

RELIABILITY INC  
Form 10-K  
March 27, 2009  
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# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## FORM 10-K

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

For the Fiscal Year Ended December 31, 2008

Commission File Number 0-7092

## RELIABILITY INCORPORATED

(Exact name of registrant as specified in its charter)

TEXAS  
(State or other jurisdiction of  
incorporation or organization)

75-0868913  
(I.R.S. Employer  
Identification Number)

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Post Office Box 218690

Houston, Texas  
(Address of principal executive offices)

77218-8690  
(Zip Code)

(281) 492-0550

(Registrant's telephone number, including area code)

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

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

Common Stock, no par value per share

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES ☐ NO ☒

Indicate by check mark whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. YES ☐ NO ☒

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 twelve 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 ninety days. YES ☒ NO ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

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.

Large accelerated filer ☐ Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☒

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12(b)-2 of the Exchange Act). YES ☒ NO ☐

State issuer's revenues for its most recent fiscal year: 0

State the aggregate market value of the voting and non-voting common equity held by non-affiliates; computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of March 9, 2009: \$76,000.

Number of shares outstanding of the issuer's Common Stock as of March 9, 2009: 6,335,965.

**Documents Incorporated by Reference**

None.



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### PART I

#### Item 1. *Description of Business*

##### THE COMPANY

Reliability Incorporated has principally been engaged in the design, manufacture, market and support of high performance equipment used to test and condition integrated circuits ( *Testing Products* ). Reliability also designed, manufactured and marketed a line of DC-DC power converters ( *Power Sources* ). Reliability and its subsidiary (collectively referred to as *Reliability* or the *Company* ) also operated a service facility in Singapore that conditioned and tested integrated circuits as a service for others ( *Services* ).

During the past eight years, Reliability Incorporated and its subsidiaries (collectively referred to as *Reliability* or the *Company* ) have sustained significant negative financial results, including substantial decreases in revenues, net income, backlog, and cash flows from operating activities that are generally attributable to operating losses. Due to the deterioration in its financial position, the Company has undergone significant restructuring to reduce its expenses and improve its liquidity, including: the closure of its *Power Sources* Costa Rica facility, significant downsizing of its domestic and international workforce, the sale of its *Power Sources* division, the closure of its *Services* division in Singapore, eliminated all research and development for test equipment, the sale of its Houston headquarters facility, and the closure of its *Test Systems* business. As a result of these actions, the Company significantly reduced its expenses, and generated some cash. However, based upon its current financial position, and an evaluation of the prospects for continuing to operate its historical business lines, the Company concluded that it should explore some other possibilities.

On April 1, 2007, Reliability completed the merger of its wholly owned subsidiary, Reliability-Medallion, Inc., a Florida corporation, into Medallion Electric Acquisition Corporation and the indirect acquisition, through Medallion Electric Acquisition Corporation, of Medallion Electric, Inc.

Medallion Electric Acquisition Corporation was incorporated under the laws of the State of Florida on December 8, 2006 to facilitate a merger between business entities and was considered to be a development stage company with no operations at March 31, 2007. On June 21, 2007, the Company changed the name of Medallion Electric Acquisition Corporation ( *MEAC* ) to Reliability Contractors of Florida, Inc. Reliability Contractors of Florida, Inc. is a wholly-owned subsidiary of Reliability.

Medallion Electric, Inc. ( *Medallion Electric* or *Medallion* ) was incorporated in the State of Florida in 1980. Medallion Electric is an electrical contracting company, located in Coral Springs, Florida, specializing in electrical contracting services to residential homebuilders, with its major assets consisting of contracts for services to be performed and accounts receivable. Medallion Electric became a wholly-owned subsidiary of Reliability Contractors of Florida, Inc. (collectively referred to as *Reliability Florida* or *Electrical Contracting Services* ).

All of the funds used for the initial acquisition payment and the Company's transaction costs related to the merger and acquisition were paid out of the Company's cash on hand. The Company funded \$750,000 to finance the acquisition. \$100,000 of such funds was made available to Medallion Electric as working capital; \$150,000 was used by MEAC to pay its transaction related expenses. The remaining \$500,000 was used to make the initial payment to Mr. Ronald Masaracchio ( *Masaracchio* ), the only shareholder of Medallion Electric for 100% of the stock of Medallion Electric. The remainder of the purchase price consisted of two notes- one for \$500,000 due in six months and one for \$1.4 million due in six months. The Company secured the \$500,000 note with the pledge of its real property in North Carolina; the \$1.4 million note was secured with the assets of Medallion Electric.

The Company planned to pay the notes from the Company's working capital, funds generated by Electrical Contracting Services, additional debt and/or equity financing, and the sale of a part of its real estate located in North Carolina. However, in early September, 2007 it became apparent, the Company was not generating enough funds and had not been successful in raising debt or equity funds to meet all of the obligations which would be due on October 1, 2007. Therefore, the Reliability Board of Directors passed a resolution on September 25, 2007 that instructed management to enter into an agreement to sell Medallion Electric, Inc. back to the previous owner, Mr. Masaracchio.

In connection with the negotiation and settlement of the relationship with Medallion, Alex Katz, an officer of Reliability and Reliability Contractors, and Mark Spoor, an officer of Reliability Contractors and Medallion, resigned from their positions and employment with such companies prior to consummation of the transaction.



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On October 12, 2007, the Company and its subsidiaries Reliability Contractors of Florida, Inc. and Medallion Electric, Inc. entered into a Settlement, Sale of Stock and Release Agreement ( Agreement ) with Mr. Masaracchio, pursuant to which Reliability Contractors sold back to Masaracchio the stock of Medallion effective October 1, 2007. The Company agreed to pay Mr. Masaracchio \$325,000 upon the closing of the sale of part of the Company's North Carolina real estate, which was under a purchase and sale contract, and transfer 100% of the Medallion stock to Masaracchio. Masaracchio agreed to release all the liens against the Company's assets, cancel all the notes, and release the Company from any and all of its obligations to him. In addition to the \$325,000, Reliability transferred to Masaracchio all the Medallion stock which held assets that were valued at approximately \$1.7 million on Reliability's balance sheet and liabilities which were generated in the normal course of business at Medallion valued at approximately \$529,000.

Upon the closing of the sale of a portion of Reliability's North Carolina real estate on October 26, 2007, Mr. Masaracchio received the \$325,000, and the sale of Medallion Electric, the release of the liens, and cancellation of all the obligations was consummated. At the time of the sale, Masaracchio held two notes totaling \$1.9 million, which were due October 1, 2007, and an earnout agreement which called for a minimum payment of \$750,000 over three years. The notes were secured by the assets of Medallion and the North Carolina property owned by Reliability. The sale of Medallion back to Masaracchio included a release of all liability on the notes and the earnout agreement, assumption of all Medallion ordinary course of business debts and obligations, mutual releases between Reliability and Masaracchio, including a release of the security for the notes. The net proceeds from the sale of a part of the North Carolina real estate to Reliability, after the \$325,000 payment and all other expenses of the sale, were \$292,000. The Company retained the ownership of 10 acres of land in North Carolina.

Upon the sale of Medallion Electric and cancellation of related liabilities, the Company's remaining asset held for sale was the 10 acres of land in North Carolina. An impairment loss of \$159,000 was recorded in the third quarter of 2007 to reduce the carrying value of the land and buildings held for sale.

In June 2008, an impairment loss of \$126,000 was recorded on the remaining 10 acres of land in North Carolina. It was sold in August 2008 with net proceeds received of \$98,000.

The Company was incorporated under the laws of the State of Texas in 1953, but the principal business of the Company, as described in this report, started in 1971, but was closed down in 2007. The Company has two wholly owned subsidiaries, Reliability Singapore, Pte Ltd. and Reliability Contractors of Florida, neither of which is operating. Upon the completion of the sale of Medallion Electric, the Company has no further operating activities and is now a shell company.

Based upon its current financial position, and an evaluation of the prospects for continuing to operate, the Company has concluded that it should sell the Company or identify a merger partner. There can be no assurances that the Company will be successful in completing such a transaction or be able to maintain sufficient liquidity over a period of time that will allow it to carry out this action, in which case the Company might be forced to dissolve or seek protection under the Federal bankruptcy statutes, or both.

The accompanying financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classifications of liabilities that may result from the possible inability of the Company to continue as a going concern.

Available sources of liquidity at December 31, 2008 include cash and cash equivalents of \$43,000. Subsequent to December 31, 2008, the Company sold 3,294,035 shares of its common stock to five individual investors at \$0.012 per share and raised an additional \$39,528.42.

**SALES AND MARKETING**

The Company historically maintained direct sales and service operations in the United States and Singapore as well as a network of distributors and sales representative in certain other key areas within the United States, Europe and Southeast Asia. Due to the sale of the Company's former Power Sources division, the closure of its Services division in Singapore and an evaluation of the prospects for continuing to operate its remaining business line, the Company no longer maintains direct sales or service operations.

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**RESEARCH AND DEVELOPMENT**

The semiconductor industry's and the electronic equipment industry's demand for increasingly complex and sophisticated equipment requires innovation and accurate anticipation of changing needs and emerging technology trends. To avoid becoming technologically obsolete over time, the Company historically committed a significant portion of its resources to research and development programs for new products and enhancements to existing products.

In August 2005, as a part of cost cutting measures, the Company suspended all research and development activities. As a result, the Company's research and development expenditures were nil in 2006, 2007 and 2008.

The Company has no present plans to resume research and development activities.

**INTELLECTUAL PROPERTY**

Historically, the Company believed that rapidly changing technology in the electronics industry made the Company's success dependent on the quality of its products and its ability to adapt to the changing technological requirements more than upon the protection of any proprietary rights. Although the Company believed that its intellectual property had value, no single item was, in itself, critical to the Company's business. Therefore, the Company has no plans to continue to protect its intellectual property through patents, copyrights, trade secrets, trademarks, and other means.

**RAW MATERIALS AND INVENTORY**

The Company discontinued its operating activities during 2007. Thus, the Company has no inventory and no plans to purchase any inventory.

