

The Reason Foundation

Financial Statements

September 30, 2017



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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, 2017, 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; 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 United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from 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, 2017, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

A handwritten signature in black ink that reads "Armanino LLP". The signature is written in a cursive, flowing style.

Armanino^{LLP}
Los Angeles, California

January 4, 2018

The Reason Foundation
Statement of Financial Position
September 30, 2017

ASSETS

Current assets	
Cash and cash equivalents	\$ 1,215,817
Investments	5,846,505
Accounts receivable, net	134,499
Pledges receivable	<u>387,015</u>
Total current assets	<u>7,583,836</u>
Other assets	
Property and equipment, net	2,882,264
Deposits	<u>139,828</u>
Total other assets	<u>3,022,092</u>
 Total assets	 <u>\$ 10,605,928</u>

LIABILITIES AND NET ASSETS

Current liabilities	
Accrued compensation expenses	\$ 1,166,745
Accounts payable and other accrued expenses	240,485
Current portion of unearned subscriptions	<u>126,810</u>
Total current liabilities	1,534,040
Unearned subscriptions, net of current portion	<u>151,043</u>
Total liabilities	<u>1,685,083</u>
Commitments (Note 10)	
Net assets	
Unrestricted	
General	3,767,630
Investment in land and building	<u>2,766,095</u>
Total unrestricted	6,533,725
Temporarily restricted	2,342,841
Permanently restricted	<u>44,279</u>
Total net assets	<u>8,920,845</u>
 Total liabilities and net assets	 <u>\$ 10,605,928</u>

The accompanying notes are an integral part of these financial statements.

The Reason Foundation
Statement of Activities
For the Year Ended September 30, 2017

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Revenues and Support				
Public Support				
Contributions	\$ 8,149,319	\$ 3,332,196	\$ -	\$ 11,481,515
Reason Magazine	805,341	-	-	805,341
Conferences	203,553	-	-	203,553
Proceeds from fundraising events, net of direct benefit costs	202,802	-	-	202,802
Miscellaneous	94	-	-	94
Net assets released from restriction	<u>2,687,615</u>	<u>(2,687,615)</u>	<u>-</u>	<u>-</u>
Total revenues, gains and other support	<u>12,048,724</u>	<u>644,581</u>	<u>-</u>	<u>12,693,305</u>
Functional expenses				
Program services				
Public Affairs	425,961	-	-	425,961
Stossel on Reason	926,623	-	-	926,623
Reason-TV	1,726,261	-	-	1,726,261
Magazine	3,900,195	-	-	3,900,195
Research	<u>4,149,514</u>	<u>-</u>	<u>-</u>	<u>4,149,514</u>
Total program services	<u>11,128,554</u>	<u>-</u>	<u>-</u>	<u>11,128,554</u>
Support services				
Management and general	293,876	-	-	293,876
Fundraising	<u>1,100,553</u>	<u>-</u>	<u>-</u>	<u>1,100,553</u>
Total support services	<u>1,394,429</u>	<u>-</u>	<u>-</u>	<u>1,394,429</u>
Total functional expenses	<u>12,522,983</u>	<u>-</u>	<u>-</u>	<u>12,522,983</u>
Change in net assets from operations	<u>(474,259)</u>	<u>644,581</u>	<u>-</u>	<u>170,322</u>
Investment activity				
Interest and dividends	94,491	451	1,019	95,961
Realized gains on sales of investment	62,784	-	-	62,784
Unrealized gains on investments	379,180	1,821	4,064	385,065
Reclassification of endowment earnings	<u>-</u>	<u>5,083</u>	<u>(5,083)</u>	<u>-</u>
Total investment activity	<u>536,455</u>	<u>7,355</u>	<u>-</u>	<u>543,810</u>
Change in net assets	62,196	651,936	-	714,132
Net assets, beginning of year	<u>6,471,529</u>	<u>1,690,905</u>	<u>44,279</u>	<u>8,206,713</u>
Net assets, end of year	<u>\$ 6,533,725</u>	<u>\$ 2,342,841</u>	<u>\$ 44,279</u>	<u>\$ 8,920,845</u>

The accompanying notes are an integral part of these financial statements.

