THE REASON FOUNDATION

COMPARATIVE FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

SEPTEMBER 30, 2012 AND 2011

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CERTIFIED PUBLIC ACCOUNTANTS
&
BUSINESS CONSULTANTS

February 4, 2013

INDEPENDENT AUDITORS' REPORT

To the Board of Directors
The Reason Foundation
Los Angeles, California

We have audited the accompanying statement of financial position of The Reason Foundation, (a nonprofit foundation) as of September 30, 2012, and the related statements of activities, functional expenses and cash flows for the year then ended. These financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from the Organization's 2011 financial statements and, in our report dated January 11, 2012 we expressed an unqualified opinion on those financial statements.

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 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 statements referred to above present fairly, in all material respects, the financial position of The Reason Foundation, as of September 30, 2012 and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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THE REASON FOUNDATION
STATEMENTS OF FINANCIAL POSITION
SEPTEMBER 30, 2012
WITH COMPARATIVE TOTALS AT SEPTEMBER 30, 2011

	2012	2011
CURRENT ASSETS		
Cash and cash equivalents (Note 2, 5, 15)	$ 577,227	$ 1,216,615
Accounts receivable, net (Note 2)	79,069	67,758
Pledges receivable, net (Note 2)	305,350	476,890
Investments (Note 2, 6)	3,670,890	3,428,157
TOTAL CURRENT ASSETS	4,632,536	5,189,420
PROPERTY AND EQUIPMENT (Note 2)		
Land	1,908,473	-
Buildings and improvements	527,874	-
Furniture and equipment	994,707	901,747
Leasehold improvements	21,725	21,725
Total	3,452,779	923,472
Less: Accumulated depreciation	(914,762)	(892,434)
NET PROPERTY AND EQUIPMENT	2,538,017	31,038
OTHER ASSETS		
Deposits	181,934	124,444
TOTAL ASSETS	$ 7,352,487	$ 5,344,902
CURRENT LIABILITIES		
Accounts payable	$ 152,164	$ 117,295
Accrued expenses	774,403	546,911
Deferred revenue	1,050	9,000
Unearned subscriptions, current portion (Note 8)	282,976	315,317
Mortgage payable, current portion (Note 10)	102,553	-
TOTAL CURRENT LIABILITIES	1,313,146	988,523
LONG TERM LIABILITIES		
Unearned subscriptions (Note 8)	80,668	103,442
Mortgage payable (Note 10)	1,080,670	-
TOTAL LIABILITIES	2,474,484	1,091,965
NET ASSETS		
Unrestricted	4,778,375	4,107,708
Temporarily restricted (Note 12)	55,349	101,950
Permanently restricted (Note 12)	44,279	43,279
TOTAL NET ASSETS	4,878,003	4,252,937
TOTAL LIABILITIES AND NET ASSETS	$ 7,352,487	$ 5,344,902

See accompanying auditors' report.
The notes are an integral part of these financial statements.

THE REASON FOUNDATION
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED SEPTEMBER 30, 2012
WITH COMPARATIVE TOTALS FOR THE YEAR ENDED SEPTEMBER 30, 2011

	2012				2011
	Unrestricted Fund	Temporarily Restricted Fund	Permanently Restricted Fund	Total Funds	Total Funds
REVENUE AND SUPPORT					
Contributions	$ 8,062,133	$ -	$ 1,000	$ 8,063,133	$ 7,123,746
Magazine	890,741	-	-	890,741	757,806
Special events	238,126	-	-	238,126	313,506
Net investment income and other income	392,282	-	-	392,282	85,818
Released from restriction (Note 13)	46,601	(46,601)	-	-	-
TOTAL REVENUE AND SUPPORT	9,629,883	(46,601)	1,000	9,584,282	8,280,876
EXPENSES					
Program services					
Foundation	418,318	-	-	418,318	309,244
Reason- Rupe	339,414	-	-	339,414	349,338
Reason-TV	1,368,694	-	-	1,368,694	1,195,539
Magazine	2,961,200	-	-	2,961,200	2,550,499
Research	2,229,354	-	-	2,229,354	2,211,232
Total program services	7,316,980	-	-	7,316,980	6,615,852
Supporting services					
Management and general	532,254	-	-	532,254	311,173
Fundraising	935,628	-	-	935,628	859,636
Total supporting services	1,467,882	-	-	1,467,882	1,170,809
Total expenses before special events	8,784,862	-	-	8,784,862	7,786,661
Special events expenses	174,354	-	-	174,354	177,868
TOTAL EXPENSES	8,959,216	-	-	8,959,216	7,964,529
CHANGE IN NET ASSETS	670,667	(46,601)	1,000	625,066	316,347
NET ASSETS AT BEGINNING OF YEAR	4,107,708	101,950	43,279	4,252,937	3,936,590
NET ASSETS AT END OF YEAR	$ 4,778,375	$ 55,349	$ 44,279	$ 4,878,003	$ 4,252,937