**CUSTOMERS AND COMPETITION**

The Company no longer has a customer base nor does it remain in a competitive market. The Company's primary competitors in the Testing Products segment were other independent manufacturers of similar systems and manufacturers of ICs who design their own equipment. The primary methods of competition in this segment are product features, quality, service, delivery, and price.

**EMPLOYEES**

As of December 31, 2007, the Company no longer had any full time paid employees. The Company contracts any work that must be done. None of the Company's employees were represented by a labor union.

**INTERNATIONAL OPERATIONS**

The Company is domiciled in the United States and previously sold products to customers for delivery outside of the U.S. However, as discussed above, the Company discontinued its last foreign operation (Singapore) in 2006 and expects to complete its winding down activities by mid-year of 2009.

**ENVIRONMENTAL MATTERS**

The Company does not expect to be affected by zoning, environmental protection, or other similar laws or ordinances.

**SEASONALITY**

The Company no longer has any operating activities.

**GOVERNMENTAL BUSINESS**

The Company does not have any business with any governmental agencies.





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**Item 1A.      *Risk Factors.***

Not applicable.

**Item 1B.      *Unresolved Staff Comments.***

Not applicable.

**Item 2.        *Description of Properties.***

In June 2006, the Company completed the sale of its former headquarters and principal administrative, engineering and manufacturing facility located in Park 10, an office and industrial park located on the west side of Houston, Texas. The Company relocated its headquarters to a 3,400 square foot leased facility, also located in Park 10, on the west side of Houston. The Company vacated this lease September 30, 2007.

The Company also owned a 43,500 square foot facility on a seventeen-acre tract of land in Durham, North Carolina. The Company sold approximately 7.5 acres and the 43,500 sq ft facility in October, 2007, for \$675,000. Three Hundred Twenty-five Thousand (\$325,000) of the proceeds from the sale was used as part of the payment made to the former owner of Medallion Electric, Inc. **See Note 4** of the Notes to the Consolidated Financial Statements. The Company's proceeds from the sale was a net of \$292,000. The Company retained the remaining 10 acres of land. An impairment loss of \$159,000 was recorded in the third quarter of 2007 to reduce the carrying value of the land and building sold in October, 2007, and the remaining 10 acres of land still held for sale. The ten acres was sold in August 2008 with net proceeds received of \$98,000. An impairment loss of \$126,000 was recorded in June 2008 to further reduce the carrying value on the ten acres to its value of final disposition.

**Item 3.        *Legal Proceedings.***

Not applicable.

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

Reliability has called a special meeting of stockholders for March 30, 2009, at 1:00 pm CDT. The meeting will be held at the Holiday Crown Plaza, 14703 Park Row, Houston, TX 77079. The sole purpose of the meeting is to select a Board of Directors to serve until the next annual meeting of stockholders or until their respective successors are elected. Management does not propose nominees, seek re-election or seek proxies for the meeting.

The Board of Directors has designated the close of business on March 13, 2009, as the record date for determining which stockholders are entitled to notice of, and to vote at, the meeting.

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The Company's common stock trades in the over-the-counter bulletin board market under the symbol REAL. Prior to February 24, 2005, the Company's stock traded on Nasdaq, until no longer meeting its listing requirements. The high and low sale prices for 2007 and 2008 are set forth below.

|      | First<br>Quarter | Second<br>Quarter | Third<br>Quarter | Fourth<br>Quarter |
|------|------------------|-------------------|------------------|-------------------|
| 2008 |                  |                   |                  |                   |
| High | \$ .15           | \$ .10            | \$ .26           | \$ .16            |
| Low  | .07              | .06               | .07              | .01               |
| 2007 |                  |                   |                  |                   |
| High | \$ .23           | \$ .30            | \$ .27           | \$ .14            |
| Low  | .17              | .19               | .10              | .05               |

The price information provided above was obtained from MSN.com and is based upon inter-dealer quotes without retail mark-ups, mark-down or commissions and may not necessarily reflect actual sale transactions.

The Company paid no cash dividends in 2007 or 2008 and had approximately 470 shareholders of record as of December 31, 2007, and 303 shareholders of record as of December 31, 2008, not counting the shareholders who hold the Company stock in street name.

The following table sets forth the number of shares of the Company's common stock reserved for issuance under the Company's equity compensation plans as of December 31, 2008:

| Plan category                                              | Number of securities to be<br>issued upon exercise of<br>outstanding options,<br>warrants and rights<br>(a) | Weighted-average<br>exercise price<br>of<br>outstanding options,<br>warrants and<br>rights<br>(b) | Number of securities<br>remaining available for<br>future issuance under<br>equity compensation plans<br>(excluding securities<br>reflected in column (a))<br>(c) |
|------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Equity compensation plans approved by security holders     | 370,000                                                                                                     | \$ 0.21                                                                                           | 0                                                                                                                                                                 |
| Equity compensation plans not approved by security holders |                                                                                                             |                                                                                                   |                                                                                                                                                                   |
| Total                                                      | 370,000                                                                                                     | \$ 0.21                                                                                           | 0                                                                                                                                                                 |

Shares of Company stock were also used to fund the matching feature of the Employee Stock Savings Plan, which was terminated effective November 16, 2006. **See Note 7** to the Company's Consolidated Financial Statements for information concerning Employee Stock Savings Plan.

No shares of common stock were sold during 2007 or 2008 that were not registered under the Securities Act. All the shares issued under the agreement to purchase Medallion Electric in 2007 were returned to the Company. No shares of common stock were repurchased by the Company or any of its affiliates in 2007 or 2008.

On March 11, 2009, the Company issued 3,294,035 shares of its common stock, no par value, to five individual investors for \$0.012 per share. All of the shares of Reliability common stock were issued pursuant to Section 4(2) of the Securities Act of 1933, as amended, and pursuant to Rule 506 of the Securities and Exchange Commission (the Commission) to accredited investors, as defined under Rule 501. None of the securities issued is convertible. The securities were sold to Jay Gottlieb (1,552,035 shares), Gregg Schneider (400,000 shares), William Vlahos

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(617,000 shares), Gary Roebuck (250,000 shares), and Larry Kaplan (475,000 shares).

### **Item 6.** *Selected Financial Data.*

Not applicable.

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**Item 7. *Management's Discussion and Analysis or Plan of Operation.***

The following discussion and analysis of financial condition and results of operations of the Company should be read in conjunction with the Consolidated Financial Statements and related notes that appear in this document.

**REVIEW OF SIGNIFICANT ACCOUNTING POLICIES**

In response to a guidance document that was issued by the Securities and Exchange Commission, the Company completed a review of its significant accounting policies. The results of the review indicated that the accounting policies that the Company has adopted are appropriate for the operations of the Company and that the Company has correctly applied the accounting policies. See **Note 1** to the Company's Consolidated Financial Statements for information concerning significant accounting policies.

Management's discussion and analysis of its financial condition and results of operations is based on the Company's Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and the related disclosure of contingent assets and liabilities, if any exist. The Company evaluates its estimates on an on-going basis, including those related to inventories, investments, assets held for sale, intangible assets, income taxes, warranty obligations, bad debts, product returns, long-lived assets and contingencies, if any. The Company bases its estimates on historical experience and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values and disclosure of amounts recorded or disclosed in the Consolidated Financial Statements of the Company.

**FORWARD-LOOKING STATEMENTS**

This Management's Discussion and Analysis and other parts of this report contain forward-looking statements that involve risks and uncertainties, as well as current expectations and assumptions. From time to time, the Company may publish forward-looking statements, including those that are contained in this report, relating to such matters as anticipated financial performance, business prospects, technological developments, new products, research and development activities and similar matters. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. In order to comply with the terms of the safe harbor, the Company notes that a variety of factors could cause the Company's actual results and experience to differ materially from the anticipated results or other expectations expressed in the Company's forward-looking statements. The risks and uncertainties that may affect the operations, performance, development and results of the Company's business include, but are not limited to, its ability to maintain sufficient working capital, adverse changes in the economy, the ability to attract and maintain key personnel, its ability to identify or complete an acceptable merger or acquisition, and future results related to acquisition, merger or investment activities. The Company's actual results could differ materially from those anticipated in these forward-looking statements, including those set forth elsewhere in this report. The Company assumes no obligation to update any such forward-looking statements.

**ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

During the past eight years, Reliability Incorporated and its subsidiaries (collectively referred to as Reliability or the Company) have sustained significant negative financial results, including substantial decreases in revenues, net income, backlog, and cash flows from operating activities that are generally attributable to operating losses. Due to the deterioration in its financial position, the Company has undergone significant restructuring to reduce its expenses and improve its liquidity, including: the closure of its Power Sources Costa Rica facility, significant downsizing of its domestic and international workforce, the sale of its Power Sources division, the closure of its Services division in Singapore, eliminated all research and development for test equipment, the sale of its Houston headquarters facility, sale of its North Carolina property and the closure of its Test Systems business. As a result of these actions, the Company significantly reduced its expenses, and generated some cash. However, based upon its financial position, and an evaluation of the prospects for continuing to operate its historical business lines, the Company concluded that it should explore some other possibilities.

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On April 1, 2007, Reliability completed the merger of its wholly owned subsidiary, Reliability-Medallion, Inc., a Florida corporation, into Medallion Electric Acquisition Corporation and the indirect acquisition, through Medallion Electric Acquisition Corporation, of Medallion Electric, Inc.

Medallion Electric Acquisition Corporation was incorporated under the laws of the State of Florida to facilitate a merger between business entities and was considered to be a development stage company with no operations at March 31, 2007. On June 21, 2007, the Company changed the name of Medallion Electric Acquisition Corporation ( MEAC ) to Reliability Contractors of Florida, Inc. Reliability Contractors of Florida, Inc. is a wholly-owned subsidiary of Reliability.

