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**FIRST STEPS, INC.  
FINANCIAL STATEMENTS AND  
INDEPENDENT AUDITOR'S REPORT**

**June 30, 2007 and 2006**

# FIRST STEPS, INC.

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## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors  
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, 2007 and 2006, 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. 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 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, 2007 and 2006, 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.

*Frasier, Dean & Howard, PLLC*

September 24, 2007

**FIRST STEPS, INC.**  
**STATEMENTS OF FINANCIAL POSITION**  
June 30, 2007 and 2006

| ASSETS                               |    | 2007                  | 2006                     |
|--------------------------------------|----|-----------------------|--------------------------|
| Current assets:                      |    |                       |                          |
| Cash and cash equivalents            | \$ | 346,935               | \$ 215,073               |
| Investments                          |    | 99,377                | 95,649                   |
| Accounts and grants receivable       |    | 10,166                | 82,796                   |
|                                      |    | <u>456,478</u>        | <u>393,518</u>           |
| Property and equipment:              |    |                       |                          |
| Building improvements and playground |    | 106,054               | 106,054                  |
| Furniture and equipment              |    | 78,077                | 71,641                   |
|                                      |    | <u>184,131</u>        | <u>177,695</u>           |
| Less: accumulated depreciation       |    | <u>(104,825)</u>      | <u>(106,799)</u>         |
|                                      |    | <u>79,306</u>         | <u>70,896</u>            |
| Property and equipment, net          |    |                       |                          |
|                                      |    | <u>79,306</u>         | <u>70,896</u>            |
| Total assets                         | \$ | <u><u>535,784</u></u> | <u><u>\$ 464,414</u></u> |
| <b>LIABILITIES AND NET ASSETS</b>    |    |                       |                          |
| Current liabilities:                 |    |                       |                          |
| Accounts payable                     | \$ | 14,524                | \$ 22,146                |
| Accrued expenses                     |    | 9,200                 | 8,800                    |
| Accrued salaries and benefits        |    | 42,715                | 60,792                   |
|                                      |    | <u>66,439</u>         | <u>91,738</u>            |
| Total current liabilities            |    |                       |                          |
|                                      |    | <u>66,439</u>         | <u>91,738</u>            |
| Net assets:                          |    |                       |                          |
| Unrestricted                         |    | 469,345               | 352,676                  |
| Temporarily restricted               |    | -                     | 20,000                   |
|                                      |    | <u>469,345</u>        | <u>372,676</u>           |
| Total net assets                     |    |                       |                          |
|                                      |    | <u>469,345</u>        | <u>372,676</u>           |
| Total liabilities and net assets     | \$ | <u><u>535,784</u></u> | <u><u>\$ 464,414</u></u> |

See accompanying notes.

**FIRST STEPS, INC.**  
**STATEMENT OF ACTIVITIES**  
For the year ended June 30, 2007

|   | <u>Unrestricted</u> | <u>Temporarily<br/>Restricted</u> | <u>Total</u>      |
|---|---------------------|-----------------------------------|-------------------|
| Public support and revenues:  |                     |                                   |                   |
| Department of Mental Health and<br>Developmental Disabilities grant | \$ 404,537          | \$ -                              | \$ 404,537        |
| Program service fees  | 330,116             | -                                 | 330,116           |
| Contributions   | 195,036             | -                                 | 195,036           |
| United Way  | 171,774             | -                                 | 171,774           |
| Department of Human Services contracts and grants                   | 63,501              | -                                 | 63,501            |
| In-kind contributions   | 63,200              | -                                 | 63,200            |
| Special events  | 32,913              | -                                 | 32,913            |
| Tennessee Early Intervention Services                               | 25,801              | -                                 | 25,801            |
| Investment income   | 14,813              | -                                 | 14,813            |
|   | <u>1,301,691</u>    | -                                 | <u>1,301,691</u>  |
| Net assets released from restrictions                               | <u>20,000</u>       | <u>(20,000)</u>                   | <u>-</u>          |
|   | <u>1,321,691</u>    | <u>(20,000)</u>                   | <u>1,301,691</u>  |
| Expenses:   |                     |                                   |                   |
| Program services  | 963,545             | -                                 | 963,545           |
| Supporting services   | 134,016             | -                                 | 134,016           |
| Fundraising   | 107,461             | -                                 | 107,461           |
|   | <u>1,205,022</u>    | -                                 | <u>1,205,022</u>  |
| Change in net assets  | 116,669             | (20,000)                          | 96,669            |
| Net assets - beginning of year                                      | <u>352,676</u>      | <u>20,000</u>                     | <u>372,676</u>    |
| Net assets - end of year  | <u>\$ 469,345</u>   | <u>\$ -</u>                       | <u>\$ 469,345</u> |

See accompanying notes.

