THE REASON FOUNDATION

FINANCIAL STATEMENTS

FOR THE YEAR ENDED SEPTEMBER 30, 2016

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INDEPENDENT AUDITOR'S REPORT

To the Board of Trustees
THE REASON FOUNDATION
Los Angeles, California

We have audited the accompanying financial statements of The Reason Foundation (the "Foundation"), which comprise the statement of financial position as of September 30, 2016, and the related statements of activities, functional expenses, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"); this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the U.S. ("U.S. GAAS"). 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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Foundation's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Foundation's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Reason Foundation as of September 30, 2016, and the changes in its net assets and its cash flows for the year then ended in conformity with U.S. GAAP.

Armanino LLP

Armanino LLP
Los Angeles, California

January 19, 2017

THE REASON FOUNDATION

STATEMENT OF FINANCIAL POSITION

SEPTEMBER 30, 2016

ASSETS

Current Assets	
Cash and cash equivalents	$ 1,309,058
Investments	4,168,535
Accounts receivable, net	147,447
Current portion of pledges receivable	1,168,099
	6,793,139
Other Assets	
Pledges receivable, net of current portion	22,141
Property and equipment, net	2,882,196
Deposits	83,434
	2,987,771
	$ 9,780,910

LIABILITIES AND NET ASSETS

Current Liabilities	
Accrued compensation expenses	$ 994,223
Accounts payable and other accrued expenses	276,207
Current portion of unearned subscriptions	135,044
	1,405,474
Long-Term Liabilities	
Unearned subscriptions, net of current portion	168,723
Total Liabilities	1,574,197
Commitments (Note 11)	
Net Assets	
Unrestricted	
General	3,651,476
Investment in land and building	2,820,053
Total unrestricted	6,471,529
Temporarily restricted	1,690,905
Permanently restricted	44,279
Total Net Assets	8,206,713
	$ 9,780,910

See accompanying notes to the financial statements.

THE REASON FOUNDATION

STATEMENT OF ACTIVITIES

FOR THE YEAR ENDED SEPTEMBER 30, 2016

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenue and Support				
Contributions	$ 8,012,012	$ 1,924,660	$ -	$ 9,936,672
Reason Magazine	864,875	-	-	864,875
Conferences	420,100	-	-	420,100
Proceeds from fundraising events, net of direct benefit costs of $15,950	262,193	-	-	262,193
Realized gains on sales of investment	42,511	-	-	42,511
Unrealized gains on investments	154,950	(396)	(885)	153,669
Interest and dividends	116,748	359	805	117,912
Miscellaneous	3,686	-	-	3,686
Reclassification of endowment earnings	-	(80)	80	-
Net Assets Released from Restrictions	1,504,430	(1,504,430)	-	-
	11,381,505	420,113	-	11,801,618
Functional Expenses				
Program services				
Public Affairs	494,571	-	-	494,571
Reason-TV	1,781,335	-	-	1,781,335
Magazine	3,606,910	-	-	3,606,910
Research	3,544,696	-	-	3,544,696
	9,427,512	-	-	9,427,512
Management and general	264,682	-	-	264,682
Fundraising	1,024,291	-	-	1,024,291
	10,716,485	-	-	10,716,485
Changes in Net Assets	665,020	420,113	-	1,085,133
Net Assets, beginning of year	5,806,509	1,270,792	44,279	7,121,580
Net Assets, end of year	$ 6,471,529	$ 1,690,905	$ 44,279	$ 8,206,713

See accompanying notes to the financial statements.

