

HARRIS AND ELIZA KEMPNER FUND

FINANCIAL STATEMENTS

**Years Ended December 31, 2016 and 2015
with Independent Auditors' Report**

HARRIS AND ELIZA KEMPNER FUND

Financial Statements

Years Ended December 31, 2016 and 2015

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Harris and Eliza Kempner Fund

We have audited the accompanying financial statements of the Harris and Eliza Kempner Fund (a nonprofit organization), which comprise the statement of assets, liabilities, and fund balances-modified cash basis as of December 31, 2016, the related statement of revenues, expenses and changes in fund balances-modified cash basis, and the statement of cash flows-combined funds-modified cash basis 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 the modified cash basis of accounting as described in Note B; this includes determining that the modified cash basis of accounting is an acceptable basis for the preparation of the financial statements in the circumstances. Management is also responsible for 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 entity'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 entity'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 Harris and Eliza Kempner Fund as of December 31, 2016, and the changes in its fund balances and its cash flows for the year then ended in accordance with the modified cash basis of accounting as described in Note B.

Basis of Accounting

We draw attention to Note B of the financial statements, which describes the basis of accounting. The financial statements are prepared on the modified cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to that matter.

Report on Summarized Comparative Information

We have previously audited the Harris and Eliza Kempner Fund's 2015 financial statements, we expressed an unmodified audit opinion on those audited financial statements in our report dated November 7, 2016. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2015, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Other Matter

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The schedule of program expenses-modified cash basis on page 12 and the schedule of general and administrative expenses-modified cash basis on page 13 are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

The image shows a handwritten signature in black ink that reads "Whitley Penn LLP". The signature is written in a cursive, flowing style.

Houston, Texas
November 13, 2017

HARRIS AND ELIZA KEMPNER FUND

STATEMENT OF ASSETS, LIABILITIES, AND FUND BALANCES - MODIFIED CASH BASIS

December 31, 2016

(with comparative totals for December 31, 2015)

	Main Fund	KCM Fixed Income Fund	J.B. Kempner Fund	Kempner Park Fund	Jennifer Ezell Fund	Student Loan Fund	2016	2015
Assets								
Cash	\$ 255,520	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 255,520	\$ 855,014
Short-term investments	3,665,633	250,000	906,315	120,909	63,373	-	5,006,230	2,622,515
Investments, at cost								
Stocks	21,351,745	-	5,064,348	248,808	130,092	-	26,794,993	29,015,978
Bonds	4,053,024	1,017,577	895,169	-	-	-	5,965,770	4,654,524
Unlisted securities	6,130,222	-	-	-	19,591	-	6,149,813	5,853,724
Adjustment to fair market value	3,013,655	11,206	287,074	21,623	12,450	-	3,346,008	3,163,452
Program-related investments	76,968	-	-	-	-	-	76,968	239,158
Accounts receivable	-	-	-	-	-	-	-	33,507
Student loans	-	-	-	-	-	8,382	8,382	23,794
Other current assets	44,993	-	-	-	-	-	44,993	20,354
Total assets	<u>\$ 38,591,760</u>	<u>\$ 1,278,783</u>	<u>\$ 7,152,906</u>	<u>\$ 391,340</u>	<u>\$ 225,506</u>	<u>\$ 8,382</u>	<u>\$ 47,648,677</u>	<u>\$ 46,482,020</u>
Liabilities								
Total liabilities	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Fund Balances								
Fund balances	38,591,760	1,278,783	7,152,906	391,340	225,506	8,382	47,648,677	46,482,020
Total fund balances	<u>38,591,760</u>	<u>1,278,783</u>	<u>7,152,906</u>	<u>391,340</u>	<u>225,506</u>	<u>8,382</u>	<u>47,648,677</u>	<u>46,482,020</u>
Total liabilities and fund balances	<u>\$ 38,591,760</u>	<u>\$ 1,278,783</u>	<u>\$ 7,152,906</u>	<u>\$ 391,340</u>	<u>\$ 225,506</u>	<u>\$ 8,382</u>	<u>\$ 47,648,677</u>	<u>\$ 46,482,020</u>

See accompanying notes to consolidated financial statements.

