FIRST STEPS, INC.

FINANCIAL STATEMENTS AND INDEPENDENT AUDITOR'S REPORT

June 30, 2011 and 2010

FIRST STEPS, INC.

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
First Steps, Inc.
Nashville, Tennessee

We have audited the accompanying statements of financial position of First Steps, Inc. (a nonprofit organization) as of June 30, 2011 and 2010, and the related statements of activities, functional expenses, and cash flows for the years then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide 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 First Steps, Inc. as of June 30, 2011 and 2010, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 28, 2011, on our consideration of the Organization's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements as a whole. The accompanying schedule of expenditures of federal awards and state financial assistance is presented for purposes of additional analysis and is not a required part of the basic 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.

Nashville, Tennessee
September 28, 2011

FIRST STEPS, INC.
STATEMENTS OF FINANCIAL POSITION
June 30, 2011 and 2010

	2011	2010
Assets		
Current assets:		
Cash and cash equivalents	$ 494,348	$ 1,434,458
Investments, net of permanently restricted funds	75,243	172,591
Accounts and grants receivable	245,430	140,419
Contributions receivable, current portion	109,083	250,000
Total current assets	924,104	1,997,468
Land, buildings and equipment:		
Land	200,000	-
Buildings and improvements	2,184,767	91,347
Furniture and equipment	28,322	43,237
Escrow deposit	-	50,000
	2,413,089	184,584
Less: accumulated depreciation	(68,964)	(74,961)
Land, buildings and equipment, net	2,344,125	109,623
Contributions receivable, net of current portion	77,267	-
Beneficial interest in assets at Community Foundation of Middle Tennessee	14,251	-
Investments, permanently restricted	500,000	500,000
Total assets	$ 3,859,747	$ 2,607,091
Liabilities and Net Assets		
Current liabilities:		
Accounts payable	$ 25,382	$ 29,037
Accrued salaries and benefits	67,094	82,320
Note payable, current portion	21,306	-
Total current liabilities	113,782	111,357
Note payable, net of current portion	1,007,943	-
Total liabilities	1,121,725	111,357
Net assets:		
Unrestricted:		
Undesigated	1,946,638	1,745,734
Designated for endowment	14,251	-
Total unrestricted net assets	1,960,889	1,745,734
Temporarily restricted	277,133	250,000
Permanently restricted	500,000	500,000
Total net assets	2,738,022	2,495,734
Total liabilities and net assets	$ 3,859,747	$ 2,607,091

See accompanying notes.

FIRST STEPS, INC.
STATEMENT OF ACTIVITIES
For the Year Ended June 30, 2011

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Public support and revenue:				
Department of Education contracts and grants	$ 891,395	$ -	$ -	$ 891,395
Contributions	300,878	248,034	-	548,912
Program service fees	430,976	-	-	430,976
United Way	134,146	-	-	134,146
Investment gain, net	88,373	29,099	-	117,472
Special events	37,629	-	-	37,629
Department of Human Services contracts and grants	24,007	-	-	24,007
In-kind contributions	18,700	-	-	18,700
Change in beneficial interest in assets held by others	14,251	-	-	14,251
Other	709	-	-	709
Loss on disposal of asset	(40,745)	-	-	(40,745)
Net assets released from restrictions	250,000	(250,000)	-	-
Total public support and revenue	2,150,319	27,133	-	2,177,452
Expenses:				
Program services	1,544,269	-	-	1,544,269
Supporting services	276,527	-	-	276,527
Fundraising	114,368	-	-	114,368
Total expenses	1,935,164	-	-	1,935,164
Change in net assets	215,155	27,133	-	242,288
Net assets - beginning of year	1,745,734	250,000	500,000	2,495,734
Net assets - end of year	$ 1,960,889	$ 277,133	$ 500,000	$ 2,738,022

See accompanying notes.