Medallion Electric, Inc. ( Medallion Electric or Medallion ) was incorporated in the State of Florida in 1980. Medallion Electric is an electrical contracting company, located in Coral Springs, Florida, specializing in electrical contracting services to residential homebuilders, with its major assets consisting of contracts for services to be performed and accounts receivable. Medallion Electric is a wholly-owned subsidiary of Reliability Contractors of Florida, Inc. (collectively referred to as Reliability Florida or Electrical Contracting Services ).

All of the funds used for the initial acquisition payment and the Company's transaction costs related to the merger and acquisition were paid out of the Company's cash on hand. The Company funded \$750,000 to finance the acquisition. \$100,000 of such funds was made available to Medallion Electric as working capital; \$150,000 was used by MEAC to pay its transaction related expenses. The remaining \$500,000 was used to make the initial payment to Mr. Ronald Masaracchio ( Masaracchio ), the only shareholder of Medallion Electric for 100% of the stock of Medallion Electric. The remainder of the purchase price consisted of two notes- one for \$500,000 due in six months and one for \$1.4 million due in six months. The Company secured the \$500,000 note with the pledge of its real property in North Carolina; the \$1.4 million note was secured with the assets of Medallion Electric.

The Company planned to pay the notes from the Company's working capital, funds generated by Electrical Contracting Services, additional debt and/or equity financing, and the sale of a part of its real estate located in North Carolina. However, in early September, 2007 it became apparent, the Company was not generating enough funds and had not been successful in raising debt or equity funds to meet all of the obligations which would be due on October 1, 2007. Therefore, the Reliability Board of Directors passed a resolution on September 25, 2007 that instructed management to enter into an agreement to sell Medallion Electric, Inc. back to the previous owner, Mr. Masaracchio.

On October 12, 2007, the Company and its subsidiaries Reliability Contractors of Florida, Inc. and Medallion Electric, Inc. entered into a Settlement, Sale of Stock and Release Agreement ( Agreement ) with Mr. Masaracchio, pursuant to which Reliability Contractors sold back to Masaracchio the stock of Medallion effective October 1, 2007. The Company agreed to pay Mr. Masaracchio \$325,000 upon the closing of the sale of part of the Company's North Carolina real estate, which was under a purchase and sale contract, and transfer 100% of the Medallion stock to Masaracchio. Masaracchio agreed to release all the liens against the Company's assets, cancel all the notes, and release the Company from any and all of its obligations to him. In addition to the \$325,000, Reliability transferred to Masaracchio all the Medallion stock which held assets that were valued at approximately \$1.7 million on Reliability's balance sheet and liabilities which were generated in the normal course of business at Medallion valued at approximately \$529,000.

Upon the closing of the sale of a portion of Reliability's North Carolina real estate on October 26, 2007, Mr. Masaracchio received the \$325,000, and the sale of Medallion Electric, the release of the liens, and cancellation of all the obligations was consummated. At the time of the sale, Masaracchio held two notes totaling \$1.9 million, which were due October 1, 2007, and an earnout agreement which called for a minimum payment of \$750,000 over three years. The notes were secured by the assets of Medallion and the North Carolina property owned by Reliability. The sale of Medallion back to Masaracchio included a release of all liability on the notes and the earnout agreement, assumption of all Medallion ordinary course of business debts and obligations, mutual releases between Reliability and Masaracchio, including a release of the security for the notes. The net proceeds from the sale of a part of the North Carolina real estate to Reliability, after the \$325,000 payment and all other expenses of the sale, were \$292,000. The Company retained the ownership of 10 acres of land in North Carolina. An impairment loss of \$159,000 was recorded in the third quarter of 2007 to reduce the carrying value of the land building sold in October 2007 and on the remaining 10 acres of land held for sale. The ten acres was sold in August 2008 with net proceeds received of \$98,000. An impairment loss of \$126,000 was recorded in June 2008 to further reduce the carrying value on the ten acres to its value of final disposition.

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Net cash used by operating activities for the year ended December 31, 2007 was \$385,000, compared to \$87,000 used by operations during 2008. The principal item contributing to the \$87,000 usage of cash in 2008 was a loss from continuing operations of \$236,000, net of a non-cash impairment of \$126,000 related to the sale of the 10 acres of land. The principal items contributing to the net cash used by operations in 2007 was a loss from continuing operations of \$616,000. In 2007, net investing activities consumed \$788,000, primarily as a result of acquiring Medallion Electric. In 2008, proceeds from the 10 acres of land held in assets held for sale generated \$98,000 in cash.

Financing activities used \$53,000 in 2007, primarily the result of the Company repaying short-term debt, while financing activities consumed zero cash in 2008.

The Company was incorporated under the laws of the State of Texas in 1953, but the principal business of the Company, as described in this report, started in 1971, but was closed down in 2007. The Company has two wholly owned subsidiaries, Reliability Singapore, Pte Ltd. and Reliability Contractors of Florida, Inc, which are not operating. The Company is now a shell corporation. The accompanying financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classifications of liabilities that may result from the possible inability of the Company to continue as a going concern.

Based upon its current financial position, and an evaluation of the prospects for continuing to operate, the Company has concluded that it should sell the Company or identify a merger partner. There can be no assurances that the Company will be successful in completing such a transaction or be able to maintain sufficient liquidity over a period of time that will allow it to carry out this action, in which case the Company might be forced to dissolve or seek protection under the Federal bankruptcy statutes, or both.

Available sources of liquidity at December 31, 2008 include cash and cash equivalents of \$43,000. On March 11, 2009, the Company issued 3,294,035 shares of its common stock, no par value, to five individual investors for \$0.012 per share or a total of \$39,528.42

**RESULTS OF OPERATIONS**

***Net Revenues and Gross Profit***

Revenues and gross profit for 2007 and 2008 from continuing operations are reported as zero for both years, as all operations were discontinued as of September 30, 2007. See **NOTE 3** of the Notes to the Consolidated Financial Statements.

***General and Administrative***

General and administrative ( G&A ) expenses primarily consist of legal, accounting and other professional services.

G&A expenses decreased from \$483,000 in 2007 to \$108,000 in 2008. The reductions were primarily the result of a decrease in payroll related costs from \$384,000 in 2007 to \$0 in 2008 as the result of staff reductions. Remaining G&A expenses relate principally to legal and accounting fees.

***Gain on the Sale of Assets***

In 2007 the Company recorded a gain of \$3,000 on the sale of excess equipment and furnishings.

***Loss from discontinued operations***

The loss from discontinued operations of \$1,377,000 in 2007 was primarily due to a loss of \$1,150,000 from the purchase and later sale of Medallion Electric, Inc. and a \$159,000 impairment charge related to the North Carolina property. The 2008 loss from discontinued operations is from a \$126,000 loss on the sale of the North Carolina property. See **Note 3** to the Company's Consolidated Financial Statements for information regarding gains and losses from discontinued operations.

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***Provision for Income Taxes***

The Company recorded no provision or benefit for income taxes in 2007 or 2008 due to its substantial cumulative operating losses. Benefits from the tax loss carryforwards have been fully reserved since realization cannot be assured. **See Note 5** to the Company's Consolidated Financial Statements for information regarding income taxes.

**OFF-BALANCE SHEET ARRANGEMENTS**

None.

**Item 7A. *Quantitative and Qualitative Disclosures About Market Risk.***

Not applicable.

**Item 8. *Financial Statements and Supplementary Data.***

The financial statements of the Company and the related reports of the Company's independent registered public accounting firms thereon are included in this report and are referenced as pages F-1 to F-16.

**Item 9. *Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.***

On March 13, 2009, Fitts, Roberts & Co., P.C. (Fitts, Roberts), the Company's independent accountant, resigned by mutual agreement with the Company, due to scheduling matters at Fitts, Roberts and its withdrawal from the public company auditing practice. The audit reports of Fitts, Roberts for the Company's fiscal year ended December 31, 2007 and for the fiscal year ended December 31, 2006 included an emphasis paragraph regarding uncertainty about the Company's ability to continue as a going concern. Except for the going concern paragraph in the audit reports on the financial statements for those two years, the reports of Fitts, Roberts did not contain an adverse opinion or disclaimer of opinion, and were not otherwise qualified or modified as to uncertainty, audit scope or accounting principles. The resignation of Fitts, Roberts was considered by the Board of Directors of the Company and approved by the Chairman of the Audit Committee, under authority from the Board of Directors.

During the two most recent fiscal years and in the subsequent interim period through March 13, 2009, there have been no disagreements with Fitts, Roberts on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedure in connection with its reports of the nature identified in Item 304(a)(1)(iv).

During the two most recent fiscal years and the subsequent interim period through March 13, 2009, Fitts, Roberts has not advised Reliability of any of the events identified in Item 304(a)(1)(v) of Regulation S-K, nor does any issue with Fitts, Roberts remain unresolved.

Reliability provided to Fitts, Roberts the disclosure contained in the Form 8-K which was filed on March 16, 2009 to report its change of auditors and requested Fitts, Roberts to furnish a letter addressed to the Securities and Exchange Commission stating whether Fitts, Roberts agreed with the statements made by the Company therein, and if not, stating the respects in which Fitts, Roberts did not agree. A letter from Fitts, Roberts was attached as Exhibit 16.1 to the Form 8-K and incorporated therein by reference.

On March 13, 2009, pursuant to authority from the Board of Directors, the Company engaged Ramirez International as independent auditors for the Company for the 2008 audit.

Neither the Company, nor anyone acting on its behalf, consulted with Ramirez International regarding (i) the application of accounting principles to a specified transaction, either completed or proposed or the type of audit opinion that might be rendered on the Company's financial statements; or (ii) any matter that was the subject of a disagreement or event identified in response to Item 304(a)(1)(iv) of Regulation S-K (there being none).





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**Item 9A. Controls and Procedures.**

**Item 9A(T). Controls and Procedures.**

(a) *Evaluation of Disclosure Controls and Procedures.* The Chief Executive Officer (CEO), evaluated the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the CEO concluded that the disclosure controls and procedures as of the end of the period covered by this report were effective such that the information required to be disclosed in reports filed under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (ii) accumulated and communicated to the CEO to allow timely decisions regarding disclosure. A controls system cannot provide absolute assurance, however, that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

*Management's Annual Report on Internal Control over Financial Reporting.* Management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act). Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes of accounting principles generally accepted in the United States.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance of achieving their control objectives.