THE REASON FOUNDATION

STATEMENT OF FUNCTIONAL EXPENSES

FOR THE YEAR ENDED SEPTEMBER 30, 2016

	Public Affairs	Reason-TV	Magazine	Research	Total Programs	Management and General	Fundraising	Total
Personnel Expenses								
Salaries	$ 369,100	$ 1,021,097	$ 1,742,235	$ 1,827,471	$ 4,959,903	$ 152,732	$ 453,757	$ 5,566,392
Payroll taxes	23,932	65,227	111,534	120,930	321,623	7,209	25,490	354,322
Employee benefits	22,233	64,450	106,988	110,056	303,727	7,586	29,021	340,334
	415,265	1,150,774	1,960,757	2,058,457	5,585,253	167,527	508,268	6,261,048
Other Expenses								
Books and periodicals	1,050	2,321	5,554	13,841	22,766	338	1,538	24,642
Commissions	-	-	35,777	-	35,777	-	-	35,777
Conference attendance and sponsorships	8,535	950	484	86,221	96,190	-	10,086	106,276
Contract services	3,789	183,707	433,663	519,750	1,140,909	21,567	16,834	1,179,310
Depreciation and amortization	3,930	11,301	18,370	20,384	53,985	1,292	4,743	60,020
Dues and subscriptions	863	2,622	4,935	32,220	40,640	1,056	6,870	48,566
Foundation-hosted events and conferences	3,256	196,144	206,568	267,300	673,268	-	163,120	836,388
Insurance	5,775	17,017	28,581	28,747	80,120	1,976	7,676	89,772
Interest	93	309	485	515	1,402	35	107	1,544
Magazine printing and distribution	501	703	508,138	906	510,248	-	692	510,940
Miscellaneous	4,586	2,879	3,070	3,369	13,904	7,930	2,294	24,128
Occupancy	16,055	48,080	80,465	80,220	224,820	7,082	21,510	253,412
On-line services	10,701	17,074	43,354	46,105	117,234	3,032	11,650	131,916
Postage and shipping	4,489	8,221	29,529	12,534	54,773	2,690	57,410	114,873
Printed material	77	135	22,671	24,739	47,622	-	27,488	75,110
Professional fees	-	-	1,103	6,150	7,253	38,006	-	45,259
Promotion and advertising	-	75	146,535	2,657	149,267	-	30,479	179,746
Supplies	9,448	34,744	16,983	27,701	88,876	6,543	20,961	116,380
Telephone	3,381	10,567	13,595	23,639	51,182	2,952	9,129	63,263
Travel	2,777	93,712	46,293	289,241	432,023	2,656	123,436	558,115
	$ 494,571	$ 1,781,335	$ 3,606,910	$ 3,544,696	$ 9,427,512	$ 264,682	$ 1,024,291	$ 10,716,485

THE REASON FOUNDATION

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED SEPTEMBER 30, 2016

Cash Flows from Operating Activities	
Changes in net assets	$ 1,085,133
Adjustments to reconcile changes in net assets to net cash provided by operating activities	
Depreciation and amortization	60,020
Realized gains on sales of investments	(42,511)
Unrealized gains on investments	(153,669)
Contributions of investments	(479,141)
Reinvested interest and dividends	(117,912)
Increase in allowance for doubtful accounts	1,270
(Increase) decrease in operating assets	
Accounts receivable	(45,290)
Pledges receivable	(207,638)
Deposits	8,829
Increase (decrease) in operating liabilities	
Accrued compensation expenses	183,375
Accounts payable and other accrued expenses	(43,825)
Unearned subscriptions	(11,680)
Net Cash Provided by Operating Activities	236,961
Cash Flows from Investing Activities	
Purchases of property and equipment	(9,197)
Purchases of investments	(210,366)
Proceeds from sales of investments	725,842
Net Cash Provided by Investing Activities	506,279
Cash Flows from Financing Activities	
Principal payments on mortgage payable	(115,543)
Net Cash Used in Financing Activities	(115,543)
Net Increase in Cash and Cash Equivalents	627,697
Cash and Cash Equivalents, beginning of year	681,361
Cash and Cash Equivalents, end of year	$ 1,309,058

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash Paid during the Year for Interest	$ 1,544

See accompanying notes to the financial statements.