See accompanying auditors' report.
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THE REASON FOUNDATION
STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED SEPTEMBER 30, 2012
WITH COMPARATIVE TOTALS FOR THE YEAR ENDED SEPTEMBER 30, 2011

	2012									2011
	Program Services						Supporting Services			
	Foundation	Reason-Rupe	Reason-TV	Magazine	Research	Total Program Services	Administration	Development	Total Expenses	Total Expenses
Books and periodicals	$ 8,745	$ 122	$ 6,182	$ 8,813	$ 8,399	$ 32,261	$ 773	$ 8,073	$ 41,107	$ 25,505
Commissions	-	-	-	34,600	-	34,600	-	-	34,600	40,616
Contract services	27,591	107,500	210,915	501,080	413,335	1,260,421	7,033	24,781	1,292,235	1,038,216
Dues and subscriptions	4,673	-	1,808	5,663	50,991	63,135	637	2,793	66,565	88,289
Insurance	3,990	-	15,050	23,069	23,768	65,877	3,730	9,162	78,769	67,798
Manufacturing and distribution	16	-	998	523,719	727	525,460	16	595	526,071	512,906
Media tracking and placement service:	16,475	-	-	-	-	16,475	-	-	16,475	14,781
Miscellaneous	3,247	31,667	19,263	19,904	19,253	93,334	5,044	7,763	106,141	84,903
On-line services	14,376	95	16,536	26,971	28,051	86,029	1,863	7,646	95,538	90,143
Postage and shipping	1,554	16	12,761	17,139	5,176	36,646	1,191	46,422	84,259	97,508
Printed material	560	40	459	13,171	6,868	21,098	-	35,030	56,128	105,002
Professional fees	816	-	3,543	6,165	5,642	16,166	799	2,149	19,114	97,373
Promotion and advertising	15	57	969	232,368	797	234,206	1,134	12,535	247,875	369,813
Rent and parking	18,286	-	77,277	117,673	108,006	321,242	17,410	45,106	383,758	367,013
Salaries, benefits, and taxes	278,193	184,087	837,458	1,343,716	1,274,328	3,917,782	223,881	592,790	4,734,453	4,162,931
Supplies	13,353	1,566	58,197	16,914	20,313	110,343	5,720	20,383	136,446	73,956
Telephone	4,862	45	8,558	11,134	16,781	41,380	1,666	6,149	49,195	52,086
Travel and entertainment	20,450	14,219	94,461	52,244	240,303	421,677	10,291	111,416	543,384	422,794
Unfulfilled pledges	-	-	-	-	-	-	250,000	-	250,000	55,000
Total expenses before depreciation	417,202	339,414	1,364,435	2,954,343	2,222,738	7,298,132	531,188	932,793	8,762,113	7,766,632
Depreciation	1,116	-	4,259	6,857	6,616	18,848	1,066	2,835	22,749	20,029
Total Expenses	$ 418,318	$ 339,414	$ 1,368,694	$ 2,961,200	$ 2,229,354	$ 7,316,980	$ 532,254	$ 935,628	$ 8,784,862	$ 7,786,661

See accompanying auditors' report.
The notes are an integral part of these financial statements.