HARRIS AND ELIZA KEMPNER FUND

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND BALANCES - MODIFIED CASH BASIS

For the Year Ended December 31, 2016

(with comparative totals for the Year Ended December 31, 2015)

	<u>Main Fund</u>	<u>KCM Fixed Income Fund</u>	<u>J.B. Kempner Fund</u>	<u>Kempner Park Fund</u>	<u>Jennifer Ezell Fund</u>	<u>Student Loan Fund</u>	<u>2016</u>	<u>2015</u>
Revenue, gains, and other support								
Dividends	\$ 811,291	\$ 85	\$ 132,715	\$ 9,756	\$ 5,982	\$ -	\$ 959,829	\$ 1,076,756
Interest	30,031	30,409	7,277	16	25	-	67,758	82,837
Net unrealized and realized gains (losses)	1,335,313	50,033	210,741	34,134	18,972	-	1,649,193	(3,235,434)
Other revenue (expenses)	1,177,686	-	1,458	154	3,315	-	1,182,613	(160,817)
Total revenue, gains, and other support	<u>3,354,321</u>	<u>80,527</u>	<u>352,191</u>	<u>44,060</u>	<u>28,294</u>	<u>-</u>	<u>3,859,393</u>	<u>(2,236,658)</u>
Expenses								
Program expenses	1,942,627	8,904	320,470	16,477	9,722	-	2,298,200	2,446,072
General and administrative expenses	329,662	10,683	49,664	2,866	1,661	-	394,536	411,559
Total expenses	<u>2,272,289</u>	<u>19,587</u>	<u>370,134</u>	<u>19,343</u>	<u>11,383</u>	<u>-</u>	<u>2,692,736</u>	<u>2,857,631</u>
(Deficit) excess of revenue over expenses	1,082,032	60,940	(17,943)	24,717	16,911	-	1,166,657	(5,094,289)
Interfund transfers	941,803	(967,037)	40,431	2,082	(1,867)	(15,412)	-	-
Changes in fund balances	<u>2,023,835</u>	<u>(906,097)</u>	<u>22,488</u>	<u>26,799</u>	<u>15,044</u>	<u>(15,412)</u>	<u>1,166,657</u>	<u>(5,094,289)</u>
Fund balances at beginning of year	<u>36,567,925</u>	<u>2,184,880</u>	<u>7,130,418</u>	<u>364,541</u>	<u>210,462</u>	<u>23,794</u>	<u>46,482,020</u>	<u>51,576,309</u>
Fund balances at end of year	<u>\$ 38,591,760</u>	<u>\$ 1,278,783</u>	<u>\$ 7,152,906</u>	<u>\$ 391,340</u>	<u>\$ 225,506</u>	<u>\$ 8,382</u>	<u>\$ 47,648,677</u>	<u>\$ 46,482,020</u>

See accompanying notes to consolidated financial statements.

HARRIS AND ELIZA KEMPNER FUND

STATEMENT OF CASH FLOWS - COMBINED FUNDS - MODIFIED CASH BASIS

	Year Ended December 31,	
	2016	2015
Cash flows from operating activities:		
Increase (decrease) in fund balances	\$ 1,166,657	\$ (5,094,289)
Adjustments to reconcile changes in fund balances to net cash used in operating activities:		
Realized gain on investments	(1,466,637)	(1,174,339)
Unrealized gain on investments	(182,556)	4,409,773
Changes in net assets and liabilities:		
Program related investments	162,190	(84,158)
Accounts receivable	33,507	425,910
Student loans receivable	15,412	7,557
Prepaid excise tax	(24,639)	(20,354)
Excise tax payable	-	(3,776)
Net cash used in operating activities	(296,066)	(1,533,676)
Cash flows from investing activities:		
Proceeds from stocks, bonds, and partnership interests	14,585,484	9,371,108
Purchases of stocks, bonds, and partnership interests	(14,747,654)	(7,473,374)
Net proceeds (purchases) of short term investments	(141,258)	268,983
Net cash provided by (used in) investing activities	(303,428)	2,166,717
Net increase (decrease) in cash and cash equivalents	(599,494)	633,041
Cash at beginning of year	855,014	221,973
Cash equivalents at end year	\$ 255,520	\$ 855,014
Supplemental disclosure of cash flow information:		
Excise taxes paid	\$ 49,090	\$ 41,792

See accompanying notes to consolidated financial statements.

HARRIS AND ELIZA KEMPNER FUND
NOTES TO FINANCIAL STATEMENTS - MODIFIED CASH BASIS
DECEMBER 31, 2016 AND 2015

A. Nature of the Fund

The Harris and Eliza Kempner Fund (the “Fund”) is a non-profit corporation classified as a private foundation within the meaning of section 509(a) of the Internal Revenue Code. The Fund was originally known as the “Galveston Fund” when it was established on December 18, 1946. The Fund awards grants to qualifying organizations functioning in the broad areas of the arts, community development, education, health and human services. Revenues are derived primarily from dividends, interest, and other gains from investment activity.