FIRST STEPS, INC.
STATEMENT OF ACTIVITIES
For the Year Ended June 30, 2010

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Public support and revenue:				
Department of Education contracts and grants	$ 821,017	$ -	$ -	$ 821,017
Contributions	163,239	250,000	-	413,239
Program service fees	406,399	-	-	406,399
United Way	126,517	-	-	126,517
Investment gain, net	77,058	-	-	77,058
In-kind contributions	56,100	-	-	56,100
Department of Human Services contracts and grants	40,159	-	-	40,159
Special events	32,627	-	-	32,627
Loss on disposal of asset	(2,590)	-	-	(2,590)
Net assets released from restrictions	20,000	(20,000)	-	-
Total public support and revenue	1,740,526	230,000	-	1,970,526
Expenses:				
Program services	1,296,683	-	-	1,296,683
Supporting services	171,868	-	-	171,868
Fundraising	109,620	-	-	109,620
Total expenses	1,578,171	-	-	1,578,171
Change in net assets	162,355	230,000	-	392,355
Net assets - beginning of year	1,583,379	20,000	500,000	2,103,379
Net assets - end of year	$ 1,745,734	$ 250,000	$ 500,000	$ 2,495,734

See accompanying notes.

FIRST STEPS, INC.
STATEMENT OF FUNCTIONAL EXPENSES
For the Year Ended June 30, 2011

	Program Services	Supporting Services	Fundraising	Total
Salaries	$ 976,770	$ 102,106	$ 91,470	$1,170,346
Employee benefits	203,864	11,391	12,564	227,819
Total salaries and employee benefits	1,180,634	113,497	104,034	1,398,165
Occupancy				
(includes in-kind of $18,700)	57,272	24,237	-	81,509
Travel	58,482	8	-	58,490
Supplies	52,297	5,049	-	57,346
Professional services	47,639	6,279	-	53,918
Interest	-	49,898	-	49,898
Utilities	32,927	10,951	-	43,878
Insurance	19,744	7,413	-	27,157
Communications	19,231	6,350	-	25,581
Maintenance	12,029	1,233	-	13,262
Miscellaneous	1,780	10,555	-	12,335
Advertising	641	10,445	-	11,086
Special events				
expenses (rental, postage)	-	-	10,334	10,334
Food	10,170	-	-	10,170
Conferences	6,013	3,565	-	9,578
Dues	536	2,264	-	2,800
Licenses	860	1,124	-	1,984
Bad debts	1,247	-	-	1,247
Total expenses before depreciation	1,501,502	252,868	114,368	1,868,738
Depreciation	42,767	23,659	-	66,426
Total expenses	$1,544,269	$ 276,527	$ 114,368	$ 1,935,164

See accompanying notes.

FIRST STEPS, INC.
STATEMENT OF FUNCTIONAL EXPENSES
For the Year Ended June 30, 2010

	Program Services	Supporting Services	Fundraising	Total
Salaries	$ 813,007	$ 111,994	$ 86,761	$1,011,762
Employee benefits	168,771	12,779	11,666	193,216
Total salaries and employee benefits	981,778	124,773	98,427	1,204,978
Occupancy				
(includes in-kind of $56,100)	104,043	9,576	-	113,619
Supplies	46,821	3,336	-	50,157
Travel	34,377	-	-	34,377
Professional services	32,177	1,860	-	34,037
Communications	18,734	6,357	-	25,091
Food	17,295	28	-	17,323
Insurance	12,326	4,509	-	16,835
Utilities	14,369	-	-	14,369
Miscellaneous	844	11,935	-	12,779
Maintenance	9,163	3,017	-	12,180
Special events				
expenses (rental, postage)	-	-	11,193	11,193
Conferences	6,196	3,153	-	9,349
Bad debts	2,692	-	-	2,692
Licenses	1,440	320	-	1,760
Advertising	657	1,042	-	1,699
Dues	499	770	-	1,269
Total expenses before depreciation	1,283,411	170,676	109,620	1,563,707
Depreciation	13,272	1,192	-	14,464
Total expenses	$1,296,683	$ 171,868	$ 109,620	$ 1,578,171

See accompanying notes.