THE REASON FOUNDATION
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	$ 625,066	$ 316,347
Adjustments to reconcile net assets to net cash provided by operating activities:		
Depreciation	22,749	20,029
Net unrealized (gains) / losses on investments	(390,961)	(24,945)
Donated investment	(1,772)	-
(Increase) decrease in assets:		
Accounts receivable, net	(11,311)	(31,924)
Pledges receivable, net	171,540	341,512
Deposits	(57,490)	(28,307)
Increase (decrease) in liabilities:		
Accounts payable	34,448	38,507
Accrued expenses	227,492	164,986
Deferred revenue	(7,950)	9,000
Unearned subscriptions	(55,115)	(20,445)
NET CASH PROVIDED BY OPERATING ACTIVITIES	556,696	784,760
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(1,329,307)	(20,848)
Purchases of investments	(2,000,000)	(656,796)
Proceeds from sales of investments	2,150,000	18,900
NET CASH (USED IN) INVESTING ACTIVITIES	(1,179,307)	(658,744)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal payments of long term debt	(16,777)	-
NET CASH (USED IN) FINANCING ACTIVITIES	(16,777)	-
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(639,388)	126,016
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	1,216,615	1,090,599
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 577,227	$ 1,216,615
SUPPLEMENTAL CASH FLOW INFORMATION		
CASH PAID DURING THE YEAR:		
Income taxes paid	$ -	$ -
Interest paid	$ 3,827	$ -
NON CASH INVESTING AND FINANCING TRANSACTION		
Debt incurred on acquisition of real property	$ 1,200,000	$ -

See accompanying auditors' report.
The notes are an integral part of these financial statements.

THE REASON FOUNDATION
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2012

Note 1 ORGANIZATION

The Reason Foundation (Foundation) was organized 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

Basis of presentation-

The financial statements are presented on the accrual basis and in accordance with the basis of Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) Numbers 958-605 and 958-205 These standards require that the Foundation report information regarding its financial position and activities according to three classes of net assets: unrestricted, temporarily restricted and permanently restricted net assets.

Summarized Comparative Financial Information-

The financial statements include certain prior-year summarized comparative information in total, but not by net asset category. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the Foundation's financial statements for the year ended September 30, 2011 from which the summarized information was derived.

Cash and Cash Equivalents-

For the purposes of the financial statement, the Foundation considers all highly liquid debt instruments purchased with a maturity date of three months or less to be cash equivalents.

Investments-

Investments in equity securities with readily determinable fair market values and all investments in debt securities are measured at fair value in the statement of financial position. Realized and unrealized gains and losses, interest and dividends on investments are reflected in the statement of activities as unrestricted unless these activities are restricted by donor or by law.

Contributions-

The Foundation has also adopted FASB ASC Number 958-605 and 958-720, "Accounting for Contributions Received and Contributions Made." In accordance with FASB ASC 958-605 and 958-720, contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support depending on the existence and/or nature of any donor restrictions. When a restriction expires (that is, when a stipulated time restriction ends or purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

Note 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT.)

Subsequent Event

Date of Management's Review - Subsequent events have been evaluated through February 4, 2013, the date that these financial statements were available to be issued.

Property and Equipment-

Property, equipment, building, and building equipment are recorded at historical cost and are being depreciated using the straight-line method over the estimated useful life of the assets. The following lives have been assigned:

Furniture and equipment	3 years
Leasehold improvements	5 years
Building improvements	7 years (placed in service November 1, 2012)
Building	39 years (placed in service November 1, 2012)

Expenditures for maintenance, repairs, and renewals of minor items are charged to expense as incurred. Major renewals and improvements are capitalized. Upon disposition, the cost and related accumulated depreciation are removed from the accounts and the resulting gain or loss is reflected in operations for the year. It is the Foundation's policy to expense items under $1,000.

Tax Status-

The Foundation is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code, and is exempt from California franchise taxes under Section 23701(d) of the State Revenue and Taxation Code. In addition, the Foundation has been determined by the Internal Revenue Service not to be a private foundation within the meaning of Section 509(a) of the code.

Use of Estimates-

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

Advertising-

Advertising costs are charged to operations when incurred and are included in functional expenses.

Accounts and Pledges Receivable-

Accounts receivable at September 30, 2012 consist of individually small amounts from a large number of entities, and include advertising sales, list rentals, and magazine subscriptions. Management of the Foundation has assessed the credit risk associated with these accounts receivable and has established an allowance for doubtful accounts to reduce the net carrying value of the receivables to net realizable value. For the year ended September 30, 2012, the allowance for doubtful accounts was $6,837.

Note 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT.)

Pledges receivable at September 30, 2012 are due from organizations, corporations, and individuals well-known to the Foundation, with a favorable past payment history. Management of the Foundation has assessed the credit risk associated with these pledges receivable and has determined that an allowance for potential uncollectible amounts is not necessary.