B. Summary of Significant Accounting Policies

Basis of Accounting

The accompanying financial statements have been prepared on the modified cash basis of accounting. This basis differs from accounting principles generally accepted in the United States of America primarily due to the Fund’s recognizing grants and other expenditures when paid rather than when incurred and recording investment revenues when received rather than when earned. Modifications to the cash basis of accounting include accruing student loan receivables, accounting for unrealized gains and losses on trading investments, and recording trading investments at fair market value.

In order to ensure observance of limitations and restrictions placed on the use of resources available to the Fund, its accounts are maintained in accordance with the principles of fund accounting. Resources for various purposes are classified for accounting and reporting purposes into funds established according to their nature and purpose. Separate accounts are maintained for each fund.

Cash

The Fund considers only monies maintained in its checking account as cash. The Fund does not have cash equivalents, because in a departure from accounting principles generally accepted in the United States of America, cash does not include highly liquid short-term investments maintained in money market funds managed by investment managers as part of the investment portfolio.

HARRIS AND ELIZA KEMPNER FUND

NOTES TO FINANCIAL STATEMENTS - MODIFIED CASH BASIS *(continued)*

B. Summary of Significant Accounting Policies (continued)

Investments and Fair Value Measurements

Fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date and utilizes a three-tier hierarchy that identifies assets and liabilities measured at fair value. The hierarchy focuses on the inputs used to measure fair value and requires that the lowest level input be used. The three levels defined are as follows:

- Level 1 — observable inputs that are based upon quoted market prices for identical assets or liabilities within active markets.
- Level 2 — observable inputs other than Level 1 that are based upon quoted market prices for similar assets or liabilities, based upon quoted prices within inactive markets, or inputs other than quoted market prices that are observable through market data for substantially the full term of the asset or liability.
- Level 3 — inputs that are unobservable for the particular asset or liability due to little or no market activity and are significant to the fair value of the asset or liability. These inputs reflect assumptions that market participants would use when valuing the particular asset or liability.

The fair values of investments in marketable equity securities are based on Level 1 inputs, while the fair values of nonmarketable equity securities are based on Level 3 inputs provided by management of the partnerships. The fair values of investments in debt securities are measured based on Level 2 inputs. Unrealized gains and losses are included in the excess (deficit) of revenues over expenses in the accompanying statement of revenues, expenses, and changes in fund balances.

Income Tax Status

The Internal Revenue Service has determined that the Fund is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code (the "Code"). The Code imposes an excise tax of 2% (reduced to 1% if certain requirements are met) on net investment income of private foundations. Excise tax expense for the years ended December 31, 2016 and 2015 was \$24,206 and \$40,568.

Expense Allocation

The costs of providing various programs and other activities have been reflected on a functional basis in the financial statements. Program expenses are those that are directly attributable to a specific program. General and administrative expenses are indirect costs that are allocated to various programs on the basis of the fair market value of the program's investments.

HARRIS AND ELIZA KEMPNER FUND

NOTES TO FINANCIAL STATEMENTS - MODIFIED CASH BASIS (continued)

B. Summary of Significant Accounting Policies (continued)

Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts and accompanying disclosures in the financial statements. Actual results could differ from those estimates.

Prior Year Totals

The financial statements include certain prior year summarized comparative information in total but not by fund. Such information does not include sufficient detail of activities by fund. Accordingly, such information should be used in conjunction with the Fund's financial statements for the year ended December 31, 2015, from which the summarized information was derived.

C. Investments and Fair Value Measurements

Fair values of assets measured on a recurring basis at December 31, 2016 are as follows:

	Cost	Fair Values			Total
		Level 1	Level 2	Level 3	
Money market investments	\$ 2,192,694	\$ 2,192,694	\$ -	\$ -	\$ 2,192,694
Treasury investments	2,813,536	2,813,536	-	-	2,813,536
Total short-term investments	5,006,230	5,006,230	-	-	5,006,230
Corporate stocks	26,794,993	29,472,476	-	-	29,472,476
Corporate bonds and Government obligations	5,965,770		5,970,243		5,970,243
Unlisted securities	6,149,813	-	-	6,813,865	6,813,865
Total other investments	38,910,576	29,472,476	5,970,243	6,813,865	42,256,584
Total investments	\$ 43,916,806	\$ 34,478,706	\$ 5,970,243	\$ 6,813,865	\$ 47,262,814