THE REASON FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED SEPTEMBER 30, 2016

NOTE 1 - NATURE OF OPERATIONS

The Reason Foundation (the "Foundation") is a California tax-exempt nonprofit corporation formed for the purpose of educating Americans in the basic principles of the classical liberal/libertarian political philosophy. Toward this end, the Foundation provides research and publications which apply free-market principles to public policy issues. The Foundation's activities include the monthly publication of Reason magazine and the publication of various studies on public policy issues.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Income Tax Status

The Foundation is a nonprofit public benefit corporation organized under the laws of California and, as such, is generally exempt from federal and state income taxes under Internal Revenue Code ("IRC") Section 501(c)(3) and corresponding state provisions. The Foundation incurs unrelated business income taxes ("UBIT") from its activities involving Reason Magazine advertising income and from rental of its mailing list. UBIT is calculated using federal and California corporate tax rates applied to any surplus from its unrelated business activities.

The Foundation’s federal income tax and informational returns for tax years ended September 30, 2013, and subsequent remain subject to examination by the Internal Revenue Service. The returns for California, the Foundation’s only state tax jurisdiction, remain subject to examination by the California Franchise Tax Board for tax years ended September 30, 2012, and subsequent.

Financial Statement Presentation

The Foundation reports information regarding its financial position and activities according to three classes of net assets: unrestricted, temporarily restricted and permanently restricted.

Unrestricted Net Assets, General - Include contributions, magazine revenue, events, and other forms of revenue that are not restricted by the donor or grantor as well as expenditures related to the general operations of the Foundation.

Unrestricted Net Assets, Investment in Land and Building - Represents the investment in land and building, net of accumulated depreciation and debt secured by the land and building.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Financial Statement Presentation (Continued)

Temporarily Restricted Net Assets - Include contributions that are temporarily restricted by the donor or grantor. When the restriction expires, the net assets of this classification are reclassified to unrestricted net assets. Restricted contributions where restrictions are met in the same reporting period are classified as unrestricted.

Permanently Restricted Net Assets - Include contributions that have been restricted by the donor in perpetuity.

Use of Estimates

Management uses estimates and assumptions in preparing financial statements. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could differ from these estimates.

Cash and Cash Equivalents

The Foundation considers all highly-liquid financial instruments purchased with an original maturity of three months or less to be cash equivalents.

Investments

Investment earnings, gains, and losses are reported as unrestricted revenue in the statement of activities unless they have been restricted by a donor or by law. Unrealized gains and losses are recognized aggregately. Realized gains and losses are recognized immediately and are computed using the specific identification method.

Accounts Receivable

Accounts receivable are unsecured and the Foundation is at-risk to the extent such amounts become uncollectible. Management has established an allowance for doubtful accounts based on management's estimate of future collections.

Pledges Receivable

The pledges receivable balance consists of unconditional promises to give monetary assets to the Foundation. Management anticipates it will collect 100% of the pledges receivable balance; thus no allowance for potentially uncollectible pledges has been established as of September 30, 2016.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Property and Equipment

Purchases of property and equipment are recorded at cost. Donated items are recorded at fair value when received. Depreciation and amortization on both purchased and donated items are recorded using the straight-line method over the shorter of the estimated useful life of the related asset or the term of the lease for leasehold improvements as follows:

Building and improvements	7 - 39
Furniture and equipment	3

Normal repairs and maintenance are expensed as incurred, whereas significant charges that materially increase values or extend useful lives are capitalized and depreciated over the estimated useful lives of the related assets.

Unearned Subscriptions

Magazine subscription revenue is generally received in advance, initially reported as unearned subscriptions, and taken into earnings on a pro-rata basis over the respective subscription periods, some of which are more than 1 year.

Impairment of Long-Lived Assets

Management reviews each asset or asset group for impairment whenever events or circumstances indicate that the carrying value of an asset or asset group may not be recoverable, but at least annually. No impairment provision was recorded by the Foundation during the year.