Note 3 FUND ACCOUNTING

The financial statements of the Foundation are reported in self-balancing fund groups as follows:

Unrestricted Fund-
The unrestricted fund is part of the net assets of the Foundation that are not subject to donor-imposed stipulations. The only limits on unrestricted net assets are broad limits resulting from the nature of the Foundation and the purposes specified in its articles of incorporation or bylaws and, perhaps, limits resulting from contractual agreements.

Temporarily Restricted Fund-
The temporarily restricted fund is part of the net assets of the Foundation resulting from contributions and other inflows of assets whose use by the Foundation is limited by donor imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions of the Foundation pursuant to those stipulations. The majority of contributions with restrictions are stipulated to be used as funds for educating Americans in the basic principles of the classical liberal/libertarian political philosophy. The use and nature of these contributions can result in a continually increasing balance in temporarily restricted net assets.

Permanently Restricted Fund-
The permanently restricted fund is used to record resources received that are permanently restricted as to use by the donor or grantor.

Note 4 FUNCTIONAL ALLOCATION OF EXPENSES

In accordance with FASB ASC Number 958-720-45 the costs of providing the program and the supporting services have been summarized on a functional basis in the statement of activities, and in the statement of functional expenses. Accordingly, certain costs have been allocated between the program and the supporting services in reasonable ratios determined by management.

Note 5 CASH AND CASH EQUIVALENTS

The cash balance includes money market funds that earn interest at a rate which fluctuates according to prime and are carried at cost which approximates market. The cash balance is comprised of the following:

Checking	$ 552,344
Money market funds	24,883
Total cash and cash equivalents	$ 577,227

Note 6 INVESTMENTS

The Foundation's investments are reported at fair value in the accompanying statements of financial position for September 30, 2012.

	Fair Value Measurements Using: Quoted Prices in Active Markets for Identical Assets (Level 1)
Mutual funds	
Common Stock	$ 1,483,132
Bond funds	2,187,757
Total investments	$ 3,670,889

FASB ASC Number 820-10 defines fair value, establishes a framework for measuring fair value, and expands disclosure about fair value measurements. This standard provides a consistent definition of fair value which focuses on an exit price between market participants in an orderly transaction, prioritizes the use of market based information over entity specific information and establishes a three level hierarchy for fair value measurements based on the transparency of information used in the valuation of an asset or liability as of the measurement date.

Fair values determined by Level 1 inputs utilize quoted prices in active markets for identical assets. Fair values determined by level 2 inputs utilize data points that are observable such as quoted prices, interest rates and yield curves. Fair values determined by level 3 inputs are unobservable data points for the asset and include situations where there is little, if any, market activity for the asset. There were no level 2 or 3 inputs as of September 30, 2012.

Note 7 MAILING LISTS

The Foundation has developed a mailing list of its subscribers during the course of its operations. For the year ended September 30, 2012, rentals of this list to certain list brokers generated revenue of $16,939.

Note 8 UNEARNED SUBSCRIPTIONS

Deferred revenue from prepaid magazine subscriptions is recognized as revenue over the term of the subscriptions. At September 30, 2012, the unearned portion of subscription revenue was as follows:

Unearned subscriptions	$ 363,644
Less: current portion	(282,976)
Long-term portion	$ 80,668

The long-term portion of the unearned subscriptions expires principally through the year ending September 30, 2014.

Note 9 LINE OF CREDIT

The Foundation maintains a $200,000 line of credit with a bank, collateralized by index, inventory, and chattel paper, accounts, equipment and general intangibles, which expires July 27, 2014. Interest accrues at the Index rate plus 3.9%. There was no outstanding balance at September 30, 2012.

Note 10 MORTGAGE PAYABLE

The Foundation has a mortgage note payable in the amount of $1,200,000. This note is secured by real property. This note is subject to an interest rate per anum of 3.73%. The monthly payment is $12,030 including interest. This note matures on July 27, 2022. In conjunction with the note, the foundation has agreed to a number of the lender's covenants. As of September 30, 2012, the company is not aware of any violations of the covenants.