**FIRST STEPS, INC.**  
**STATEMENT OF ACTIVITIES**  
For the year ended June 30, 2006

|   | <u>Unrestricted</u> | <u>Temporarily<br/>Restricted</u> | <u>Total</u>      |
|---|---------------------|-----------------------------------|-------------------|
| Public support and revenues:  |                     |                                   |                   |
| Department of Mental Health and<br>Developmental Disabilities grant | \$ 435,500          | \$ -                              | \$ 435,500        |
| Contributions   | 242,469             | 20,000                            | 262,469           |
| Program service fees  | 260,033             | -                                 | 260,033           |
| Department of Human Services contracts and grants                   | 233,512             | -                                 | 233,512           |
| United Way  | 206,797             | -                                 | 206,797           |
| Special events  | 61,665              | -                                 | 61,665            |
| In-kind contributions   | 56,100              | -                                 | 56,100            |
| Tennessee Early Intervention Services                               | 24,392              | -                                 | 24,392            |
| Gain on disposal of property and equipment                          | 7,200               | -                                 | 7,200             |
| Investment income   | 2,795               | -                                 | 2,795             |
|   | <u>1,530,463</u>    | <u>20,000</u>                     | <u>1,550,463</u>  |
| Total public support and revenues                                   |                     |                                   |                   |
|   | 1,530,463           | 20,000                            | 1,550,463         |
| Net assets released from restrictions                               | <u>29,000</u>       | <u>(29,000)</u>                   | <u>-</u>          |
|   | <u>1,559,463</u>    | <u>(9,000)</u>                    | <u>1,550,463</u>  |
| Expenses:   |                     |                                   |                   |
| Program services  | 1,243,167           | -                                 | 1,243,167         |
| Supporting services   | 125,633             | -                                 | 125,633           |
| Fundraising   | 111,131             | -                                 | 111,131           |
|   | <u>1,479,931</u>    | <u>-</u>                          | <u>1,479,931</u>  |
| Total expenses  |                     |                                   |                   |
|   | 1,479,931           | -                                 | 1,479,931         |
| Change in net assets  | 79,532              | (9,000)                           | 70,532            |
| Net assets - beginning of year                                      | <u>273,144</u>      | <u>29,000</u>                     | <u>302,144</u>    |
| Net assets - end of year  | <u>\$ 352,676</u>   | <u>\$ 20,000</u>                  | <u>\$ 372,676</u> |

See accompanying notes.

**FIRST STEPS, INC.**  
**STATEMENT OF FUNCTIONAL EXPENSES**  
For the year ended June 30, 2007

|   | <u>Program<br/>Services</u> | <u>Supporting<br/>Services</u> | <u>Fundraising</u>    | <u>Total</u>            |
|---|-----------------------------|--------------------------------|-----------------------|-------------------------|
| Salaries                                  | \$ 588,310                  | \$ 77,573                      | \$ 84,605             | \$ 750,488              |
| Employee benefits                         | 132,148                     | 8,379                          | 12,243                | 152,770                 |
| <br>Total salaries and employee benefits  | <br>720,458                 | <br>85,952                     | <br>96,848            | <br>903,258             |
| <br>Rent (includes in-kind of \$56,100)   | <br>66,070                  | <br>8,597                      | <br>-                 | <br>74,667              |
| Professional services                     | 32,884                      | 17,425                         | -                     | 50,309                  |
| Maintenance                               | 29,476                      | 3,733                          | -                     | 33,209                  |
| Supplies                                  | 24,295                      | 4,855                          | -                     | 29,150                  |
| Travel                                    | 19,393                      | 486                            | -                     | 19,879                  |
| Food                                      | 16,208                      | -                              | -                     | 16,208                  |
| Utilities                                 | 12,313                      | -                              | -                     | 12,313                  |
| Communications                            | 9,070                       | 2,586                          | -                     | 11,656                  |
| Special events expenses (rental, postage) | -                           | -                              | 10,613                | 10,613                  |
| Insurance                                 | 10,000                      | -                              | -                     | 10,000                  |
| Conferences                               | 4,166                       | 2,771                          | -                     | 6,937                   |
| Miscellaneous                             | 2,751                       | 3,113                          | -                     | 5,864                   |
| Bad debts                                 | 1,371                       | 732                            | -                     | 2,103                   |
| Advertising                               | 1,369                       | 648                            | -                     | 2,017                   |
| Licenses                                  | 1,435                       | 220                            | -                     | 1,655                   |
| Dues                                      | 32                          | 1,337                          | -                     | 1,369                   |
| <br>Total expenses before depreciation    | <br>951,291                 | <br>132,455                    | <br>107,461           | <br>1,191,207           |
| <br>Depreciation                          | <br>12,254                  | <br>1,561                      | <br>-                 | <br>13,815              |
| <br>Total expenses                        | <br><u>\$ 963,545</u>       | <br><u>\$ 134,016</u>          | <br><u>\$ 107,461</u> | <br><u>\$ 1,205,022</u> |