FIRST STEPS, INC.
STATEMENTS OF CASH FLOWS
For the Years Ended June 30, 2011 and 2010

	2011	2010
Cash flows from operating activities:		
Change in net assets	$ 242,288	$ 392,355
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	66,426	14,464
Loss on disposal of asset	40,745	2,590
Contribution of stock	(10,110)	-
Realized and unrealized gains on investments, net	(114,731)	(65,992)
Changes in operating assets and liabilities:		
Accounts and grants receivable	(105,011)	(34,104)
Contributions receivable	63,650	(250,000)
Beneficial interest in assets held by others	(14,251)	-
Accounts payable	(3,655)	11,123
Accrued expenses	-	(11,000)
Accrued salaries and benefits	(15,226)	2,066
Net cash provided by operating activities	150,125	61,502
Cash flows from investing activities:		
Proceeds from sale of investments	222,189	150,915
Purchase of investments	-	(179,491)
Escrow deposit	-	(50,000)
Purchase of property and equipment	(1,291,673)	(11,116)
Net cash used in investing activities	(1,069,484)	(89,692)
Cash flows from financing activities:		
Payments on long-term debt	(20,751)	-
Net cash used in financing activities	(20,751)	-
Net decrease in cash and cash equivalents	(940,110)	(28,190)
Cash and cash equivalents - beginning of year	1,434,458	1,462,648
Cash and cash equivalents - end of year	$ 494,348	$ 1,434,458
Supplemental cash flow information:		
Cash paid during the year for interest	$ 49,898	$ -
Supplemental schedule of noncash investing and financing activities:		
Contribution of stock	$ 10,110	$ -
Land and building acquired with escrow deposit	$ 50,000	$ -
Land and building acquired by issuance of note payable	$ 1,050,000	$ -

See accompanying notes.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

First Steps, Inc. (the "Organization") is a not-for-profit corporation located in Nashville, Tennessee, that provides education and care for children with special needs and medical conditions alongside their typically developing peers in an inclusive environment, and supports their families.

Financial Statement Presentation

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Net assets and revenues, expenses and gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Organization and changes therein are classified and reported as follows:

> Unrestricted net assets – Net assets that are not subject to donor-imposed stipulations.
>
> Temporarily restricted net assets – Net assets subject to donor-imposed stipulations that may or will be met, either by actions of the Organization and/or the passage of time. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statements of activities as net assets released from restrictions.
>
> Permanently restricted net assets – Net assets subject to donor-imposed stipulations that they be maintained permanently by the Organization. Generally the donors of these assets permit the Organization to use all or part of the income on related investments for general or specific purposes.

Cash Equivalents

The Organization considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Investments

In accordance with accounting principles generally accepted in the United States of America, investments in marketable securities and all investments in debt securities are reported at their fair values in the statements of financial position. Unrealized gains and losses are included in the statements of activities.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Fair Value Measurements

Financial accounting standards relating to fair value measurements establish a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 – inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset and liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 – inputs to the valuation methodology are unobservable and significant to the fair value measurement.

An asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques should maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value on a recurring basis:

Investments - Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include highly liquid government securities and certain other products, such as mutual funds. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows and are classified within Level 2 of the valuation hierarchy. In certain cases where there is limited activity, or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy.

No changes in the valuation methodologies have been made during the period from July 1, 2009 through June 30, 2011.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Fair Value Measurements (Continued)

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Organization believes its valuation methods are appropriate and consistent with that of other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in different fair value measurements at the reporting date. (See Note 2)

Receivables

Accounts, grants and contributions receivable are reviewed periodically as to their collectability. Management provides for losses on receivables using the allowance method. Based on collection experience and management's review, no allowance for doubtful accounts is considered necessary at June 30, 2011 and 2010.

