as compared to 2010.

Included in the above results are non-cash expenses for the three months ended March 31, 2011 and 2010, consisting of:

	Three Months Ended March 31,	
	2011	2010
Stock-based compensation	\$ 16,328	\$ 41,011
Depreciation	7,954	8,388
Periodic pension costs, interest and fees	120,500	113,037
Total	\$ 144,782	\$ 162,436

Interest Expense

Total interest expense was \$65,626 for the three months ended March 31, 2011 and was relatively unchanged from \$66,146 for the three months ended March 31, 2010.

Income Taxes

Income tax expense was \$1,180 and \$1,230 for the three months ended March 31, 2011 and 2010, respectively, consisting of state taxes.

Net Loss

For the three months ended March 31, 2011, we recorded a net loss of \$332,391 or \$(.01) per share compared to a net loss of \$272,793 or \$(.01) per share for the three months ended March 31, 2010.

Liquidity and Capital Resources

At March 31, 2011, we had cash of \$16,246 available for our working capital needs and planned capital asset expenditures. Our primary liquidity needs are the financing of working capital and capital expenditures. Our primary source of liquidity is cash provided by collections of accounts receivable and our factoring line of credit. At March 31, 2011, we had approximately \$156,000 of availability under this line.

At March 31, 2011, we had a working capital deficit of approximately \$4.2 million and a current ratio of .11. Our objective is to improve our working capital position through profitable operations. The O&W Plan's current liabilities have a significant impact on our working capital. Without the current liabilities of the O&W Plan of approximately \$3.1 million, our working capital deficit would have been approximately \$1.1 million at March 31, 2011.

During 2011, we financed our business activities through sales with recourse of our accounts receivable. During 2010, we financed our business activities through the issuance of notes payable to related parties, sales with recourse of our accounts receivable and capital leases. Also, during 2010, a related party note holder converted accrued interest payable into shares of our common stock. In addition, during May and August 2010, we received an aggregate of

\$90,000 through working capital loans from our current acting chief executive officer and from one of our directors of which \$70,000 was repaid to our current acting chief executive officer during 2010.

Our goal is to increase sales and generate cash flow from operations. We implemented expense reductions during 2010 and during the first quarter of 2011. Recently, we have discussed terminating the O&W Plan with the PBGC, which if accomplished, would provide a reduction in net periodic pension plan costs, legal fees and actuarial fees, which totaled \$151,863 during the three months ended March 31, 2011. We believe the capital resources available under our factoring line of credit, cash from additional related party loans and cash generated by improving the results of our operations provide sources to fund our ongoing operations and to support the internal growth we expect to achieve for at least the next 12 months. If we do not improve the results of our operations in future periods, we expect that additional working capital will be required to fund our business. Although we have no assurances, we believe that related parties, who have previously provided working capital to us will continue to provide working capital loans to us on similar terms, as in the past, as may be necessary to fund our on-going operations for at least the next 12 months. If we experience significant growth in our sales, we believe that this may require us to increase our financing line, finance additional accounts receivable, or obtain additional working capital from other sources to support our sales growth. There is no assurance that in the event we need additional funds that adequate additional working capital will be available or, if available, will be offered on acceptable terms.

We anticipate financing our external growth from acquisitions and our longer-term internal growth through one or more of the following sources: cash from collections of accounts receivable; additional borrowing; issuance of equity; use of our existing revolving credit facility; or a refinancing of our accounts receivable credit facility.

We do not have the funds available to make required contributions to the Plan which approximate \$2.2 million or intend to make any contributions to the Plan during 2011.

Recently, we discussed terminating the Plan with the PBGC, which included a cap on our potential financial obligation with respect to the Plan and the PBGC, which may have the effect of reducing the Company's potential Treasury obligations. This result, if accomplished, would have a material effect on our balance sheet, improve our working capital, and substantially reduce our defined benefit plan expense thereby improving our results of operations. However, there are no assurances that an agreement satisfactory to the PBGC and us will be concluded.