Endowment

Net assets associated with the endowment fund are classified and reported based on the existence or absence of donor-imposed restrictions. The Foundation's endowment consists of accumulated contributions restricted by the donors to create a permanent endowment. Earnings from the investments associated with the endowment are appropriated for expenditure annually by management and applied to current operations.

Contribution Revenue

Contributions consist primarily of donations from foundations, businesses and the general public. Contributions are accrued when committed to the Foundation by the donor.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Functional Expenses

The Foundation allocates its expenses on a functional basis among its various programs and support services. Expenses that can be identified with a specific program or support service are allocated directly according to their natural expense classification. Other expenses that are common to several functions are allocated accordingly.

Advertising

Promotion and advertising costs totaling $179,746 are expensed as incurred.

Concentration of Risk

Occasionally the Foundation's cash balances exceed FDIC-insured limits. The Foundation has not experienced and does not anticipate any losses related to these balances.

Subsequent Events

The Foundation has evaluated events subsequent to September 30, 2016, to assess the need for potential recognition or disclosure in the financial statements. Such events were evaluated through January 19, 2017, the date the financial statements were available to be issued. Based upon this evaluation, it was determined no subsequent events occurred that require recognition or additional disclosure in the financial statements.

THE REASON FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED SEPTEMBER 30, 2016

NOTE 3 - INVESTMENTS

The Foundation reports its investments at fair value among three categories of price inputs available. These categories of inputs are quoted prices in active markets for identical assets (Level 1); significant other observable inputs (Level 2); and significant unobservable inputs (Level 3). The following table sets forth by level, within the fair value hierarchy, the Foundation's assets at fair value as of September 30, 2016:

	Level 1	Level 2	Level 3	Total
Stock funds	$ 2,383,549	$ -	$ -	$ 2,383,549
REIT index funds	106,047	-	-	106,047
Bond funds	1,364,715	-	-	1,364,715
U.S. Treasury Funds	155,918	-	-	155,918
Gold exchange-traded fund	158,306	-	-	158,306
	$ 4,168,535	$ -	$ -	$ 4,168,535

Activity in the investments during the year was as follows:

Balance, beginning of year	$ 3,890,778
Purchases of investments	210,366
Contributions of investments	479,141
Reinvested interest and dividends	117,912
Proceeds from sales of investments	(725,842)
Realized gains on sales of investments	42,511
Unrealized gains on investments	153,669
Balance, end of year	$ 4,168,535

NOTE 4 - ACCOUNTS RECEIVABLE

Accounts receivable consist of the following:

Accounts receivable	$ 158,603
Allowance for doubtful accounts	(11,156)
	$ 147,447

THE REASON FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED SEPTEMBER 30, 2016

NOTE 5 - PLEDGES RECEIVABLE

Pledges receivable consists of the following:

Due in less than one year	$ 1,168,099
Due in one to five years	25,040
	1,193,139
Discount to net present value	(2,899)
	$ 1,190,240

The Foundation has discounted its multi-year pledges receivable at an annual discount rate of 3%.

NOTE 6 - PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

Land	$ 1,908,473
Building and improvements	1,008,828
Furniture and equipment	1,208,115
	4,125,416
Accumulated depreciation and amortization	(1,243,220)
	$ 2,882,196

NOTE 7 - LINE OF CREDIT

The Foundation maintained a $200,000 line of credit with a bank, secured by all personal property of the Foundation, with interest at the bank's index rate (3.5% as of September 30, 2016) plus .5%, renewable annually. There was no outstanding balance as of September 30, 2016.

NOTE 8 - DEFERRED COMPENSATION

The Foundation has accrued $100,000 per year over the past three years, which was deposited into a newly formed IRC Section 457(f) nonqualified simplified employee retirement plan (the "Plan") during the year. In addition, investments of the Plan generated income totaling $13,301. The Board of Trustees may make discretionary contributions to the Plan in the future.