See accompanying notes.

**FIRST STEPS, INC.**  
**STATEMENT OF FUNCTIONAL EXPENSES**  
For the year ended June 30, 2006

|   | Program<br>Services | Supporting<br>Services | Fundraising       | Total               |
|---|---------------------|------------------------|-------------------|---------------------|
| Salaries                                  | \$ 808,854          | \$ 71,875              | \$ 79,265         | \$ 959,994          |
| Employee benefits                         | 169,001             | 7,886                  | 11,502            | 188,389             |
| Total salaries and employee benefits      | 977,855             | 79,761                 | 90,767            | 1,148,383           |
| Rent (includes in-kind of \$56,100)       | 54,875              | 7,675                  | -                 | 62,550              |
| Professional services                     | 30,852              | 11,083                 | -                 | 41,935              |
| Food                                      | 40,101              | -                      | -                 | 40,101              |
| Supplies                                  | 31,215              | 2,587                  | -                 | 33,802              |
| Maintenance                               | 23,568              | 2,183                  | -                 | 25,751              |
| Communications                            | 17,849              | 2,580                  | -                 | 20,429              |
| Special events expenses (rental, postage) | -                   | -                      | 20,364            | 20,364              |
| Travel                                    | 16,883              | 525                    | -                 | 17,408              |
| Insurance                                 | 13,323              | 1,397                  | -                 | 14,720              |
| Utilities                                 | 9,485               | 916                    | -                 | 10,401              |
| Contribution (Note 9)                     | -                   | 8,450                  | -                 | 8,450               |
| Conferences                               | 3,184               | 1,858                  | -                 | 5,042               |
| Miscellaneous                             | 603                 | 2,599                  | -                 | 3,202               |
| Bad debts                                 | 3,023               | -                      | -                 | 3,023               |
| Licenses                                  | 2,290               | 55                     | -                 | 2,345               |
| Dues                                      | 627                 | 1,651                  | -                 | 2,278               |
| Advertising                               | 1,564               | 60                     | -                 | 1,624               |
| Transportation                            | 436                 | -                      | -                 | 436                 |
| Total expenses before depreciation        | 1,227,733           | 123,380                | 111,131           | 1,462,244           |
| Depreciation                              | 15,434              | 2,253                  | -                 | 17,687              |
| Total expenses                            | <u>\$ 1,243,167</u> | <u>\$ 125,633</u>      | <u>\$ 111,131</u> | <u>\$ 1,479,931</u> |

See accompanying notes.



**FIRST STEPS, INC.**  
**STATEMENTS OF CASH FLOWS**  
For the years ended June 30, 2007 and 2006

|  | <u>2007</u>       | <u>2006</u>       |
|--|-------------------|-------------------|
| Cash flows from operating activities:  |                   |                   |
| Change in net assets   | \$ 96,669         | \$ 70,532         |
| Adjustments to reconcile change in net assets<br>to net cash provided by operating activities: |                   |                   |
| Depreciation   | 13,815            | 17,687            |
| Contribution of common stock   | (4,957)           | -                 |
| In-kind contribution of property and equipment   | (7,100)           | -                 |
| Realized and unrealized (gains) losses on investments, net                                     | (7,075)           | 1,602             |
| Gain on disposal of property and equipment   | -                 | (7,200)           |
| Changes in operating assets and liabilities:   |                   |                   |
| Accounts and grants receivable   | 72,630            | 987               |
| Accounts payable   | (7,622)           | 13,728            |
| Accrued expenses   | 400               | 400               |
| Accrued salaries and benefits  | (18,077)          | 5,297             |
|  | <u>138,683</u>    | <u>103,033</u>    |
| Net cash provided by operating activities  |                   |                   |
| Cash flows from investing activities:  |                   |                   |
| Proceeds from sale of investments, net   | 58,304            | 15,461            |
| Purchase of investments  | (50,000)          | (4,397)           |
| Proceeds from sale of property and equipment   | -                 | 14,100            |
| Purchase of property and equipment   | (15,125)          | (11,194)          |
|  | <u>(6,821)</u>    | <u>13,970</u>     |
| Net cash (used in) provided by investing activities  |                   |                   |
| Net increase in cash and cash equivalents  | 131,862           | 117,003           |
| Cash and cash equivalents - beginning of year  | <u>215,073</u>    | <u>98,070</u>     |
| Cash and cash equivalents - end of year  | <u>\$ 346,935</u> | <u>\$ 215,073</u> |
| Supplemental disclosure:   |                   |                   |
| Non-cash property and equipment additions  | <u>\$ 7,100</u>   | <u>\$ -</u>       |
| Contribution of common stock   | <u>\$ 4,957</u>   | <u>\$ -</u>       |