The following table sets forth our sources and uses of cash for the periods presented:

	Three Months Ended March 31,	
	2011	2010
Net cash used by operating activities	\$ (5,278)	\$ (13,339)
Net cash used by investing activities	(5,452)	(3,068)
Net cash used by financing activities	(6,179)	(28,746)
Net decrease in cash	\$ (16,909)	\$ (45,153)

Cash Flows Used by Operating Activities

Cash used by operations during the three months ended March 31, 2011 was \$5,278 compared with \$13,339 for the same period in 2010. Our operating cash flow is primarily affected by the overall profitability of our contracts, our ability to invoice and collect from our clients in a timely manner, and our ability to manage our vendor payments. We bill our clients weekly or monthly after services are performed, depending on the contract terms. Our net loss of \$332,391 for the three months ended March 31, 2011 was offset principally by a decrease in accounts receivable of \$197,852 which provided cash and an increase in accrued pension obligations of \$132,921, which did not use cash.

Cash Flows Used by Investing Activities

Cash used by investing activities during the three months ended March 31, 2011 was \$5,452 compared with \$3,068 for the same period in 2010. Cash used by investing activities was primarily for capital expenditures for computer hardware, software and web site development. We expect to continue to invest in computer hardware and software to update our technology to support the growth of our business. We do not have plans for significant capital expenditures in the near future.

Cash Flows Used by Financing Activities

Cash used by financing activities was \$6,179 and \$28,746 for the three months ended March 31, 2011 and 2010, respectively, for principal payments on notes payable. We anticipate that we will use approximately \$25,000 through the next twelve months for funding contractual requirements of current maturities of long-term debt obligations due to banks.

Credit Agreement

We have secured an accounts receivable financing line of credit from an independent finance organization institution that allows us to sell selected accounts receivable invoices to the financial institution with full recourse against us in the amount of \$2 million, including a sublimit for one major client of \$1.5 million. This provides us with the cash needed to finance certain costs and expenses. At March 31, 2011, we had financing availability, based on eligible accounts receivable, of \$156,000 under this line. We pay fees based on the length of time that the invoice remains unpaid.

Other Trends

As discussed above, we believe that our operations as currently structured will result in improved financial performance in future periods. We will continue to implement expense reductions if we do not realize improved sales or improved gross profit margins.

There is no assurance, however, that our current resources will be adequate to fund the liabilities for the O&W Plan or our current operations and business expansion or that we will be successful in raising additional working capital through operations or debt financing. Our failure to raise necessary working capital could force us to curtail operations, which would have a material adverse effect on our financial condition and results of operations.

The current recessionary economy that we have continued to experience since 2009 has impacted certain portions of our business and our growth opportunities as certain projects are deferred pending funding or improved economic conditions. The sales decreases that we experienced in 2011 and 2010 were principally a result of reduced sales to U.S. Government agencies and an establishment of the U.S. Government. Certain projects were completed and were not replaced by the same volume of new projects. In addition, during 2010 certain consulting services performed by our employees were in-sourced by the U.S. Government and certain employees were converted to U.S. Government employees. However, one of our major sources of revenue is from ongoing data center support which is critical to the operation of clients and is not solely dependent upon current economic factors. Our focus areas include virtualization and data center projects which are based on a client's need to upgrade or centralize its data centers and such projects provide a rate of return that justifies these projects. We believe that our formal relationships with Microsoft, Hewlett Packard, VMware, Dell, and others provide us with a competitive advantage versus those companies that do not have such qualifications and bid against us on certain projects.

Since 2009, the United States and worldwide capital and credit markets experienced significant price volatility, dislocations and liquidity disruptions, which have caused market prices of many stocks to fluctuate substantially and the spreads on prospective debt financings to widen considerably. These circumstances have materially impacted liquidity in the financial markets, making terms for certain financings less attractive, and in some cases have resulted in the unavailability of financing. Continued uncertainty in the capital and credit markets may negatively impact our business, including our ability to access additional financing at reasonable terms, which may negatively affect our ability to make future acquisitions or expansions of our business. A prolonged downturn in the financial markets may cause us to seek alternative sources of potentially less attractive financing, and may require us to adjust our business plan accordingly. These events also may make it more difficult or costly for us to raise capital through the issuance of our equity securities. The disruptions in the financial markets may have a material adverse effect on the market value of our common stock and other adverse effects on our business.

Osley & Whitney, Inc. Retirement Plan

The following discussion of the O&W Plan relates to the business that was closed and sold and its current effect on our operations and financial position. Prior to December 30, 2002, we owned 100% of the common stock of Osley & Whitney, Inc. (O&W). On December 30, 2002, we sold 100% of the O&W common stock to a third party, but continued to act as the sponsor of the O&W Plan. Although we continued to act as the sponsor of the O&W Plan after the sale, during 2007 management determined that it had no legal obligation to do so.