Land, Buildings and Equipment

Land, buildings and equipment are recorded at cost or, if donated, at the estimated fair market value as of the date of donation. The Organization generally capitalizes an asset if its life is estimated to be one year or greater and the cost is $1,000 or greater. Depreciation is provided using the straight-line basis over the estimated useful lives of the respective assets, which range from 5 - 39 years. Expenditures for repairs and maintenance are charged to expense as incurred.

Income Tax Status

The Organization is a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code, and the Organization is classified as an organization that is not a private foundation as defined in Section 509(a) of the Internal Revenue Code. Therefore, no provision for federal income taxes is included in the accompanying financial statements.

The Organization adopted Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC") guidance concerning the accounting for income taxes recognized in an entity's financial statements. This guidance prescribes a minimum probability threshold that a tax position must meet before a financial statement benefit is recognized. The minimum threshold is defined as a tax position that is more likely than not to be sustained upon examination by the applicable taxing authority, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The tax benefit to be recognized is measured as the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. The Organization does not believe there are any uncertain tax positions at June 30, 2011. Additionally, the Organization has not recognized any tax related interest and penalties in the accompanying financial statements. Federal tax years that remain open for examination include the years ended June 30, 2008 through June 30, 2011.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Unconditional Promises to Give

Contributions are recognized when the donor makes a promise to give to the Organization that is, in substance, unconditional. Contributions that are restricted by the donor are reported as increases in unrestricted net assets if the restrictions expire in the fiscal year in which the contributions are recognized. All other donor restrictions are reported as increases in temporarily or permanently restricted net assets depending on the nature of the restrictions. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets.

In-Kind Contributions

The Organization records various types of in-kind support including contributed facilities and equipment. Contributions of tangible assets are recognized at fair market value when received. The amounts reflected in the accompanying financial statements as in-kind contributed facilities are offset by like amounts included in expenses.

Contributed professional services are recognized if the services received (a) create or enhance long-lived assets or (b) require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation. The Organization receives contributed time from volunteers which does not meet this recognition criteria. Accordingly, the value of this contributed time has not been determined and is not reflected in the accompanying financial statements.

Permanently Restricted Endowment Funds

The Uniform Prudent Management Institutional Funds Act (“UPMIFA”) was enacted in Tennessee effective July 1, 2007. The FASB ASC provides guidance on the net asset classification of donor-restricted endowment funds for a nonprofit organization that is subject to an enacted version of UPMIFA. It also requires disclosure of a description of the governing board’s interpretation of the law that underlies the organization’s net asset classification of donor-restricted endowment funds, a description of the organization’s policies for the appropriation of endowment assets for expenditures (its endowment spending policies), a description of the organization’s endowment investment policies, and additional disclosures not previously required. (See Note 7)

Functional Allocation of Expenses

The costs of providing program services and supporting services have been summarized on a functional basis in the statements of activities. Accordingly, certain costs have been allocated among the programs and supporting services benefited based upon estimates by management.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Use of Estimates

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

Reclassifications

Certain 2010 balances have been reclassified to conform with 2011 presentation.

Subsequent Events

The Organization evaluated subsequent events through September 28, 2011 when these financial statements were available to be issued. The Organization is not aware of any significant events that occurred subsequent to the statement of financial position date but prior to the filing of this report that would have a material impact on the financial statements.

NOTE 2 – INVESTMENTS

The following table sets forth the Organization's major categories of assets measured at fair value on a recurring basis, by level within the fair value hierarchy, as of June 30, 2011:

	Fair Value	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
Investments in securities:				
Certificate of deposit	$ 15,000	$ 15,000	$ -	$ -
Fixed income investments-domestic	229,859	31,943	197,916	-
Equity investments:				
Small/Mid Cap U.S. Equity fund	70,508	-	70,508	-
Large Cap U.S. Equity fund	129,784	-	129,784	-
International Equity fund	130,092	-	130,092	-
Total investment in securities	$ 575,243	$ 46,943	$ 528,300	$ -

NOTE 2 – INVESTMENTS (Continued)

The following table sets forth the Organization's major categories of assets measured at fair value on a recurring basis, by level within the fair value hierarchy, as of June 30, 2010:

	Fair Value	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
Investments in securities:				
Certificates of deposit	$ 30,000	$ 30,000	$ -	$ -
Fixed income investments–domestic	240,145	31,880	208,265	-
Equities:				
Public real estate Equity fund	25,488	-	25,488	-
Small/Mid Cap U.S. Equity fund	81,818	-	81,818	-
Large Cap U.S. Equity fund	159,410	-	159,410	-
International Equity fund	127,730	-	127,730	-
Preferred stock	8,000	8,000	-	-
Total investment in securities	$ 672,591	$ 69,880	$ 602,711	$ -

The following schedule summarizes the investment returns for the years ended June 30:

	2011	2010
Interest and dividends	$ 2,741	$ 11,066
Realized and unrealized gains, net	114,731	65,992
	$ 117,472	$ 77,058

NOTE 3 – CONTRIBUTIONS RECEIVABLE

Contributions receivable consist of the following at June 30:

	2011	2010
Capital campaign pledges	$ 186,350	$ 250,000
Less allowance for doubtful accounts	-	-
	$ 186,350	$ 250,000
Receivable in less than one year	$ 109,083	$ 250,000
Receivable in one to five years	77,267	-
	$ 186,350	$ 250,000

NOTE 4 – ENDOWMENT FUND AT COMMUNITY FOUNDATION OF MIDDLE TENNESSEE

The Community Foundation of Middle Tennessee (the "Foundation") maintains investments on behalf of the Organization. The Foundation has ultimate authority and control over the investments. However, the Organization is the beneficiary of these funds and receives distributions of income, subject to the Community Foundation's spending policy. The investments result from unrestricted amounts transferred by the Organization to the Foundation in prior years. During fiscal 2011, the Organization adopted the provisions of FASB ASC 958. The Organization has recorded the related asset "beneficial interest in assets at Community Foundation of Middle Tennessee" in the accompanying statement of financial position as of June 30, 2011. The Organization has recorded revenue of $14,251 for the year ended June 30, 2011 in the statement of activities.

NOTE 5 – NOTE PAYABLE

On July 13, 2010, the Organization acquired a building to serve as its principal facility for programs and administration at a cost of $2,225,000. The purchase was financed through the issuance of a $1,050,000 promissory note payable to a financial institution that requires interest at 5.38%, with monthly principal and interest payments of $6,423 through July 2015, at which time all remaining principal and interest will be due. Amounts outstanding under this debt arrangement were $1,029,249 at June 30, 2011. The note is collateralized by land and building.

Interest expense for the years ended June 30, 2011 and 2010 was $49,898 and $0, respectively.

Following is a summary of future principal maturities under the note payable agreement:

Years ending June 30,	
2012	$ 21,306
2013	22,651
2014	23,918
2015	25,256
2016	936,118
Total principal maturities	1,029,249
Less current portion	(21,306)
Long-term obligations	$ 1,007,943

NOTE 6 – LINE OF CREDIT

At June 30, 2011, the Organization had available a $100,000 revolving line-of-credit with a bank. Payments of interest only at the prime rate plus 0.75%, with a minimum rate of 4.00%, will be due monthly. Amounts outstanding and interest thereon are due on November 1, 2011. No borrowings were outstanding at June 30, 2011.

NOTE 7 – NET ASSETS

Temporarily restricted net assets are available for the following purposes at June 30:

	2011	2010
Capital campaign	$ 96,034	$ -
Other specified projects	2,000	-
Building purchase and debt retirement	150,000	250,000
Investment earnings on endowment	29,099	-
	$ 277,133	$ 250,000

Permanently restricted net assets consist of the following endowment funds at June 30:

	2011	2010
Investments to be held for production of income:		
General endowment	$ 500,000	$ 500,000

The interest earned on permanently restricted net assets is available to the Organization on an unrestricted basis.