The CEO evaluated the effectiveness of the Company's internal control over financial reporting as of December 31, 2008. In making this assessment, the CEO used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control - Integrated Framework. Based on this evaluation, the CEO concluded that, as of December 31, 2008, internal control over financial reporting was effective.

The consolidated financial statements of the Company for 2007 have been audited by the independent registered public accounting firm of Fitts, Roberts & Co., LLC and for 2008 by the independent registered public accounting firm of Ramirez International, both of which were given unrestricted access to all financial records and related data, including minutes of all meetings of stockholders and the Board of Directors. This annual report does not include an attestation report of the Company's registered public accounting firms regarding internal account control over financial reporting. Management's report was not subject to attestation by the Company's public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report.

(b) *Changes in Internal Control over Financial Reporting.* There were no changes in the Company's internal controls over financial reporting, known to the CEO, that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Item 9B. Other Information**

Not applicable.

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Directors of the Company at December 31, 2008 were as follows:

| Name               | Director |     | Other positions and offices presently held with the Company (and                              |
|--------------------|----------|-----|-----------------------------------------------------------------------------------------------|
|                    | since    | Age | other principal occupation, if different)                                                     |
| Larry Edwards      | 1995     | 67  | Chairman of the Board of Directors, President and Chief Executive Officer                     |
| Thomas L. Langford | 1980     | 67  | (Group Vice President, Consolidated Contractors International Co. S.A.L.)                     |
| Philip Uhrhan      | 1997     | 59  | (Retired)                                                                                     |
| C. Lee Cooke, Jr.  | 2004     | 64  | (President, Chief Executive Officer, Habitek International, d/b/a U.S. Medical Systems, Inc.) |
| David C. Kurland   | 2007     | 48  | (Chief Counsel, Sunco, Inc.)                                                                  |

Mr. Edwards has been President and Chief Executive Officer of the Company since 1993 and has been a Director and Chairman of the Board of Directors since 1995. From 1990 to 1993, he served as President and Chief Operating Officer of the Company. Mr. Edwards joined the Company in 1977 as Manager of Engineering, Planning and Manufacturing Systems, and subsequently held the positions of Vice President Operations, Corporate Vice President Systems, and Executive Vice President Systems.

Mr. Langford has been a Director of the Company since 1980. Mr. Langford's principal occupation has been that of Group Vice President of Consolidated Contractors International Co. S.A.L., an engineering and construction company, since February 2001. He was Executive Vice President of Stone and Webster, Inc., a professional engineering, construction and consulting company, from 1997 to July 2000. In June 2000, Stone and Webster, Inc. filed a Chapter 11 Bankruptcy, and Mr. Langford served, from July 2000 until January 2001 as President and Chief Restructuring Officer of the Debtor in Possession of Stone and Webster. From 1991 until 1996, Mr. Langford was President of Parsons Corporation, an engineering and construction company.

Mr. Uhrhan has been a Director of the Company since 1997. Mr. Uhrhan is retired. He served as Vice President Finance of Solvay America, Inc., a chemical and pharmaceuticals company, from 1996 until February of 2007. Mr. Uhrhan was a Partner with Ernst & Young LLP for more than five years prior to his employment by Solvay America, Inc.

Mr. C. Lee Cooke, Jr. has been a Director of the Company since July 2004. Since 1991, he has been President and Chief Executive Officer of Habitek International, Inc. d/b/a U.S. Medical Systems, Inc., a biomedical company. He served as Chairman of the Board, Chief Executive Officer and President of Sharps Compliance Corp. from March 1992 until July 1998. Mr. Cooke served as Chairman of the Board for Tanisys Technology, Inc. (Tanisys), a developer and marketer of semi-conductor testing equipment from February 2002 until February 2003 and served as Chief Executive Officer from March 2002 until February 2003. Mr. Cooke serves as an advisory director to the Staubach Group, CTLLC, a real estate representative company. Mr. Cooke also serves on the board of two other private companies. Mr. Cooke was President and Chief Executive Officer of CUville, Inc., d/b/a Good2CU.com, from 1999 until 2000. Mr. Cooke served as Chief Executive of The Greater Austin Chamber of Commerce from 1983 to 1987. From 1972 to 1983, Mr. Cooke also served in various management roles with Texas Instruments. From 1988 to 1991 he served in the elected position of Mayor of Austin, Texas. Mr. Cooke has served as director of New Century Equity Holdings Corp. (New Century), a publicly-held holding company focused on high growth companies since 1996.

Mr. Kurland has been a Director of the Company since April, 2007. Since 2001, Mr. Kurland has served as Chief Counsel for Sunco, Inc. (R&M), a major refining and chemical company, where he is responsible for regulatory and corporate compliance matters. From 1992 to 2001 he was Chief Counsel for Rohm and Haas. He practiced law with a mid-sized law firm in Philadelphia, Pennsylvania for 1989 to 1992,

Directors serve a one-year term and hold office until their successors are elected by the shareholders, unless they shall sooner resign.



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The Company has an Audit Committee comprised of its four independent directors, Messrs. Langford, Uhrhan, Kurland, and Cooke. The Board has determined that the Company has two audit committee financial experts, as defined by the Securities and Exchange Commission, serving on its audit committee. Mr. Uhrhan, Chairman of the committee, and Mr. Langford qualify as financial experts and both are independent, as independence for audit committee members is defined by the Securities and Exchange Commission.

Executive officers of the Company as of December 31, 2008 were as follows:

| <b>Name</b>   | <b>Age</b> | <b>Officer of Reliability Incorporated Since</b> | <b>Position Currently Held with Reliability Incorporated</b>              |
|---------------|------------|--------------------------------------------------|---------------------------------------------------------------------------|
| Larry Edwards | 67         | 1981                                             | Chairman of the Board of Directors, President and Chief Executive Officer |

Mr. Edwards has been President and Chief Executive Officer of the Company since 1993 and became a Director and Chairman of the Board of Directors in 1995. Mr. Edwards has been employed by the Company in various capacities since 1977.

The Company has a code of ethics that applies to all directors, officers and employees, including its principal executive officer and principal financial officer (who is also its principal accounting officer).

The Company will provide to any person without charge a copy of the code of ethics upon written request to the Company's chief executive officer at the Company's principal executive offices. No amendments to or waivers of the code of were made in 2007 or 2008.

**Item 11. *Executive Compensation.***  
**Summary compensation table**

The following table provides information as to the compensation paid by the Company to its executive officers during fiscal years 2008 and 2007.

| (a)<br><b>Name and principal position</b>                | <b>Annual compensation</b> |                      |                             |                                      |                     |
|----------------------------------------------------------|----------------------------|----------------------|-----------------------------|--------------------------------------|---------------------|
|                                                          | (b)<br><b>Year</b>         | (c)<br><b>Salary</b> | (f)<br><b>Option Awards</b> | (i)<br><b>All other Compensation</b> | (j)<br><b>Total</b> |
| Larry Edwards                                            | 2008                       | \$ 0                 | \$ 0                        | \$ 0                                 | \$ 0                |
| President, Chairman of the Board and                     |                            |                      |                             |                                      |                     |
| Chief Executive Officer                                  | 2007                       | \$ 77,972            | \$ 0                        | \$ 105,952                           | \$ 183,924          |
| James M. Harwell                                         | 2008                       | \$ 0                 | \$ 0                        | \$ 0                                 | \$ 0                |
| Executive Vice President and                             |                            |                      |                             |                                      |                     |
| Acting Chief Financial Officer                           | 2007                       | \$ 95,860            | \$ 0                        | \$ 61,545                            | \$ 157,405          |
| Mr. Harwell resigned from the Company in November, 2007. |                            |                      |                             |                                      |                     |

The Company has no employment contracts, long-term compensation plans, awards, defined benefit plans, stock appreciation rights or option plans except for the Amended and Restated 1997 Stock Option Plan. The Company has termination of employment or change in control agreements with its executive officers consisting of one weeks base pay for each year of service plus two weeks base pay. The Company paid

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\$105,952 to Mr. Edwards and \$61,545 to Mr. Harwell upon stopping to pay all salaries, which is shown in column (i) for 2007.

In addition to base salary, the Company has an incentive bonus plan which applies to the CEO, all executive officers, directors and all salaried employees of the Company. The incentive plan has three components:

1. a quantitative measure of the Company's performance based on income before income tax; and
2. a qualitative measure of each individual's performance during the year; and
3. a target incentive which is a quantitative percent of base salary.

The Company was not profitable during 2007 or 2008; therefore, no bonuses were paid. As a result column (d) is intentionally omitted in the compensation table above.

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Under the Company's Amended and Restated 1997 Stock Option Plan (Option Plan), which expired in 2006, stock option grants were available for officers, directors, and key employees. The objective of the Option Plan was to promote the interest of the Company by providing an ownership incentive to officers, directors, and key employees, to reward outstanding performance, and to encourage continued employment. The Board of Directors, which acted as the Plan Administrator, determined to whom options were granted, the type of options, the number of shares covered by such options and the option vesting schedule. All options were issued at market value on the date of the grant and generally had a ten-year contractual term with graded vesting.

The amounts shown in column (f) represent the grant date fair value estimate of options granted during the last two completed fiscal years to the named individuals. See Note 8 to the Company's Consolidated Financial Statements for information concerning the Stock Options.

The Company sponsored an Employee Stock Savings Plan (the Plan), until November 16, 2006, when the Plan was terminated. The Plan allowed all U.S. employees, who had been employed for six months, to contribute up to 100% of defined compensation to the Plan. The Company matched employee contributions at a rate equal to 50% of the employee's contributions, but limited to 2% of the employee's defined compensation. In addition, the Company contributed an amount equal to 1% of defined compensation to all plan participants. The Plan also provided for the Company to make additional voluntary profit sharing contributions based on the consolidated profits of the Company. The Company did not make any additional voluntary profit sharing contribution in 2008, 2007 or 2006. See Note 7 to the Company's Consolidated Financial Statements for information regarding the Employee Stock Savings Plan.