NOTE 9 - TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets and releases during the year are as follows:

	Released from Restrictions	Balance, September 30, 2016
Time Restricted	$ (1,293,722)	$ 1,190,240
Privatization Award Fund	(4,258)	85,742
Reason Media Awards Dinner	(71,250)	52,500
Internship Fund	(25,200)	32,024
Education Research	(50,000)	-
Talent Development	(60,000)	240,000
Transportation Research	-	70,800
Unappropriated Earnings on Permanent Endowment	-	19,599
	$ (1,504,430)	$ 1,690,905

THE REASON FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED SEPTEMBER 30, 2016

NOTE 10 - ENDOWMENT

Interpretation of Relevant Law

The Board of Trustees of the Foundation has interpreted the California Uniform Prudent Management of Institutional Funds Act ("UPMIFA") as requiring the preservation of the fair value of the initial gifts of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Foundation classifies as permanently restricted net assets (1) the original value of gifts donated to the permanent endowment and (2) the original value of subsequent gifts to the permanent endowment. Investment returns are available for appropriation and, therefore, classified as temporarily restricted net assets until appropriated by the Board of Trustees for expenditure. In accordance with UPMIFA, the Foundation considers the following factors in making a determination to appropriate or accumulate donor restricted endowment funds:

(1) The duration and preservation of the fund

(2) The purposes of the Foundation and the donor-restricted endowment fund

(3) General economic conditions

(4) The possible effect of inflation and deflation

(5) The expected total return from income and the appreciation of investments

(6) Other resources of the Foundation

(7) The investment policies of the Foundation.

Return Objectives and Risk Parameters

The Foundation has elected to incorporate endowment assets within the broader investment strategy as approved by the Investment Committee of the Board of Trustees. That strategy provides that investment and endowment assets are to be allocated 50% to fixed income securities and 50% to equities and gold funds. Actual returns in any given year may vary.

Spending Policy and How Investment Objectives Relate to Spending Policy

The Foundation has a policy of appropriating for distribution each year up to 5% of the fair value of the invested assets, except in years in which the Foundation experiences a net investment loss from earnings, gains, and losses. In establishing this policy, the Foundation considered the long-term expected return on its endowment.

NOTE 10 - ENDOWMENT (Continued)

Endowment Net Asset Composition by Type of Fund

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	$ -	$ 19,599	$ 44,279	$ 63,878
	$ -	$ 19,599	$ 44,279	$ 63,878

Changes in Endowment Net Assets During the Year Ended

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Balance, October 1, 2015	$ -	$ 19,716	$ 44,279	$ 63,995
Investment income	-	359	805	1,164
Realized and unrealized gains	-	(396)	(885)	(1,281)
Reclassification of investment return	-	(80)	80	-
Balance, September 30, 2016	$ -	$ 19,599	$ 44,279	$ 63,878

NOTE 11 - COMMITMENTS

The Foundation leases office space in Washington, DC, through April 2023.

The scheduled minimum lease payments under the lease terms are as follows:

Year Ending September 30,	
2017	$ 192,718
2018	197,524
2019	202,454
2020	207,529
2021	212,716
Thereafter	347,062
	$ 1,360,003

NOTE 11 - COMMITMENTS (Continued)

Rent expense totaled $186,283 for the year.

The Foundation leases a vehicle through August 2018.

The scheduled minimum lease payments under the lease terms are as follows:

Year Ending September 30,		
2017	$	4,564
2018		4,184
	$	8,748

Lease payments made during the year totaled $4,564.

NOTE 12 - RETIREMENT PLAN

The Foundation offers an IRC Section 403(b) individual defined contribution plan (the "Plan") for all eligible employees. Participants may make salary deferrals to their individual accounts up to the maximum allowable deferral amounts for defined contribution plans. The Foundation does not make contributions to the Plan.