The Reason Foundation
Statement of Functional Expenses
For the Year Ended September 30, 2017

	Public Affairs	Stossel on Reason	Reason-TV	Magazine	Research	Total Program Services	Management and General	Fundraising	Total
Personnel expenses									
Salaries	\$ 306,775	\$ 295,315	\$ 1,020,158	\$ 1,990,995	\$ 1,937,422	\$ 5,550,665	\$ 150,256	\$ 465,011	\$ 6,165,932
Payroll taxes	26,016	9,998	68,954	124,423	124,047	353,438	11,570	40,425	405,433
Employee benefits	34,094	8,404	85,438	154,331	140,889	423,156	19,213	59,735	502,104
Total personnel expenses	<u>366,885</u>	<u>313,717</u>	<u>1,174,550</u>	<u>2,269,749</u>	<u>2,202,358</u>	<u>6,327,259</u>	<u>181,039</u>	<u>565,171</u>	<u>7,073,469</u>
Books and periodicals	4,093	242	2,194	2,759	4,381	13,669	1,969	1,577	17,215
Commissions	-	-	-	27,982	-	27,982	-	-	27,982
Conference attendance and sponsorships	8,500	-	1,040	1,384	140,509	151,433	151	14,224	165,808
Contract services	361	478,120	213,026	439,108	961,330	2,091,945	17,507	18,399	2,127,851
Depreciation and amortization	2,908	1,591	10,006	18,329	16,876	49,710	1,423	4,415	55,548
Dues and subscriptions	1,987	200	5,786	5,191	69,489	82,653	1,323	6,525	90,501
Foundation-hosted events and conferences	-	6,008	109,208	94,236	167,187	376,639	299	206,609	583,547
Insurance	4,387	-	15,956	28,900	26,180	75,423	2,321	6,585	84,329
Magazine printing and distribution	-	79	3,943	546,327	107	550,456	-	213	550,669
Miscellaneous	2,445	-	4,223	9,272	2,992	18,932	6,452	4,444	29,828
Occupancy	14,313	39,837	52,643	91,914	84,390	283,097	11,252	21,974	316,323
On-line services	666	-	3,834	21,021	16,681	42,202	393	1,261	43,856
Postage and shipping	8,751	6,221	4,039	64,593	40,413	124,017	8,345	55,042	187,404
Printed material	-	19,554	138	14,702	11,810	46,204	1,665	42,595	90,464
Professional fees	-	7,312	-	-	85	7,397	48,870	-	56,267
Promotion and advertising	149	4,058	-	156,275	7,240	167,722	-	40,589	208,311
Supplies	1,079	42,859	15,089	15,665	33,931	108,623	5,782	7,538	121,943
Telephone	3,431	-	8,937	17,359	28,013	57,740	3,028	7,749	68,517
Travel	6,006	6,825	101,649	75,429	335,542	525,451	2,057	95,643	623,151
	<u>\$ 425,961</u>	<u>\$ 926,623</u>	<u>\$ 1,726,261</u>	<u>\$ 3,900,195</u>	<u>\$ 4,149,514</u>	<u>\$ 11,128,554</u>	<u>\$ 293,876</u>	<u>\$ 1,100,553</u>	<u>\$ 12,522,983</u>

The accompanying notes are an integral part of these financial statements.

The Reason Foundation
Statement of Cash Flows
For the Year Ended September 30, 2017

Cash flows from operating activities	
Change in net assets	\$ 714,132
Adjustments to reconcile change in net assets to net cash provided by operating activities	
Depreciation and amortization	55,548
Realized gains on sales of investments	(62,784)
Unrealized gains on investments	(385,065)
Contributions of investments	(278,252)
Reinvested interest and dividends	(95,961)
Decrease in allowance for doubtful accounts	(2,969)
Changes in operating assets and liabilities	
Accounts receivable	15,917
Pledges receivable	803,225
Deposits	(56,394)
Accrued compensation expenses	172,522
Accounts payable and other accrued expenses	(35,722)
Unearned subscriptions	(25,914)
Net cash provided by operating activities	<u>818,283</u>
Cash flows from investing activities	
Purchases of property and equipment	(55,616)
Purchases of investments	(1,544,165)
Proceeds from sales of investments	<u>688,257</u>
Net cash used in investing activities	<u>(911,524)</u>
Net decrease in cash and cash equivalents	(93,241)
Cash and cash equivalents, beginning of year	<u>1,309,058</u>
Cash and cash equivalents, end of year	<u>\$ 1,215,817</u>

The accompanying notes are an integral part of these financial statements.

The Reason Foundation
Notes to Financial Statements
September 30, 2017

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.

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, 2014, 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, 2013, 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* - 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.
- *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.

The Reason Foundation
Notes to Financial Statements
September 30, 2017

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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, 2017.

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 purchases 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 years
Furniture and equipment	3 years

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.

The Reason Foundation
Notes to Financial Statements
September 30, 2017

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 recorded and reported when committed to the Foundation by the donor.

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 \$208,311 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.

The Reason Foundation
Notes to Financial Statements
September 30, 2017

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Subsequent events

The Foundation has evaluated events subsequent to September 30, 2017, to assess the need for potential recognition or disclosure in the financial statements. Such events were evaluated through January 4, 2018, 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.

