

RELIABILITY INC  
Form 11-K  
June 28, 2004  
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# SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

## FORM 11-K

ANNUAL REPORT PURSUANT TO SECTION 15 (d) of

THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2003

Commission File No. 2-83256

A. Full title of the plan and the address of the plan, if different from that of the issuer named below:

**RELIABILITY INCORPORATED EMPLOYEE STOCK SAVINGS PLAN**

B. Name of issuer of the securities held pursuant to the plan and the address of its principal executive office:

**RELIABILITY INCORPORATED**

**16400 Park Row**

**Houston, Texas 77084**

**P. O. Box 218370**

**Houston, Texas 77218-8370**



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RELIABILITY INCORPORATED

EMPLOYEE STOCK SAVINGS PLAN

December 31, 2003

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RELIABILITY INCORPORATED

EMPLOYEE STOCK SAVINGS PLAN

Report of Independent Registered Public Accounting Firm

The Administrative Committee

Reliability Incorporated Employee

Stock Savings Plan

We have audited the accompanying statement of net assets available for benefits of the Reliability Incorporated Employee Stock Savings Plan as of December 31, 2002. This financial statement is the responsibility of the Plan's management. Our responsibility is to express an opinion on this financial statement 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. 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 statement referred to above presents fairly, in all material respects, the net assets available for benefits of the Plan at December 31, 2002, in conformity with U.S. generally accepted accounting principles.

/s/ ERNST & YOUNG LLP

Houston, Texas

June 16, 2003

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RELIABILITY INCORPORATED

EMPLOYEE STOCK SAVINGS PLAN

STATEMENTS OF NET ASSETS AVAILABLE FOR BENEFITS

	<b>December 31,</b>	
	<b>Unaudited</b>	
	<b>2003</b>	<b>2002</b>
	<u>          </u>	<u>          </u>
Plan assets:		
Investments, at fair value (Note G)	\$ 2,778,195	\$ 3,108,828
	<u>          </u>	<u>          </u>
Total assets	\$ 2,778,195	\$ 3,108,828
Net plan liabilities:		
Net pending trades		14,349
	<u>          </u>	<u>          </u>
Cash overdraft	466	
	<u>          </u>	<u>          </u>
Net assets available for benefits	\$ 2,777,729	\$ 3,094,479
	<u>          </u>	<u>          </u>

See accompanying notes.

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RELIABILITY INCORPORATED  
EMPLOYEE STOCK SAVINGS PLAN

STATEMENT OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS

Year ended December 31, 2003

	<b>(Unaudited)</b>
Investment income (loss):	
Interest and dividends	\$ 39,947
Net appreciation in fair value of investments	594,242
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Total investment gain	634,189
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Contributions:	
Employee	203,120
Employer	42,486
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Total contributions	245,606
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Deductions:	
Withdrawals and terminations	(1,196,315)
Administrative fees	(230)
	<hr/>
Total deductions	(1,196,545)
	<hr/>
Decrease in net assets available for benefits	(316,750)
Net assets available for benefits at beginning of year	3,094,479
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Net assets available for benefits at end of year	\$ 2,777,729
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See accompanying notes.

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RELIABILITY INCORPORATED  
EMPLOYEE STOCK SAVINGS PLAN  
NOTES TO FINANCIAL STATEMENTS

December 31, 2003

**NOTE A EXAMINATION OF FINANCIAL STATEMENTS**

The rules for Form 11-K require financial statements to be examined to the extent required by ERISA. ERISA does not require plans that have less than 100 participants as of the beginning of the plan year to have the financial statements examined. Whereas the plan had less than 100 participants as of January 1, 2003, the financial information for 2003 has not been examined by an independent registered public accountant. The financial statements of the plan for 2002 were examined by an independent registered public accountant, whose report, as it relates to the comparative financial data for 2002 presented herein, is included as part of this report.

**NOTE B - PARTICIPATION AND CONTRIBUTIONS**

In July 1983, Reliability Incorporated (the Company or Employer) adopted an Employee Stock Savings Plan (the Plan). The following description of the Plan provides only general information. Participants should refer to the Plan Agreement for a more complete description of the Plan's provisions. The Plan is subject to certain provisions of the Employee Retirement Income Security Act of 1974 (ERISA). The Plan is administered by an Administrative Committee (the Committee) appointed by the Board of Directors of the Company. All assets of the Plan, except for the Loan Fund, are held under discretionary trust agreements.

Any United States employee of the Employer who has completed six months of service including at least 900 hours of service or one year of service including at least 1,000 hours of service becomes a member (Member) of the Plan on the first day of the next month following the date on which the employee becomes eligible and may elect to make contributions to the Plan.