There were no payments or Company matching contributions to the Employee Stock Savings Plan in 2007 or 2008.

**Outstanding equity awards**

The following table discloses information regarding all option awards, to executive officers, to purchase the Company's Common Stock as of December 31, 2008.

**Option Awards**

| Name           | Number of Securities Underlying<br>Unexercised Options |                     | Option         |                 |
|----------------|--------------------------------------------------------|---------------------|----------------|-----------------|
|                | # Exercisable                                          | # Unexercisable (1) | Exercise Price | Expiration Date |
| (a)            | (b)                                                    | (c)                 | (e)            | (f)             |
| Larry Edwards: | 200,000                                                |                     | \$ .21         | 7/19/2016       |

(1) All issued options are vested and became exercisable on January 20, 2007.

**Director Compensation**

The following table provides information as to the compensation paid by the Company to each of its non-employee directors during fiscal year 2008.

| Name                       | Fees Earned or<br>Paid in Cash | Option<br>Awards | Total |
|----------------------------|--------------------------------|------------------|-------|
| (a)                        | (b)                            | (c)              | (h)   |
| Each non-employee director | \$ 0                           |                  | \$ 0  |

The amount shown in column (c) represents the grant date fair value estimate of options granted during 2008 to each non-employee director. Since no options were granted in 2008 column (c) is blank. See Note 8 to the Company's Consolidated Financial Statements for information concerning the Stock Options.

**Item 12.**      *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.*  
**Principal shareholders**

Based on information available to the Company through filings with the Securities and Exchange Commission, each of the following persons or groups beneficially owned 5% or more of the 6,335,965 shares of common stock outstanding as of December 31, 2008.



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| <b>Name and Address of Beneficial Owner</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | <b>Amount and Nature of Beneficial Ownership</b> | <b>Percent of Class</b> |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------|-------------------------|
| Minerva Group, L.P.<br>50 Monument Road, Suite 201, Bala Cynwyd, PA 19004                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | 457,000                                          | 7.21%                   |
| Gregg Schneider<br>10445 Wilshire Blvd., #1806, Los Angeles, CA 90024                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             | 500,000                                          | 7.89%                   |
| Jay Gottlieb<br>27 Misty Brook Lane, New Fairfield, CT 06812                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      | 951,220                                          | 15.01%                  |
| William Vlahos<br>601 Montgomery St., Ste. 1112, San Francisco, CA 94111                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | 633,000                                          | 9.99%                   |
| On March 11, 2009, the Company issued 3,294,035 shares of its common stock, no par value, to five individual investors for \$0.012 per share. The securities were sold to Jay Gottlieb (1,552,035 shares), Gregg Schneider (400,000 shares), William Vlahos (617,000 shares), Gary Roebuck (250,000 shares), and Larry Kaplan (475,000 shares). This increased Mr. Gottlieb's holdings to 2,503,255 shares (25.99%), Mr. Schneider's holdings to 900,000 shares (9.35%), and Mr. Vlahos' holdings to 1,250,000 shares (12.98%) of the 9,630,000 then outstanding. |                                                  |                         |

The Company's Employees Stock Savings Plan (the Plan) was terminated effective November 16, 2006. The Plan owned a total of 412,625 shares (6.5% of the 6,335,965 shares of common stock outstanding as of December 31, 2006) of common stock. All the shares have been distributed to the owner of the shares or his designated plan as of March 25, 2008. No Plan participant owned 5% or more of the Company's shares through the Plan. See Note 7 to the Company's Consolidated Financial Statements for information concerning the Employee Stock Savings Plan.

**Security ownership of management**

As of December 31, 2008, the amount of common stock owned by the directors of the Company, each executive officer named in the compensation table and all directors and officers as a group is shown in the table below. The business address of each named person is P.O. Box 218690, Houston, Texas 77218.

| <b>Name of individual or group</b>              | <b>Amount and Nature of Beneficial Ownership (1), (2)</b> | <b>Percent of Class (3)</b> |
|-------------------------------------------------|-----------------------------------------------------------|-----------------------------|
| Larry Edwards                                   | 422,785                                                   | 6.30%                       |
| C. Lee Cooke, Jr.                               | 15,000                                                    | .22                         |
| Thomas L. Langford                              | 35,000                                                    | .52                         |
| Philip Uhrhan                                   | 20,000                                                    | .29                         |
| All executive officers and directors as a group | 492,785                                                   | 7.35%                       |

- (1) Each person has the sole power to vote and sell the shares shown in this column except that Mr. Edwards has shared power with his spouse to vote and sell 61,200 of the shares reported above.
- (2) Includes the following number of stock options: Mr. Edwards, 200,000; Mr. Cooke, 15,000 shares; Mr. Langford 15,000 shares; Mr. Uhrhan, 15,000 shares; all directors and executive officers as a group 245,000 shares.
- (3) The percent stated in this column is based on the total beneficial ownership of the individual or group as a percent of the 6,335,965 shares of common stock outstanding as of December 31, 2008, plus the 370,000 shares acquirable under stock options on December 31, 2008.

**Item 13. *Certain Relationships and Related Transactions and Related Transactions, and Director Independence.***

Directors C. Lee Cooke, Jr., Thomas L. Langford, Philip Uhrhan and David C. Kurland are all considered independent by the Company. The Company has not conducted any business with any of such directors or the companies with which they are associated, nor is any of such directors associated with the Company's auditors. None of such directors owns even one half of one percent of the Company's stock (excluding options), and none receives a fee for acting as a director. No family member of any of such directors is or has been employed by the Company.



**Table of Contents****Index to Financial Statements****Item 14. Principal Accountant's Fees and Services**

Fitts, Roberts & Co., P.C. was the Company's independent accountants until March 11, 2008, when they were replaced by Ramirez International (see Item 9 above).

**Audit Fees Paid to Principal Accounting Firm**

Aggregate fees of Reliability to Fitts, Roberts & Co., P.C. paid during fiscal year 2007 and 2008 are listed below:

| Fee category   | 2007      | 2008      |
|----------------|-----------|-----------|
| Audit fees     | \$ 59,925 | \$ 16,250 |
| Tax fees       | 12,400    | 10,600    |
| All other fees | 6,975     |           |
| Total fees     | \$ 79,300 | \$ 26,850 |

**Audit Fees:** Consists of fees billed for professional services rendered for the audit of Reliability's consolidated financial statements and review of the interim consolidated financial statements included in quarterly reports and services that are normally provided by its independent registered public accounting firm.

**Audit-Related Fees:** Consists of fees billed for assurance and related services that are reasonably related to the performance of the audit or review of Reliability's consolidated financial statements and are not reported under Audit Fees. These services include employee benefit plan audits and consultations concerning financial accounting and reporting standards.

**Tax Fees:** Consists of tax compliance/preparation and other tax services. Tax compliance/preparation consists of fees billed for professional services related to federal, state and international tax compliance. Other tax services consist of fees billed for other miscellaneous tax consulting and planning.

**Pre-Approval Policies and Procedures for Audit and Non-Audit Services.**

The Audit Committee has developed policies and procedures concerning its pre-approval of the performance of audit and non-audit services for the Company by Fitts, Roberts. These policies and procedures provide that the Chairman of the Audit Committee must pre-approve 100% of all audit and permitted non-audit services (including the fees and terms thereof). The Chairman reports all such services approved to the full Audit Committee at its next meeting. In pre-approving all audit services and permitted non-audit services, the Audit Committee or a delegated member must consider whether the provision of the permitted non-audit services is compatible with maintaining the independence of Fitts, Roberts and its status as the Company's independent auditors.

**PART IV****Item 15. Exhibits**

a) The following financial statements are filed as part of this report:

1. Consolidated Financial Statements: Listed in the Index to Financial Statements provided in response to Item 8 hereof (see p. F-1 for Index)
- 2.

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Financial Statement Schedule. Financial Statement schedules are omitted because they are inapplicable or the required information is shown in the financial statements or noted therein.

b) The following exhibits are filed as part of this report:

- 3.1 Restated Articles of Incorporation (with amendment). Reference is made to Exhibit 3 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1995.
- 3.2 Restated Bylaws. Reference is made to Exhibit 3.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 2003.
- 3.3 Amended Bylaws. Reference is made to Exhibit 3.01 of the Company's Form 8-K, filed on April 6, 2007.
- 21 List of Subsidiaries.
- 23.1 Consent of Independent Registered Public Accounting Firm Fitts, Roberts & Co., LLC.
- 23.2 Consent of Independent Registered Public Accounting Firm Ramirez International.
- 31.1 Certification Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act.
- 32 Certification Pursuant to Rule 13a-14(b)/15d-14(b) and Section 1350, Chapter 63, Title 18 of the United States Code (Certification will not be deemed filed for purposes of Section 18 of the Securities Act of 1934, as amended).

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**SIGNATURES**

In accordance with Section 13 or (15(d) of the Exchange Act, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DATE: March 27, 2008

RELIABILITY INCORPORATED  
(Registrant)

BY /s/ LARRY EDWARDS  
Larry Edwards, Chairman of the Board of Directors,  
President and Chief Executive Officer

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

DATE: March 27, 2008

BY /s/ LARRY EDWARDS  
Larry Edwards, Chairman of the Board of Directors,  
President and Chief Executive Officer

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the Company and in the capacities and on the dates indicated.