During 2007, we submitted information to the Treasury advocating that we had no legal obligation to act as the sponsor of the O&W Plan to ascertain whether the Treasury concurred or disagreed with this position. We subsequently provided responses to Treasury inquiries related to this determination. In October 2009, we received a report from the Treasury that stated that the Treasury staff disagreed with our position and as a result, we are responsible for excise taxes attributed to the funding deficiency of \$1,836,359 for the years 2003 through 2007 which funding deficiency can only be corrected by our contributing \$1,836,359 to the O&W Plan. The report also states that proposed 10% excise taxes of \$348,500, penalties for late payment of excise taxes of approximately \$1.2 million, and 100% excise taxes of approximately \$3.5 million related to the years ended December 31, 2006 and 2007 may be imposed. Penalties for late payment may be removed if we provide reasonable cause for not paying the excise taxes and the Treasury concurs with our position. We and our outside legal counsel disagree with significant aspects of both the factual findings and legal conclusions set forth in the report and, in accordance with Treasury procedures, we

have responded with a detailed analysis of our opposition to their findings. We will diligently pursue all appropriate steps to perfect our appeal rights and attempt to prevail on the merits of our position, which will include filing a protest, requesting an appeals conference, and, if needed, petitioning the tax court and advocating our position in that forum.

If we do not ultimately prevail, we will become obligated for O&W Plan contributions of approximately \$2.2 million as of March 31, 2011 and 10% excise taxes on accumulated unfunded O&W Plan contributions for the Plan years ended December 31, 2006 and 2007 of approximately \$348,500, as stated above, and potentially additional 10% excise taxes of approximately \$440,000 for the plan years ended December 31, 2009 and 2008, which have not been accrued based upon our determination that we have no legal obligation to act as the O&W Plan sponsor and our belief that the likelihood is not probable that we will be required to pay these excise taxes. Further, if we do not ultimately prevail, we may be required to pay interest on these excise taxes and potentially incur penalties for late payment of excise taxes and additional excise taxes up to 100% of each year's required funding deficiency. We have accrued amounts related to excise taxes, penalties and interest on unfunded contributions for 2003, 2004 and 2005 of approximately \$473,000 as of March 31, 2011 (\$470,000 at December 31, 2010). No excise taxes, penalties or interest for 2006, 2007, 2008, 2009, and 2010 have been accrued at March 31, 2011 or December 31, 2010.

During 2006, the PBGC 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.

On April 29, 2009, acting for the O&W Plan, we sent the O&W Plan participants a notice of intent to terminate the plan in a distress termination with a proposed termination date of June 30, 2009. We also provided additional documentation regarding our status and the status of the O&W Plan. The termination of the O&W Plan is subject to approval by the PBGC. We provided information to the PBGC which management believes satisfies the requirements of the PBGC. Recently, we discussed terminating the Plan with the PBGC, which included a cap on our potential financial obligation with respect to the Plan and the PBGC, and which may have the effect of reducing our potential Treasury obligations as summarized above. However, there are no assurances that an agreement satisfactory to the PBGC and us will be concluded.

At March 31, 2011, we had an accrued pension obligation liability of \$4,435,382 (\$4,314,883 at December 31, 2010), which includes the underfunded amount plus interest on past due payments and excise taxes including penalties and interest of approximately \$473,000. Accumulated other comprehensive loss of \$2,961,147 (\$2,961,147 at December 31, 2010) has been recorded as a reduction of stockholders' deficiency.

The market value of the O&W Plan assets decreased from \$1,601,276 at December 31, 2010 to \$1,559,150 at March 31, 2011. The decrease was comprised of investment returns of \$72,365, offset by benefit payments of \$113,549 and expenses of \$942.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

As a smaller reporting company we are not required to provide the information required by this Item.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures. Our management, with the participation of our 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 (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 SEC'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 control over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

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

In January and March 2011, we granted options to purchase an aggregate of 60,000 shares of our common stock at exercise prices ranging from \$.03 to \$.09 per share. These grants were exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Infinite Group, Inc.
(Registrant)

Date May 13, 2011

/s/ James Villa
James Villa
Acting Chief Executive Officer
(Principal Executive Officer)

Date May 13, 2011

/s/ James Witzel
James Witzel
Chief Financial Officer
(Principal Financial Officer)