The Organization's endowment consists of a gift from Massey Foundation of $500,000 which was received in 1991. The donor stipulated that only the income from this endowment gift should be available directly or indirectly for operations of the Organization. The initial gift and earnings thereon are maintained in the Organization's brokerage account. As required by accounting principles generally accepted in the United States, net assets associated with endowment funds are classified and reported based upon the existence or absence of donor-imposed restrictions. Additional endowment funds consist of assets designated by the Board of Directors which are held in investment accounts. As required by generally accepted accounting principles, net assets associated with endowment funds are classified and reported based upon the existence or absence of donor-imposed restrictions.

The Board of Directors has interpreted UPMIFA as requiring that the Organization classify as permanently restricted net assets a) the original value of donor-restricted gifts to the permanent endowment, b) the original value of subsequent donor-restricted gifts to the permanent endowment, and c) accumulations (interest, dividends, capital gain/loss) 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. With reference to the Massey Foundation's $500,000 gift, the Organization holds the $500,000 as permanently restricted. The earnings thereon are used for unrestricted purposes and are periodically moved to a separate account. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are approved for expenditure by the Organization in a manner consistent with the standard of prudence prescribed by UPMIFA.

FIRST STEPS, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
June 30, 2011 and 2010

NOTE 7 – NET ASSETS (Continued)

Endowment Net Asset Composition by Type of Fund as of June 30, 2011:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Board designated endowment fund	$ 14,251	$ -	$ -	$ 14,251
Donor restricted endowment funds	-	29,099	500,000	529,099
Total endowment	$ 14,251	$ 29,099	$ 500,000	$ 543,350

Changes in Endowment Net Assets for the fiscal year ended June 30, 2011:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	$ -	$ -	$ 500,000	$ 500,000
Contributions and other	14,251	-	-	-
Investment return:				
Net appreciation (realized and unrealized)	-	29,099	-	-
Endowment net assets, end of year	$ 14,251	$ 29,099	$ 500,000	$ 500,000

Endowment Net Asset Composition by Type of Fund as of June 30, 2010:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor restricted endowment funds	$ -	$ -	$ 500,000	$ 500,000

Changes in Endowment Net Assets for the fiscal year ended June 30, 2010:

Endowment net assets, beginning of year	$ -	$ -	$ 500,000	$ 500,000
Investment return:				
Net depreciation (realized and unrealized)	-	-	-	-
Endowment net assets, end of year	$ -	$ -	$ 500,000	$ 500,000

NOTE 7 – NET ASSETS (Continued)

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the Organization to retain as a fund of perpetual duration.

The Organization has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Under this policy, as approved by the Board of Directors, the endowment assets are to be invested in cash and cash equivalents, fixed income, equities and publicly traded real estate. In order to ensure proper levels of diversification of investments, equity and fixed income investments are each capped at 50% of total investments. To satisfy its long-term rate-of-return objectives, the Organization relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends).

The Organization has a policy of distributing annually 0%-5% of a three-year moving average from the endowment fund. This distribution is made with the understanding that the spending rate plus inflation will not normally exceed the total return from the investment. Any spending will be approved by the Finance Committee and the Board of Directors. Specific agreements with donors for income taken relative to their specific endowment gifts are exempted.

NOTE 8 – IN-KIND CONTRIBUTIONS

The Organization received total in-kind contributions of $18,700 and $56,100, respectively, during the years ended June 30, 2011 and 2010, which was comprised of in-kind rent.

NOTE 9 – PENSION PLAN

The Organization has a simplified employee pension plan covering all personnel who are at least 21 years old and performed services for the Organization for at least one year. Pension expense for the years ended June 30, 2011 and 2010 was $12,104 and $16,533, respectively. The contribution to the plan was equal to 2% of eligible employees' compensation in 2011 and 2010. As of June 30, 2011, the Organization ceased making contributions into this pension plan.

Effective July 1, 2011, the Organization instituted a 401(k) profit sharing plan covering all personnel who are at least 21 years old and performed services for the Organization for at least three months. The Organization will make matching contributions equal to 100% of the salary reduction contributions made by employees up to 2% of employees' compensation.