/s/ LARRY EDWARDS  
Larry Edwards, Director

DATE: March 27, 2008

/s/ THOMAS L. LANGFORD  
Thomas L. Langford, Director

DATE: March 27, 2008

/s/ PHILIP UHRHAN  
Philip Uhrhan, Director

DATE: March 27, 2008

/s/ C. LEE COOKE JR.  
C. Lee Cooke, Jr., Director

DATE: March 27, 2008

/s/ DAVID KURLAND.  
David Kurland, Director

DATE: March 27, 2008

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**RELIABILITY INCORPORATED**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders

Reliability Incorporated

We have audited the accompanying consolidated balance sheet of Reliability Incorporated as of December 31, 2007, and the related consolidated statements of operations, stockholders' equity, and cash flows for the year ended December 31, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Reliability Incorporated at December 31, 2007, and the consolidated results of its operations, changes in stockholders' equity and its cash flows for each of the year ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the financial statements, the Company's negative trends, including recurring losses from operations and negative cash flows from operating activities raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 1. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

We were not engaged to examine management's assertion about the effectiveness of Reliability Incorporated's internal control over financial reporting as of December 31, 2007, included as Item 8A in the accompanying 10K, and accordingly, we do not express an opinion thereon.

/s/ Fitts, Roberts & Co., P.C.

Houston, Texas

March 31, 2008

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders

Reliability Incorporated

We have audited the accompanying consolidated balance sheet of Reliability Incorporated as of December 31, 2008, and the related consolidated statements of operations, stockholders' equity (deficit), and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of the Company's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Reliability Incorporated at December 31, 2008, and the consolidated results of its operations, changes in stockholders' equity (deficit) and its cash flows for the year then ended, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, the Company's circumstances raise substantial doubt about its ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Ramirez International

Financial & Accounting Services, Inc.

Irvine, California

March 27, 2009



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**RELIABILITY INCORPORATED**  
**CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share data)

|                                                                                        | December 31,<br>2008 | December 31,<br>2007 |
|----------------------------------------------------------------------------------------|----------------------|----------------------|
| <b>ASSETS</b>                                                                          |                      |                      |
| Current assets:                                                                        |                      |                      |
| Cash and cash equivalents                                                              | \$ 43                | \$ 32                |
| Prepaid expenses                                                                       |                      | 33                   |
| Assets of discontinued operations                                                      |                      | 106                  |
| Total current assets                                                                   | 43                   | 171                  |
| Other assets                                                                           |                      |                      |
| Assets held for sale                                                                   |                      | 225                  |
| Total Assets                                                                           | \$ 43                | \$ 396               |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b>                                  |                      |                      |
| Current liabilities:                                                                   |                      |                      |
| Accounts payable and accrued liabilities                                               | \$ 31                | \$ 42                |
| Accrued liabilities of discontinued operations                                         | 13                   | 120                  |
| Total current liabilities                                                              | 44                   | 162                  |
| Stockholders' equity (deficit):                                                        |                      |                      |
| Common stock, without par value; 20,000,000 shares authorized; 6,690,265 shares issued | 9,767                | 9,767                |
| Accumulated deficit                                                                    | (8,674)              | (8,439)              |
| Less treasury stock at cost, 354,300 shares                                            | (1,094)              | (1,094)              |
| Total stockholders' equity (deficit)                                                   | (1)                  | 234                  |
|                                                                                        | \$ 43                | \$ 396               |

See accompanying notes.

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**RELIABILITY INCORPORATED**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands, except per share data)

|                                                                 | Year ended December 31, |            |
|-----------------------------------------------------------------|-------------------------|------------|
|                                                                 | 2008                    | 2007       |
| Revenue                                                         | \$                      | \$         |
| Costs and expenses:                                             |                         |            |
| General and administrative                                      | 108                     | 483        |
| Impairment on real estate held for sale                         | 126                     | 159        |
| Total costs and expenses                                        | 234                     | 642        |
| (Gain) loss on sale of assets                                   | 1                       | (3)        |
| Operating income (loss) from continuing operations              | (235)                   | (639)      |
| Other income (expense):                                         |                         |            |
| Interest income                                                 |                         | 19         |
| Other income (expense)                                          | (1)                     | 4          |
| Total other income (expense)                                    | (1)                     | 23         |
| Income (loss) from continuing operations, before income taxes   | (236)                   | (616)      |
| Provision for income taxes                                      |                         |            |
| Income (loss) from continuing operations                        | (236)                   | (616)      |
| Income (loss) from discontinued operations, net of income taxes | 1                       | (1,377)    |
| Net (loss)                                                      | \$ (235)                | \$ (1,993) |
| Basic and diluted earning income (loss) per share:              |                         |            |
| Continuing operations                                           | \$ (.04)                | \$ (.10)   |
| Discontinued operations                                         |                         | (.21)      |
| Net income (loss)                                               | \$ (.04)                | \$ (.31)   |
| Weighted average shares:                                        |                         |            |
| Basic                                                           | 6,336                   | 6,336      |
| Diluted                                                         | 6,336                   | 6,336      |

See accompanying notes.

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**RELIABILITY INCORPORATED**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(In thousands)**

|                                                                                  | <b>Year Ended December 31,</b> |             |
|----------------------------------------------------------------------------------|--------------------------------|-------------|
|                                                                                  | <b>2008</b>                    | <b>2007</b> |
| Cash flows from operating activities:                                            |                                |             |
| Net income (loss)                                                                | \$ (235)                       | \$ (1,993)  |
| Income (loss) from discontinued operations                                       | 1                              | (1,377)     |
| Income (loss) from continuing operations                                         | (236)                          | (616)       |
| Adjustments to reconcile net income (loss) to cash used by operating activities: |                                |             |
| Depreciation and amortization                                                    |                                | 2           |
| Impairment loss on real estate                                                   | 126                            | 159         |
| (Gain) loss on sale of real estate                                               | 1                              | (3)         |
| Changes in operating assets and liabilities:                                     |                                |             |
| Accounts receivable                                                              |                                | (2)         |
| Prepaid expenses                                                                 | 33                             | 3           |
| Accounts payable and accrued liabilities                                         | (11)                           | (104)       |
| Total adjustments                                                                | 149                            | 55          |
| Net cash (used) by continuing operations                                         | (87)                           | (561)       |
| Net cash (used) by discontinued operations                                       |                                | (176)       |
| Net cash (used) by operating activities                                          | (87)                           | (385)       |
| Cash flows from investing activities:                                            |                                |             |
| Capital expenditures                                                             |                                | (1)         |
| Proceeds from sale of assets                                                     | 98                             |             |
| Acquisition of business (net of cash acquired)                                   |                                | (787)       |
| Net cash provided (used) by investing activities                                 | 98                             | (788)       |
| Cash flows from financing activities:                                            |                                |             |
| Repayments of short-term debt                                                    |                                | (53)        |
| Net cash (used) provided by financing activities                                 |                                | (53)        |
| Net increase (decrease) in cash                                                  | 11                             | (1,226)     |
| Cash and cash equivalents:                                                       |                                |             |
| Beginning of period                                                              | 32                             | 1,258       |
| End of period                                                                    | \$ 43                          | \$ 32       |
| Supplemental cash flow information:                                              |                                |             |
| Owner financing of acquisition costs                                             |                                | \$ 2,635    |

See accompanying note.

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**RELIABILITY INCORPORATED**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)**  
**AND ACCUMULATED OTHER COMPREHENSIVE INCOME**  
  
**(In thousands)**

|                              | Common Stock |          |                                  | Treasury Stock<br>(At Cost) |            | Retained<br>Earnings<br>(Deficit) | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Total<br>Amount |
|------------------------------|--------------|----------|----------------------------------|-----------------------------|------------|-----------------------------------|-----------------------------------------------------------|-----------------|
|                              | Shares       | Amount   | Additional<br>Paid-in<br>Capital | Shares                      | Amount     |                                   |                                                           |                 |
| Balance at December 31, 2006 | 6,690        | \$ 9,449 | \$ 318                           | (354)                       | \$ (1,094) | \$ (6,446)                        | \$                                                        | \$ 2,227        |
| Net (loss)                   |              |          |                                  |                             |            | (1,993)                           |                                                           | (1,993)         |
| Balance at December 31, 2007 | 6,690        | \$ 9,449 | \$ 318                           | (354)                       | \$ (1,094) | \$ (8,439)                        | \$                                                        | \$ 234          |
| Net (loss)                   |              |          |                                  |                             |            | (235)                             |                                                           | (235)           |
| Balance at December 31, 2008 | 6,690        | \$ 9,449 | \$ 318                           | (354)                       | \$ (1,094) | \$ (8,674)                        | \$                                                        | \$ (1)          |

See accompanying notes.

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**RELIABILITY INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2008**

**1. DISCONTINUANCE OF ALL OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*DISCONTINUANCE OF ALL OPERATIONS AND LIQUIDITY*

During the past eight years, Reliability Incorporated and its subsidiaries (collectively referred to as *Reliability* or the *Company*) have sustained significant negative financial results, including substantial decreases in revenues, net income, backlog, and cash flows from operating activities that are generally attributable to operating losses. Due to the deterioration in its financial position, the Company has undergone significant restructuring to reduce its expenses and improve its liquidity, including: the closure of its Power Sources Costa Rica facility, significant downsizing of its domestic and international workforce, the sale of its Power Sources division, the closure of its Services division in Singapore, eliminated all research and development for test equipment, and the sale of its Houston headquarters facility. As a result of these actions, the Company significantly reduced its expenses and generated some cash. However, based upon its current financial position, and an evaluation of the prospects for continuing to operate its historical business lines, the Company concluded that it should explore other possibilities.

On April 1, 2007, Reliability completed the merger of its wholly owned subsidiary, Reliability-Medallion, Inc., a Florida corporation, into Medallion Electric Acquisition Corporation and the indirect acquisition, through Medallion Electric Acquisition Corporation, of Medallion Electric, Inc. Medallion Electric Acquisition Corporation was incorporated under the laws of the State of Florida on December 8, 2006 to facilitate a merger between business entities and was considered to be a development stage company with no operations at March 31, 2007. On June 21, 2007, the Company changed the name of Medallion Electric Acquisition Corporation ( *MEAC* ) to Reliability Contractors of Florida, Inc. Reliability Contractors of Florida, Inc. is a wholly-owned subsidiary of Reliability.