At September 30, 2012	$ 1,183,223
Less: current portion	(102,553)
Long-term portion	$ 1,080,670

Maturities of long term debt as of September 30, 2012 for the succeeding years are as follows:

Years ended September 30,	
2013	102,553
2014	106,444
2015	110,483
2016	114,675
2017	119,027
Thereafter	630,041
	$ 1,183,223

Note 11 COMMITMENTS

The Foundation leases office space in Los Angeles, California and Washington, District of Columbia expiring October 31, 2012 and February 28, 2013, respectively. The Foundation has an automobile lease expiring September 9, 2014. Future minimum annual rental payments under these lease agreements are as follows:

Year Ending September 30,	Los Angeles Office	Washington Office	Automobile	Total
2013	$ 15,356	$ 68,129	$ 5,460	$ 83,485
2014	-	-	5,005	-
2015	-	-	-	-
Totals	$ 15,356	$ 68,129	$ 10,465	$ 83,485

Rental expense for the year ended September 30, 2012, amounted to $385,322.

Note 12 RESTRICTED NET ASSETS

The restricted net assets are available for the various research programs for the following purposes:

Temporarily Restricted Funds:

Magazine	$ 14,433
Donor restricted funds	40,916
Total	$ 55,349

Permanently Restricted Fund:

Donor restricted investments in perpetuity income is expendable to support general operations.	$ 44,279

Note 13 NET ASSETS RELEASED FROM RESTRICTION

Net assets were released from donor restrictions by incurring expenses satisfying the restricted purposes or by occurrences of other events specified by donors.

Purpose/ Time Restrictions Accomplished:

Magazine	$ 18,900
Pledges satisfied by passage of time	27,701
Total	$ 46,601

Note 14 TAX-SHELTERED RETIREMENT PLAN

Any full time employee of the Foundation may set up a tax-sheltered retirement plan in accordance with Section 403(b) of the Internal Revenue Code. The Foundation assists the employee in setting up the plan and will arrange for the contributions to be made through payroll deductions. The Foundation does not make contributions to such plans.

Note 15 CONCENTRATION OF CREDIT RISK

Financial instruments which potentially subject the Foundation to concentrations of credit risk consist of cash and cash equivalents, investments, accounts receivable and pledges receivable. The Foundation places its cash and money market funds principally with a high credit quality financial institution where the funds are guaranteed by the Federal Deposit Insurance Corporation (FDIC). At times, such cash and money market fund balances may be in excess of the FDIC insurance limits. Management of the Foundation regularly reviews the financial stability of its cash and money market fund depository and deems the risk of loss due to these concentrations to be minimal. Management of the Foundation has assessed the credit risk associated with the investments held at September 30, 2012 and has determined that an allowance for potential losses due to credit risk in the investment portfolio is not necessary. At September 30, 2012, all accounts were under FDIC limits.

Note 16 ACCOUNTING FOR UNCERTAINTY IN INCOME TAXES

The Foundation is exempt from taxation under Internal Revenue Code Section 501 (c) (3) and California Revenue and Taxation Code Section 23701(d). The Foundation is subject to a 2% (1% if certain criteria are met) federal excise tax on net investment income.

As required by FASB ASC Number 740-10, "Accounting for Uncertainty in Income Taxes," the Foundation recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Management of the Foundation does not believe the financial statements include any uncertain tax positions. The Foundation's returns for the years ended September 30, 2009, 2010, and 2011, are subject to examination by federal and state taxing authorities, generally for three years after they are filed.

Note 17 DONOR DESIGNATED ENDOWMENT

The Foundation's endowment consists of a fund established to create a permanent endowment. As required by generally accepted accounting principles, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The Board of Trustees of the Foundation has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date 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 (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund.

The investment committee has recommended the following investment policy which includes the endowment fund. This policy was adopted by the full Board of Trustees. Net assets are to be invested 70% in fixed income and 30% in equities. The spending policy is to allow distribution of an amount equal to 5% of the fair market value of the endowment fund. In any year in which the endowment experiences a net investment loss, no distributions will be made.

Endowment Net Asset Composition by Type of Fund as of September 30, 2012 is as follows:

	Permanently Restricted
Donor-restricted endowment funds	$ 44,279
Total funds	$ 44,279

Changes in endowment net assets as of September 30, 2012 are as follows:

	Permanently Restricted
Endowment net assets, beginning of year	$ 43,279
Contributions	1,000
Investment income	-
Net appreciation (depreciation)	-
Amounts appropriated for expenditure	-
Endowment net assets, end of year	$ 44,279