Under the Plan, a Member may contribute, through payroll deductions, up to 100 percent of his compensation (Employee Contribution), as defined in the Plan Agreement. Members may increase or decrease contribution percentages each pay period. Members may elect to invest their contributions in various mutual funds, a common collective trust fund or in The Reliability Incorporated Common Stock Fund (Common Stock).

The Employer matches the Employee Contribution by an amount (Employer Contribution) equal to 50 percent of the Employee Contribution up to a maximum of 2% of the Member's compensation. Also, the Employer annually contributes, for employed Members, a supplemental amount (Employer Voluntary Contribution) equal to 1% of each Member's compensation for the period during which he was a Member. An additional discretionary contribution (Discretionary Contribution) may be made. The amount of the Discretionary Contribution, if any, will be determined annually by the Board of Directors and will be contributed as a percent of each Member's compensation. The Employer did not make a Discretionary Contribution for 2003.





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RELIABILITY INCORPORATED

EMPLOYEE STOCK SAVINGS PLAN

NOTES TO FINANCIAL STATEMENTS - (Continued)

December 31, 2003

**NOTE B - PARTICIPATION AND CONTRIBUTIONS**    *Continued*

A Member receives a vested interest in the balances in the Employer Contribution, Employer Voluntary Contribution and Discretionary Contribution accounts plus allocated earnings and realized and unrealized gains and losses thereon ( Employer Account ) based upon years of service (as defined in the Plan) as follows:

<u>Years of service</u>	<u>Vested interest in Employer Account</u>
Less than 2	0%
2	20
3	40
4	60
5	80
6 or more	100

A Member always has a 100 percent vested interest in the balance in his Employee Contributions plus allocated earnings and realized and unrealized gains and losses thereon (his Employee Account ). Upon death or total and permanent disability, a Member is automatically 100% vested in his Employer Account. All Members become fully vested in all their accounts if the Company terminates the Plan and account balances will be distributed as prescribed by ERISA.

**NOTE C - SIGNIFICANT ACCOUNTING POLICIES**

***Basis of Accounting***

The accompanying financial statements have been prepared using the accrual basis of accounting. Benefits are recorded when paid.

***Investment Valuation***

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Investments in Common Stock and mutual funds are stated at their fair value based on quoted market prices. The investment in the Stable Value Fund is based on the Fund's net asset value, as determined by the issuer based on the fair value of the underlying investments and the investment in the Money Market Fund is stated at cost, which approximates fair value.

Amounts contributed by the Company are invested solely in The Reliability Incorporated Common Stock Fund. Members may begin diversifying out of the Employer contributed portion of the Reliability Incorporated Common Stock Fund beginning at age 55 if they have completed ten years of service. Common Stock may be purchased by Smith Barney Corporate Trust Company ( Trustee ) directly from the Company or in the open market. The Trustee has not purchased any stock directly from the Company since 1998. The purchase price per share for stock purchased from the Company is the closing price on the day prior to the purchase by the Trustee. Gains and losses realized on the sale of Reliability Incorporated Common Stock are recorded on an average cost basis.

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EMPLOYEE STOCK SAVINGS PLAN  
NOTES TO FINANCIAL STATEMENTS - (Continued)

December 31, 2003

*Administrative Expenses*

Certain administrative expenses are paid by the Company.

*Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

*Risks and Uncertainties*

The Plan provides for investments in various investment securities, which in general, are exposed to various risks, such as interest rate, credit and overall market volatility risks. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and that such change could materially affect the amounts reported in the statements of net assets available for benefits and participant account balances.

**NOTE D - WITHDRAWALS AND TERMINATIONS**

A Member may elect to withdraw all or a portion of his after-tax Employee Contributions at any time. Certain restrictions apply to withdrawals of pre-tax Employee Contributions. A Member making a withdrawal from pre-tax Employee Contributions is not permitted to make future pre-tax Employee Contributions prior to the first day of the month following the expiration of six months from the date of such withdrawal.

Upon a Member's termination of employment, the Member will generally receive a benefit in the form of a lump sum distribution.

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The non-vested portions of the Employer Accounts of a Member whose employment is terminated prior to the attainment of six years of service or who retires prior to Normal Retirement Age (as defined in the Plan), are forfeited and allocated among the other Members in the ratio that each such Member's defined compensation for the Plan Year, or that portion of the Plan Year during which he was a Member of the Plan, bears to the total defined compensation for all Members for the Plan Year. Forfeitures do not reduce the Employer's Contribution or the Employer's Voluntary Contributions.