Medallion Electric, Inc. ( *Medallion Electric* or *Medallion* ) was incorporated in the State of Florida in 1980. Medallion Electric is an electrical contracting company, located in Coral Springs, Florida, specializing in electrical contracting services to residential homebuilders, with its major assets consisting of contracts for services to be performed and accounts receivable. Medallion Electric is a wholly-owned subsidiary of Reliability Contractors of Florida, Inc. (collectively referred to as *Reliability Florida* or *Electrical Contracting Services* ).

All of the funds used for the initial acquisition payment and the Company's transaction costs related to the merger and acquisition were paid out of the Company's cash on hand. The Company funded \$750,000 to finance the acquisition. \$100,000 of such funds was made available to Medallion Electric as working capital; \$150,000 was used by MEAC to pay its transaction related expenses. The remaining \$500,000 was used to make the initial payment to the sole shareholder of Medallion Electric for 100% of the stock of Medallion Electric. The remainder of the purchase price consisted of two notes- one for \$500,000 due in six months and one for \$1.4 million due in six months. The Company secured the \$500,000 note with the pledge of its real property in North Carolina; the \$1.4 million note was secured with the assets of Medallion Electric.

The Company planned to pay the notes from the Company's working capital, funds generated by Electrical Contracting Services, additional debt and/or equity financing, and the sale of a part of its real estate located in North Carolina. However, in early September, 2007 it became apparent, the Company was not generating enough funds and had not been successful in raising debt or equity funds to meet all of the obligations which would be due on October 1, 2007. Therefore, the Reliability Board of Directors passed a resolution on September 25, 2007 that instructed management to enter into an agreement to sell Medallion Electric, Inc. back to the previous owner. On October 12, 2007, the Company and its subsidiaries Reliability Contractors of Florida, Inc. and Medallion Electric, Inc. entered into a Settlement, Sale of Stock and Release Agreement ( *Agreement* ) with Mr. Ronald Masaracchio, the previous owner, pursuant to which Reliability Contractors sold back the stock of Medallion effective October 1, 2007. The Company agreed to pay \$325,000 upon the closing of the sale of part of the Company's North Carolina real estate, which was under a purchase and sale contract, and transfer 100% of the Medallion stock to the previous owner, who agreed to release all the liens against the Company's assets, cancel all the notes, and release the Company from any and all of its obligations to him. In addition to the \$325,000, Reliability transferred all the stock of Medallion which held assets that were valued at approximately \$1.7 million on Reliability's balance sheet and liabilities which were generated in the normal course of business at Medallion valued at approximately \$529,000.



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**RELIABILITY INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**December 31, 2008**

Upon the closing of the sale of a portion of Reliability's North Carolina real estate on October 26, 2007, the previous owner received the \$325,000, and the sale of Medallion Electric, the release of the liens, and cancellation of all the obligations was consummated. At the time of the sale, the previous owner held two notes totaling \$1.9 million, which were due October 1, 2007, and an earnout agreement which called for a minimum payment of \$750,000 over three years. The notes were secured by the assets of Medallion and the North Carolina property owned by Reliability. The sale of Medallion back to previous owner included a release of all liability on the notes and the earnout agreement, assumption of all Medallion ordinary course of business debts and obligations, mutual releases between Reliability and previous owner, including a release of the security for the notes. The net proceeds from the sale of a part of the North Carolina real estate to Reliability, after the \$325,000 payment and all other expenses of the sale, were \$292,000. The Company retained the ownership of 10 acres of land in North Carolina. An impairment loss of \$159,000 was recorded in the third quarter of 2007 to reduce the carrying value of the land and building sold in October 2008 and the remaining 10 acres of land held for sale. The ten acres was sold in August of 2008 with net proceeds received of \$98,000. An impairment loss of \$126,000 was recorded in June 2008 to further reduce the carrying value on the ten acres to its value of final disposition.

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. However, upon the completion of the sale of Medallion Electric, the Company has no further operating activities and is now a shell company. The Company has concluded that it should sell the company or identify a merger partner. There can be no assurances that the Company will be successful in completing such a transaction or be able to maintain sufficient liquidity over a period of time that will allow it to carry out these actions, in which case the Company might be forced to liquidate or seek protection under the Federal bankruptcy statutes, or both.

The accompanying financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classifications of liabilities that may result from the possible inability of the Company to continue as a going concern.

***BASIS OF PRESENTATION***

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for financial information and with instructions to Form 10-K. The consolidated financial statements include the financial transactions and accounts of the Company and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

The Company's business segments, Services, Testing Products, and Electrical Contracting Services are reported as discontinued operations in the accompanying Balance Sheet and Statement of Operations for each period presented.

***ACCOUNTING ESTIMATES***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

***CASH EQUIVALENTS***

For the purposes of the statements of cash flows, the Company considers all highly liquid cash investments that mature in three months or less when purchased, to be cash equivalents. Cash equivalents are stated at cost, which approximates fair value.





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**RELIABILITY INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**December 31, 2008**

*IMPAIRMENT OF LONG-LIVED ASSETS; ASSETS HELD FOR SALE*

The Company has adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. This Statement requires that long-lived assets to be disposed of by sale, including those of discontinued operations, be measured at the lower of carrying value or fair value less costs to sell.

*STOCK OPTIONS*

January 1, 2006, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards 123(R), *Share-Based Payment* ( SFAS 123(R) ). SFAS 123(R) requires that the compensation cost relating to stock-based payments, including grants of employee stock options, be recognized in financial statements. That cost is measured based on the fair value of the equity instruments issued. SFAS 123(R) allows two methods for determining the effects of the transition: the modified-prospective transition method and the modified-retrospective method of transition. The Company adopted the modified-prospective method. Under this transition method, the Company recognizes the fair value of stock-based compensation awards as compensation expense in its statement of operations on a straight line basis, over the vesting period, for awards granted after January 1, 2006 and for unvested awards outstanding as of December 31, 2005.

*INCOME TAXES*

Deferred income taxes are provided under the liability method and reflect the net tax effects of temporary differences between the tax basis of assets and liabilities and their reported amounts in the consolidated financial statements. The Company establishes valuation allowances when the realization of specific deferred tax assets are subject to uncertainty. The Company records no tax benefits on its operating losses, as the losses will have to be carried forward and realization of any benefit is uncertain.

*EARNINGS PER SHARE*

The Company determines earnings per share in accordance with Statement of Financial Accounting Standards (SFAS) No. 128, *Earnings Per Share*. Basic earnings (loss) per share is computed by dividing net income (loss) available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. Since the Company generated net losses in 2008 and 2007, outstanding stock options would have been anti-dilutive and were not considered in these calculations

**Table of Contents****Index to Financial Statements****RELIABILITY INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****December 31, 2008****2. ACQUISITION OF BUSINESS, GOODWILL AND SUBSEQUENT DISPOSAL OF ACQUIRED BUSINESSES****ACQUISITION**

On April 1, 2007, the Company consummated the merger of its wholly owned subsidiary, Reliability-Medallion, Inc., a Florida corporation, into Medallion Electric Acquisition Corporation, a Florida corporation ( *MEAC* ), and the indirect acquisition, through MEAC, of Medallion Electric, Inc., a Florida corporation ( *Medallion Electric* ). Medallion Electric is an electrical contracting company for homebuilders in Florida, with its major assets consisting of contracts for services to be performed and accounts receivable.

MEAC was a privately held company owned by eight shareholders unrelated to the Company. One shareholder unrelated to the Company or MEAC or any of MEAC's shareholders owned Medallion Electric.

The Company funded \$750,000 to MEAC after the Merger. \$100,000 of such funds was made available to Medallion Electric as working capital; \$150,000 was used by MEAC to pay its transaction related expenses. MEAC used the remaining \$500,000 to make the initial payment to the shareholder of Medallion Electric for his stock of Medallion Electric and delivered two notes for the remainder of the purchase price - one for \$500,000 due in six months and one for \$1,414,795 due in six months. The Company secured the \$500,000 note with the pledge of its real property in North Carolina; the \$1,414,795 note is secured with the assets of Medallion Electric.

Goodwill was recorded as the excess of the acquisition cost over the fair value of acquired net assets. The Medallion Electric acquisition cost is as follows (in thousands):

|                                     |          |
|-------------------------------------|----------|
| Cash payment to Medallion Electric  | \$ 500   |
| Promissory notes payable            | 1,915    |
| Guaranteed earnout over three years | 750      |
| Professional fees and expenses      | 329      |
|                                     | \$ 3,494 |

The fair value of the assets acquired and liabilities assumed at the date of acquisition is as follows (in thousands):

|                        |       |
|------------------------|-------|
| Cash                   | \$ 72 |
| Other current assets   | 1,340 |
| Property and equipment | 122   |
| Other assets           | 5     |
| Total assets acquired  | 1,539 |
| Current liabilities    | 218   |
| Long-term debt         | 19    |

|                           |          |
|---------------------------|----------|
| Total liabilities assumed | 237      |
| Net assets acquired       | \$ 1,302 |

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The excess of the cost over the fair value of acquired net assets resulted in goodwill, as follows (in thousands):

|                          |          |
|--------------------------|----------|
| Purchase price           | \$ 3,494 |
| Less net assets acquired | (1,302)  |
| Goodwill                 | \$ 2,192 |

**DISPOSITION**

The Company passed a resolution on September 25, 2007 to sell Medallion Electric back to its previous owners and the operation was sold effective October 1, 2007, as discussed in Note 1. Medallion Electric is included as a discontinued operations as disclosed in Note 3.

**3. DISCONTINUED OPERATIONS**

On April 18, 2006, the Company announced plans to close down its Services division located in Singapore. During the wind down of operations, the division has maintained a small number of employees to complete unfinished jobs, provide limited services for its customers while they seek alternative service providers, prepare equipment for sale and vacate the division's leased facility. The liquidation of the Company's former Services division was substantially complete as of June 30, 2007.

In April of 2007, following the acquisition of Medallion Electric, the Company concluded that it should abandon its Testing Products business in favor of concentrating all available resources on its newly acquired business line, Electrical Contracting Services.

On September 25, 2007, the Company's Board of Directors passed a resolution to sell Medallion Electric to the previous owner. Therefore, the Electrical Contracting Services (Medallion Electric) is included as a discontinued operation.