The following table presents the changes in Level 3 instruments measured on a recurring basis for the year ended December 31, 2016:

January 1, 2016	\$ 7,438,634
Unrealized losses included in earnings	<u>(624,769)</u>
December 31, 2016	<u>\$ 6,813,865</u>

HARRIS AND ELIZA KEMPNER FUND

NOTES TO FINANCIAL STATEMENTS - MODIFIED CASH BASIS (continued)

C. Investments and Fair Value Measurements (continued)

Investments in corporate stocks by fund are as follows:

	Cost	Fair Value
Main Fund	\$ 21,351,745	\$ 23,705,848
J.B. Kempner Fund	5,064,348	5,353,932
Kempner Park Fund	248,808	270,431
Jennifer Ezell Fund	130,092	142,265
	\$ 26,794,993	\$ 29,472,476

The relationship between carrying values and fair values of investments is as follows:

	Cost	Fair Value	Excess of Fair Value over Cost
Balance, end of year	\$ 43,916,806	\$ 47,262,814	\$ 3,346,008
Balance, beginning of year	42,146,741	45,310,193	3,163,452
Increase in unrealized gain			182,556
Net realized gain			1,466,637
Total net unrealized and realized gains			\$ 1,649,193

D. Program-Related Investments

The Fund has disbursed monies in the form of program-related investments within and surrounding the local community including organizations like the Galveston Opera House, Galveston Arts Center, and Galveston Historical Foundation among others. The investments are carried at the face value of the investment less repayments made. The carrying values of the investments approximate the fair market values of the investments as a result of their short investment periods. The investments at December 31, 2016 are as follows:

Organization	Carrying Value	Period	Interest Rate
The Grand 1894 Opera House	\$ 67,752	2 years	1.5%
Samaritan Women at the Wall	9,216	2 years	1.0%
	\$ 76,968		

HARRIS AND ELIZA KEMPNER FUND

NOTES TO FINANCIAL STATEMENTS - MODIFIED CASH BASIS *(continued)*

E. Grants Payable

The Fund, as a result of adopting the modified cash basis of accounting, does not record grants payable in its financial statements. Grants are expensed when paid. However, the following is a summary of grant activity for the year ended December 31, 2016:

Grants payable at January 1, 2016	\$ 847,037
Grants approved in 2016	1,153,852
Grants paid in 2016	<u>(1,669,428)</u>
Grants payable at December 31, 2016	<u>\$ 331,461</u>

F. Related Party Transactions

Investment and management fees of approximately \$64,000 were paid to Kempner Capital Management for the management of a substantial portion of the Fund's investment portfolio during the year ended December 31, 2016. Mr. Harris L. Kempner, Jr., President of Kempner Capital Management is a Kempner family member.

Approximately 14% of the Fund's holdings are managed by the Directors rather than by the investment managers. These assets are in Kempner family related investments and include Black Stone Minerals LP, Kempner Securities LP, and Galveston Finale LP.

G. Money Purchase Pension Plan

On April 1, 1994, the Fund initiated a noncontributory money purchase pension plan covering all employees (excluding non-resident aliens) whose employment is not governed by a collective bargaining agreement and who have completed one year of service. Employer contributions are discretionary and are allocated to all participants eligible to share in the allocations in the same proportion that each participant's compensation bears to the total compensation of all participants for such year. Amounts paid during the year ended December 31, 2016 totaled \$18,927.

H. Concentration of Market Risk

The Fund has significant investments in mutual funds and in equity and debt securities and is therefore subject to market risk. Investments are managed by investment advisors who are supervised by the Board of Directors. Though the market value of investments is subject to fluctuations on a year to year basis, the Board of Directors believe that the investment policy is prudent for the long-term welfare of the Fund.

The Fund's cash and investment accounts held in financial institutions and brokerage firms are insured by the Securities Investor Protection Corporation ("SIPC"). The SIPC provides coverage for customers of failed brokerage firms. This coverage does not apply to losses due to market rate risk.

HARRIS AND ELIZA KEMPNER FUND

NOTES TO FINANCIAL STATEMENTS - MODIFIED CASH BASIS *(continued)*

I. Concentration of Credit Risk

The Fund's non-interest bearing cash and deposit accounts are insured up to \$250,000 by the Federal Depository Insurance Corporation ("FDIC") at each financial institution. While the Fund's cash on hand at December 31, 2016 exceeded the FDIC limit, the Fund did not experience any losses related to amounts in excess of the FDIC limit.