### **NOTE E - MEMBER LOANS**

A Member may borrow up to the lesser of 1) \$50,000 or 2) 50 percent of his non-forfeitable accrued benefit. The minimum loan amount is \$1,000 and the maximum loan term is five years for general loans and 15 years for home loans. Loan payments are made through payroll deductions. Loans are stated at cost which approximates fair value.

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 EMPLOYEE STOCK SAVINGS PLAN  
 NOTES TO FINANCIAL STATEMENTS - (Continued)

December 31, 2003

**NOTE F - FEDERAL INCOME TAX AND ERISA**

The Plan received a determination letter from the Internal Revenue Service dated September 7, 2001, stating that the Plan is qualified under Section 401(a) of the Internal Revenue Code (the Code) and, therefore, the related trust is exempt from taxation. The Plan has subsequently been amended for certain tax legislation enacted since the date of the determination letter. The Plan is required to operate in conformity with the Code to maintain its qualification. The Plan's Administrative Committee believes the Plan, as amended, is being operated in compliance with the applicable requirements of the Code and, therefore, believes that the Plan and the related trust are tax exempt.

**NOTE G - INVESTMENTS**

The following table presents details related to individual investments representing 5% or more of the Plan's net assets.

	<b>December 31,</b>	
	<b>(Unaudited)</b>	
	<b>2003</b>	<b>2002</b>
Large Capitalization Value Equity Investments Fund	\$ 511,832	\$ 702,214
Stable Value Fund	553,458	655,065
Reliability Incorporated Common Stock*	486,138	556,242
Large Capitalization Growth Investments Fund	505,930	505,618
Small Capitalization Growth Investments Fund	326,121	326,028
International Equity Investments Fund	196,564	278,276
SEI Prime Obligation Fund	144,441	39,001

\* Indicates both non-member directed and member directed

During 2003, the Plan's investments, including gains and losses in investments bought and sold, as well as held during the year, appreciated in value as follows:

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	<u>(Unaudited)</u>
Reliability Incorporated Common Stock	\$ 48,709
Mutual funds	545,533
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Net appreciation	\$ 594,242
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RELIABILITY INCORPORATED  
 EMPLOYEE STOCK SAVINGS PLAN  
 NOTES TO FINANCIAL STATEMENTS - (Continued)

December 31, 2003

**NOTE H - NON-MEMBER DIRECTED INVESTMENTS**

Information about the significant components of the changes in net assets relating to Reliability Incorporated Common Stock Fund is as follows:

	<u>(Unaudited)</u>
Employer Contributions	\$ 42,486
Employee Contributions	39,592
Net appreciation in fair value of Common Stock	48,709
Withdrawals and terminations	(200,891)
	(70,104)
Net decrease	(70,104)
Net assets at beginning of the year	556,242
	\$ 486,138
Net assets at end of the year	\$ 486,138

**NOTE I - RECONCILIATION OF FINANCIAL STATEMENTS TO FORM 5500**

The following is a reconciliation of net assets available for benefits per the financial statements to the Form 5500:

	December 31,	
	(Unaudited)	
	2003	2002
Net assets available for benefits per the financial statements	\$ 2,777,729	\$ 3,094,479
Less amounts allocated to withdrawing participants	(137,058)	(2,763)
Less amounts allocated to participant for contributions	(5,000)	
	\$ 2,635,671	\$ 3,091,716
Net assets available for benefits per the Form 5500	\$ 2,635,671	\$ 3,091,716

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The following is a reconciliation of benefits paid to participants per the financial statements to Form 5500 for the period ended December 31, 2003:

	<u>(Unaudited)</u>
Benefits paid to participants per the financial statements	\$ 1,196,315
Less prior year pending distributions	(2,763)
Plus amounts allocated to withdrawing participants	137,058
	<u>                    </u>
Benefits paid to participants per the Form 5500	<u>\$ 1,330,610</u>

Amounts allocated to withdrawing participants are recorded on the Form 5500 for benefit claims that have been processed and approved for payment prior to December 31, but which have not yet been paid as of that date.



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EMPLOYEE STOCK SAVINGS PLAN

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Administrative Committee of the Plan has duly caused this annual report to be signed by the undersigned thereunto duly authorized.

RELIABILITY INCORPORATED EMPLOYEE STOCK  
SAVINGS PLAN

By: Administrative Committee  
(Plan Administrator)

/s/ Carl V. Schmidt

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Date: June 28, 2004

Administrative Committee Member

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RELIABILITY INCORPORATED

INDEX TO EXHIBITS

<b><u>Exhibit Number</u></b>	<b><u>Description</u></b>
23	Consent of Independent Registered Public Accounting Firm, dated June 24, 2004, related to Employee Stock Savings Plan and Trust.