The loss from the discontinued Electrical Contracting Services includes the loss on the disposition of the Electrical Contracting Service (Sale of Medallion Electric) as follows:

|                                                 | 2007       |
|-------------------------------------------------|------------|
| Electrical Contracting Services: (in thousands) |            |
| Assets sold                                     | \$ (3,882) |
| Liabilities extinguished                        | 3,168      |
| Costs of sale of business                       | (325)      |
| Loss on Disposition                             | \$ (1,039) |

The assets and liabilities of the Company's former Services division are reported as assets of discontinued operations and accrued liabilities of discontinued operations in the accompanying Consolidated Balance Sheets for each period presented. The assets and accrued liabilities from discontinued operations are as follows (in thousands):

|                                          | December 31,<br>2008 | December 31,<br>2007 |
|------------------------------------------|----------------------|----------------------|
| Assets:                                  |                      |                      |
| Cash                                     | \$                   | \$ 91                |
| Accounts receivable                      |                      | 15                   |
|                                          | \$                   | \$ 106               |
| Accrued liabilities:                     |                      |                      |
| Accrued payroll and termination benefits | \$ 13                | \$ 113               |
| Other accrued liabilities                |                      | 7                    |
|                                          | \$ 13                | \$ 120               |

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The loss from the operations of the Electrical Contracting Services is included in the table below.

Results of operations for the Company's former Power Sources, Services, Testing Products, and Electrical Contracting Services segments are reported as discontinued operations in the accompanying Statement of Operations for each period presented. Net sales and the loss from discontinued operations are as follows (in thousands):

|                                             | 2008 | 2007       |
|---------------------------------------------|------|------------|
| Revenues:                                   |      |            |
| Services                                    |      | 36         |
| Testing Products                            |      | 6          |
| Electrical Contracting Services             |      | 1,956      |
|                                             | \$   | \$ 1,998   |
| Income (loss) from discontinued operations: |      |            |
| Services                                    | 1    | (131)      |
| Testing Products                            |      | 4          |
| Electrical Contracting Services             |      | (1,250)    |
|                                             | \$ 1 | \$ (1,377) |

**4. IMPAIRMENT LOSS**

On October 26, 2007, seven and one half acres of the land and a building that had been held for sale for a number of years were sold for \$675,000 cash. The Company retained 10 acres of land adjacent to the property that was sold. An impairment loss of \$159,000 was recorded in the third quarter of 2007 to reduce the carrying value of the real estate held for sale. The remaining ten acres was sold in August 2008 with net proceeds received of \$98,000, and an impairment loss of \$126,000 recorded in June 2008 to reduce the carrying value of the ten acres to its value at final disposition.

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The components of income (loss) before income taxes from continuing operations are as follows (in thousands):

|                                          | <b>2008</b>           | <b>2007</b> |
|------------------------------------------|-----------------------|-------------|
|                                          | <b>(In thousands)</b> |             |
| Income (loss) from continuing operations | \$ (236)              | \$ (616)    |

The components of income tax expense (benefit) consists of the following (in thousands):

|                       | <b>2008</b> | <b>2007</b> |
|-----------------------|-------------|-------------|
| Federal income taxes: |             |             |
| Current               | \$          | \$          |
| Deferred              |             |             |
| State income taxes:   |             |             |
| Current               |             |             |
| Deferred              |             |             |
| Foreign income taxes: |             |             |
| Current               |             |             |
| Deferred              |             |             |
|                       | \$          | \$          |

The Company's effective tax rate differs from the U. S. federal statutory rate of 34% as follows:

|                                                                  | <b>2008</b>           | <b>2007</b> |
|------------------------------------------------------------------|-----------------------|-------------|
|                                                                  | <b>(In thousands)</b> |             |
| Income tax expense (benefit) at the U. S. federal statutory rate | \$ (80)               | \$ (209)    |
| Change in valuation allowance                                    | 80                    | 209         |
|                                                                  | \$                    | \$          |

The significant components of the Company's net deferred tax assets (liabilities) at December 31, 2008 were as follows (in thousands):

|                      | <b>2008</b> | <b>2007</b> |
|----------------------|-------------|-------------|
| Deferred tax assets: |             |             |
| Impairment reserves  | \$          | \$ 54       |



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|                              |       |       |
|------------------------------|-------|-------|
| Net operating loss carryover | 5,442 | 5,308 |
| Capital loss carryover       | 199   | 199   |
| Total deferred tax assets    | 5,641 | 5,561 |
| Valuation allowance          | 5,641 | 5,561 |
| Net deferred tax assets      | \$ 0  | \$ 0  |

The Company has established valuation allowances related to certain tax benefits where management believes that the available evidence indicates that it is more likely than not that the Company will not realize the tax benefit. The Company intends to maintain a full valuation allowance until sufficient positive evidence exists to support reversal of the valuation allowance.

At December 31, 2008, the Company had U.S. net operating loss carryforwards of \$15.5 million that will expire commencing in 2023 through 2028. These carryforwards may be subject to certain limitations on annual utilization in the event of a change in ownership, as defined by tax law.

The Company made no cash payments for income taxes in 2008 or 2007.

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Accrued liabilities as of December 31, 2008 and 2007 consists of the following (in thousands):

|                      | <b>2008</b>  | <b>2007</b>  |
|----------------------|--------------|--------------|
| Legal and Accounting | \$ 27        | \$ 16        |
| Property Tax         |              | 5            |
| Insurance            |              | 19           |
| Other                | 4            | 2            |
| <b>Total</b>         | <b>\$ 31</b> | <b>\$ 42</b> |

**7. EMPLOYEE STOCK SAVINGS PLAN**

The Reliability Incorporated Employee Stock Saving Plan (the "Plan") (As Amended and Restated Effective January 1, 2000) was terminated effective November 16, 2006, with all accounts fully vested as of such date. The Company filed the termination of the Plan with the Internal Revenue Service to request a favorable letter of determination and notified all employees covered by the Plan of its termination, and their rights to final payment thereunder. The Company received a favorable letter of determination from the Internal Revenue Service.

The Plan allowed eligible United States employees to contribute up to 100% of defined compensation to the Plan and to elect to have contributions not be subject to Federal income taxes under Section 401(k) of the Internal Revenue Code. The Company matched employee contributions to the Plan at a rate equal to 50% of the employee's contribution, but the Company's matching contribution was limited to 2% of the employee's defined compensation. The Company also made a voluntary contribution of an amount equal to 1% of the defined compensation of all participants. The Company also contributed a profit sharing amount based on the consolidated profits of the Company. The maximum profit sharing contribution was 5% of compensation. The Company's contributions for matching and voluntary contributions were \$0 in 2007 and \$0 in 2008.

The Company registered and reserved 500,000 shares in 1992, and registered and reserved 500,000 additional shares in 2001, of common stock for sale to the Plan. The registration statements cover shares purchased both in the open market and from the Company. The Plan did not purchase any shares from the Company during the three-year period ending in 2008.

At December 31, 2008, 354,300 reserved shares remain unissued under the 2001 registration statement. There are no plans to issue the reserved shares as the plan has been terminated.

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On January 1, 2006, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards 123(R), *Share-Based Payment* ( *SFAS 123(R)* ). SFAS 123(R) requires that the compensation cost relating to stock-based payments, including grants of employee stock options, be recognized in financial statements. The Company recognizes the fair value of stock-based compensation awards as compensation expense in its statement of operations on a straight line basis, over the vesting period, for awards granted after January 1, 2006 and for unvested awards outstanding as of December 31, 2005.

The fair value of each option is estimated on the date of grant using a Black-Scholes option-pricing model. Expected volatilities are based on a number of factors, including historical volatility of the Company's stock. The Company uses the *shortcut* method described in SAB Topic 14D.2 for determining the expected life used in the valuation model. 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 the grant. As the Company has not declared dividends since it became a public entity, no dividend yield is used in the calculation.

Under the Company's Amended and Restated 1997 Stock Option Plan (the *Plan* ), no further option grants are allowed after February 26, 2007, but options theretofore granted shall remain in effect until satisfied or terminated pursuant to the Plan. No options were granted under the Plan during the year ended December 31, 2008.

At December 31, 2006, all options were fully vested, thus no further stock option expense will be recorded related to the Plan. The weighted-average remaining contractual term, as of December 31, 2007, was 8.80 years for outstanding and exercisable options. The following table summarizes option activity for the year ended December 31, 2008:

|                                          | <b>Number of<br/>Options</b> | <b>Weighted<br/>Average<br/>Price</b> |
|------------------------------------------|------------------------------|---------------------------------------|
| Balance as of December 31, 2006          | 951,851                      | \$ 1.67                               |
| Expired or canceled                      | (581,851)                    | 2.60                                  |
| Exercised                                |                              |                                       |
| Granted                                  |                              |                                       |
| Balance as of December 31, 2007 and 2008 | 370,000                      | \$ .21                                |

All the options outstanding on the 370,000 shares under the Company's Stock Option Plan are exercisable until July 18, 2016, when they expire. In addition to the options outstanding under the Company's Stock Option Plan, 100,000 options issued in connection with a business combination were outstanding and exercisable at December 31, 2007 at \$1.50 per share. These options were forfeited January 18, 2008.

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**INDEX TO EXHIBITS**

| <b>Exhibit<br/>Number</b> | <b>Description</b>                                                                                                                                                                                                                 |
|---------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 21                        | List of Subsidiaries.                                                                                                                                                                                                              |
| 23.1                      | Consent of Independent Registered Public Accounting Firm Fitts, Roberts & Co.,LLC.                                                                                                                                                 |
| 23.2                      | Consent of Independent Registered Public Account Firm Ramirez International.                                                                                                                                                       |
| 31.1                      | Certification Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act                                                                                                                                                  |
| 32                        | Certification Pursuant to Rule 13a-14(b)/15d-14(b) and Section 1350, Chapter 63, Title 18 of the United States Code (Certification will not be deemed filed for purposes of Section 18 of the Securities Act of 1934, as amended). |