J. Other Revenue

Other revenue primarily consists of royalties and other miscellaneous income. Non-deductible expenses are netted against miscellaneous income in the accompanying statement of revenues, expenses, and changes in fund balances.

K. Commitments and Contingencies

The Fund is a party to a Memorandum of Understanding ("MOU") with the Galveston County Recovery Fund. The Fund committed to provide \$50,000 in the event of a federally declared disaster in Galveston or Galveston County. The funds are pledged, but not paid until a disaster has been declared and the fund has resumed operations. The MOU and commitment of funds renews annually.

L. Subsequent Events

In preparing the Fund's financial statements, management has evaluated all subsequent events and transactions for potential recognition or disclosure through November 13, 2017, the date the financial statements were available for issuance.

SUPPLEMENTAL INFORMATION

HARRIS AND ELIZA KEMPNER FUND

SCHEDULE OF PROGRAM EXPENSES - MODIFIED CASH BASIS

For the Year Ended December 31, 2016

(with comparative totals for the Year Ended December 31, 2015)

	<u>Main Fund</u>	<u>KCM Fixed Income Fund</u>	<u>J.B. Kempner Fund</u>	<u>Kempner Park Fund</u>	<u>Jennifer Ezell Fund</u>	<u>2016</u>	<u>2015</u>
Program Expenses							
Collection	\$ 484	\$ -	\$ -	\$ -	\$ -	\$ 484	\$ 1,544
Foreign taxes	12,187	-	3,016	317	180	15,700	11,802
Grants	1,368,917	-	278,086	14,217	8,208	1,669,428	1,797,791
Investment and management	276,299	8,904	39,368	1,943	1,334	327,848	361,428
Matching gift program	284,740	-	-	-	-	284,740	273,507
Total Program Expenses	<u>\$ 1,942,627</u>	<u>\$ 8,904</u>	<u>\$ 320,470</u>	<u>\$ 16,477</u>	<u>\$ 9,722</u>	<u>\$ 2,298,200</u>	<u>\$ 2,446,072</u>

HARRIS AND ELIZA KEMPNER FUND

SCHEDULE OF GENERAL AND ADMINISTRATIVE EXPENSES - MODIFIED CASH BASIS

For the Year Ended December 31, 2016

(with comparative totals for the Year Ended December 31, 2015)

	Main Fund	KCM Fixed Income Fund	J.B. Kempner Fund	Kempner Park Fund	Jennifer Ezell Fund	2016	2015
General and Administrative Expenses:							
Accounting	\$ 28,521	\$ 924	\$ 4,297	\$ 248	\$ 144	\$ 34,134	\$ 35,396
Audit	13,787	447	2,077	120	69	16,500	19,701
Entertainment	1,342	43	202	12	7	1,606	611
Excise and other tax	20,113	652	3,030	175	101	24,071	41,191
Insurance	34,724	1,125	5,231	302	175	41,557	38,566
Legal	-	-	-	-	-	-	211
Memberships	4,067	132	613	35	20	4,867	5,015
Miscellaneous	261	8	39	2	1	311	51
Office equipment	3,036	99	458	27	16	3,636	17,389
Office rent	9,601	311	1,446	83	48	11,489	10,541
Office supplies	1,183	38	178	10	6	1,415	1,469
Payroll expenses	159,728	5,176	24,063	1,389	805	191,161	189,309
Payroll taxes	12,312	399	1,855	107	62	14,735	14,593
Parking	1,110	36	167	10	6	1,329	2,209
Retirement plan and profit sharing	18,184	589	2,740	158	92	21,763	20,543
Registration	5,672	184	854	49	29	6,788	2,845
Student loan administrative fees	-	-	-	-	-	-	1,345
Computer software and services	7,661	249	1,154	67	38	9,169	-
Printed material	141	5	21	1	1	169	163
Kempner paper preservation	2,081	67	314	18	10	2,490	-
Loss on disposition of assets	-	-	-	-	-	-	-
Travel	6,138	199	925	53	31	7,346	10,411
Total General and Administrative Expenses	<u>\$ 329,662</u>	<u>\$ 10,683</u>	<u>\$ 49,664</u>	<u>\$ 2,866</u>	<u>\$ 1,661</u>	<u>\$ 394,536</u>	<u>\$ 411,559</u>