NOTE 10 – CONCENTRATIONS

The Organization receives a significant amount of its support through grants from the Tennessee Department of Education ("DOE"). In 2011 and 2010, the DOE accounted for approximately 41% and 42%, respectively, of the Organization's total public support and revenues. A significant reduction in the level of this support, if this were to occur, could have an adverse effect on the Organization's programs and services.

The Organization had grants receivable due from DOE of $224,562 and $138,426 at June 30, 2011 and 2010, respectively.

NOTE 11 – OPERATING LEASE COMMITMENTS

During fiscal years 2011 and 2010, the Organization maintained lease agreements accounted for as operating leases. Rent expense for the years ended June 30, 2011 and 2010 was $13,262 and $27,180, respectively.

Future minimum lease payments required under operating leases that have initial or remaining noncancelable lease terms in excess of one year as of June 30, 2011 are as follows:

Year ended June 30,	
2012	$ 11,960
2013	11,960
2014	868
2015	868
2016	217
	$ 25,873

SUPPLEMENTAL INFORMATION

FIRST STEPS, INC.
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS AND STATE FINANCIAL ASSISTANCE
For the Year Ended June 30, 2011

Federal Grantor / Pass-Through Grantor	CFDA Number	State Contract Number	Receivable at June 30, 2010	Cash Receipts	Expenditures/ Revenue Recognized	Receivable at June 30, 2011
Federal Awards						
State of Tennessee, Department of Human Services						
USDA Child and Adult Care Food Program	10.558	03-47-60382-004	$ 1,332	$ 8,788	$ 7,782	$ 326
State of Tennessee, Department of Education						
Special Education - Grants for Infants and Families - Recovery Act	84.393A	DGA-C000008	30,408	193,464	293,380	130,324
Total Federal Awards			31,740	202,252	301,162	130,650
State Financial Assistance						
State of Tennessee, Department of Education						
TN Early Intervention Services	n/a	DGA-C000008	98,125	600,750	596,863	94,238
TN Early Intervention Services - Ayudando Ninos	n/a	7244	9,893	9,893	-	-
Total Department of Education			108,018	610,643	596,863	94,238
State of Tennessee, Department of Human Services						
Families First Certificate Program	n/a	n/a	1,329	15,888	16,225	1,666
Total State Financial Assistance			109,347	626,531	613,088	95,904
Total Federal Awards and State Financial Assistance			$ 141,087	$ 828,783	$ 914,250	$ 226,554

Basis of Presentation:

Note: The accompanying Schedule of Expenditures of Federal Awards and State Financial Assistance summarizes the expenditures of First Steps, Inc. under programs of the federal and state governments for the year ended June 30, 2011. The schedule is presented using the accrual basis of accounting. Grant revenues are recognized when the related program expenditures are incurred.

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Directors of
First Steps, Inc.

We have audited the financial statements of First Steps, Inc. (a nonprofit organization) as of and for the year ended June 30, 2011, and have issued our report thereon dated September 28, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Organization's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified the following deficiency in internal control over financial reporting, that we consider to be a significant deficiency in internal control over financial reporting:

Financial Reporting

The Organization currently relies on its independent auditor to assist in making final adjustments to its internal accounting records and prepare its audited financial statements with full disclosures in accordance with generally accepted accounting principles. It should be noted that adjustments for 2011 were primarily to record additional capital campaign contributions receivable of $126,350.

Management response: Management has historically relied on the auditors to compile the financial statements using data supplied by the Director of Finance. The Director of Finance will work closely with the auditors to develop a year end process that reduces the likelihood of audit adjustments.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Organization's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the Organization in a separate letter dated September 28, 2011.

The Organization's response to the finding identified in our audit is described above. We did not audit the Organization's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Board of Directors, management, others within the Organization, and the State of Tennessee and is not intended to be and should not be used by anyone other than these specified parties.

Nashville, Tennessee
September 28, 2011