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 investments at fair value as of September 30, 2017:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Fair Value</u>
Stock funds	\$ 2,865,808	\$ -	\$ -	\$ 2,865,808
REIT index funds	91,894	-	-	91,894
Bond funds	2,174,705	-	-	2,174,705
U.S. Treasury funds	512,228	-	-	512,228
Gold exchange-traded fund	<u>201,870</u>	<u>-</u>	<u>-</u>	<u>201,870</u>
	<u>\$ 5,846,505</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,846,505</u>

Activity in the investments during the year was as follows:

Balance, beginning of year	\$ 4,168,535
Purchases of investments	1,544,165
Contributions of investments	278,252
Reinvested interest and dividends	95,961
Proceeds from sales of investments	(688,257)
Realized gains on sales of investments	62,784
Unrealized gains on investments	<u>385,065</u>
Balance, end of year	<u>\$ 5,846,505</u>

The Reason Foundation
Notes to Financial Statements
September 30, 2017

4. ACCOUNTS RECEIVABLE

Accounts receivable consist of the following:

Accounts receivable	\$ 142,686
Allowance for doubtful accounts	<u>(8,187)</u>
	<u>\$ 134,499</u>

5. PLEDGES RECEIVABLE

Pledges receivable consist of the following:

Due in less than one year	\$ 371,610
Due in one to five years	<u>16,200</u>
	387,810
Discount to net present value	<u>(795)</u>
	<u>\$ 387,015</u>

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

6. PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

Land	\$ 1,908,473
Building and improvements	1,008,828
Furniture and equipment	1,253,346
Leasehold improvements	<u>10,385</u>
	4,181,032
Accumulated depreciation and amortization	<u>(1,298,768)</u>
	<u>\$ 2,882,264</u>

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 (4.25% as of September 30, 2017) plus .5%, renewable annually. There was no outstanding balance as of September 30, 2017.

The Reason Foundation
Notes to Financial Statements
September 30, 2017

8. TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets during the year are as follows:

	Released from Restrictions	Balance, September 30, 2017
Time Restricted	\$ (1,108,189)	\$ 387,015
Stossel on Reason	(750,000)	1,500,000
Pension Integrity	(450,000)	150,000
Privatization Award Fund	(19,210)	66,532
Reason Media Awards Dinner	(52,500)	139,000
Internship Fund	(6,559)	25,465
Talent Development	(240,000)	-
Transportation Research	(23,364)	47,436
Magazine	(18,195)	16,805
Unappropriated Earnings on Permanent Endowment	(19,598)	10,588
	<u>\$ (2,687,615)</u>	<u>\$ 2,342,841</u>

9. 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.

The Reason Foundation
Notes to Financial Statements
September 30, 2017

9. ENDOWMENT (continued)

Interpretation of Relevant law (continued)

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.

Endowment composition

Endowment net asset composition by type of fund as of September 30, 2017, is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	<u>\$ -</u>	<u>\$ 10,588</u>	<u>\$ 44,279</u>	<u>\$ 54,867</u>

The Reason Foundation
Notes to Financial Statements
September 30, 2017

9. ENDOWMENT (continued)

Endowment composition (continued)

Changes in endowment net assets for the year ended September 30, 2017, are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Balance, beginning of year	\$ -	\$ 19,599	\$ 44,279	\$ 63,878
Contributions	-	3,233	-	3,233
Investment income	-	451	1,019	1,470
Realized and unrealized gains	-	1,821	4,064	5,885
Amounts expended during the year	-	(19,599)	-	(19,599)
Reclassification of investment return	-	5,083	(5,083)	-
	<u>-</u>	<u>(9,011)</u>	<u>-</u>	<u>(9,011)</u>
Balance, end of year	<u>\$ -</u>	<u>\$ 10,588</u>	<u>\$ 44,279</u>	<u>\$ 54,867</u>

10. COMMITMENTS

Office space leases

The Foundation leases office spaces in Washington, D.C. and New York, through April 2023 and May 2020, respectively.

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

Year ending September 30,

2018	\$ 293,476
2019	301,282
2020	274,721
2021	212,716
2022	218,038
Thereafter	<u>129,023</u>
	<u>\$ 1,429,256</u>

Rent expenses total \$205,222 for the year.

The Reason Foundation
Notes to Financial Statements
September 30, 2017

10. COMMITMENTS (continued)

Vehicle lease

The Foundation leases a vehicle through August 2018.

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

Year ending September 30,

2018

\$ 4,184

\$ 4,184

Rent expense totaled \$4,564 for the year.

11. RETIREMENT PLAN

403(b) plan

The Foundation offers an IRC Section 403(b) individual defined contribution plan (the "403(b) 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.

457(f) plan

The Foundation established a nonqualified IRC Section 457(f) employee retirement plan (the "457(f) Plan") on behalf of an officer. During the current fiscal year, the Foundation deposited \$100,000 into the 457(f) Plan. Investments of the 457(f) Plan generated income totaling \$46,797 during the year. The amount included in the accrued compensation expenses on the accompanying statement of financial position totaled \$75,000 at September 30, 2017. The Board of Trustees may make discretionary contributions to the 457(f) Plan in the future.