See accompanying notes.

**FIRST STEPS, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2007 and 2006**

**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.

**Basis of 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 statement of activities as net assets released from restrictions.

**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 Statement of Financial Accounting Standards (“SFAS”) No. 124, “*Accounting for Certain Investments Held by Not-for-Profit Organizations*,” investments in marketable securities with readily determinable fair values and all investments in debt securities are reported at their fair values in the statement of financial position. Fair value is determined by using quoted market prices, when available. Unrealized gains and losses are included in the statement of activities.

**Receivables**

Accounts and grants receivable are reviewed periodically as to their collectibility. Based on collection experience and management’s review, no allowance for doubtful accounts is considered necessary at June 30, 2007 and 2006.

**FIRST STEPS, INC.**  
**NOTES TO FINANCIAL STATEMENTS (Continued)**  
**June 30, 2007 and 2006**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Property and Equipment**

Property and equipment are recorded at cost or, if donated, at the estimated fair market value as of the date of donation. Depreciation is provided using the straight-line basis over the estimated useful lives of the respective assets, which range from five to ten 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.

**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.

**FIRST STEPS, INC.**  
**NOTES TO FINANCIAL STATEMENTS (Continued)**  
June 30, 2007 and 2006

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Functional Allocation of Expenses**

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

**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 certain amounts and disclosures. Actual results could differ from those estimates.

**NOTE 2 – INVESTMENTS**

Investments at fair value, as of June 30, 2007 and 2006, are summarized as follows:

|                 | <u>2007</u>      | <u>2006</u>      |
|-----------------|------------------|------------------|
| Mutual funds    | \$ 49,377        | \$ 95,649        |
| Municipal bonds | <u>50,000</u>    | <u>-</u>         |
|                 | <u>\$ 99,377</u> | <u>\$ 95,649</u> |

The following schedule summarizes the investment returns for the years ended June 30, 2007 and 2006:

|   | <u>2007</u>      | <u>2006</u>     |
|---|------------------|-----------------|
| Interest and dividends                      | \$ 7,738         | \$ 4,397        |
| Realized and unrealized gains (losses), net | <u>7,075</u>     | <u>(1,602)</u>  |
|   | <u>\$ 14,813</u> | <u>\$ 2,795</u> |

**NOTE 3 – RESTRICTIONS ON NET ASSETS**

Temporarily restricted net assets are available for the following purposes at June 30, 2007 and 2006:

|                             | <u>2007</u> | <u>2006</u>      |
|-----------------------------|-------------|------------------|
| Next fiscal year operations | <u>\$ -</u> | <u>\$ 20,000</u> |

**FIRST STEPS, INC.**  
**NOTES TO FINANCIAL STATEMENTS (Continued)**  
**June 30, 2007 and 2006**

**NOTE 4 – IN-KIND CONTRIBUTIONS**

The Organization received total in-kind contributions of \$63,200 and \$56,100 during the years ended June 30, 2007 and 2006, respectively. In-kind rent amounted to \$56,100 for the years ended June 30, 2007 and 2006. In 2007, the Organization received \$7,100 of donated office equipment and furniture.

**NOTE 5 – 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, 2007 and 2006 was \$12,035 and \$16,374, respectively. The contribution to the plan is equal to 2% of eligible employees' compensation in 2007 and 2006.

**NOTE 6 – CONCENTRATIONS**

The Organization receives a significant amount of its support through grants from the Tennessee Department of Mental Health and Developmental Disabilities ("DMH") and the Tennessee Department of Human Services ("DHS"). In 2007 and 2006, the DMH accounted for 31% and 28%, respectively, of the Organization's total public support and revenues. In 2007 and 2006, the DHS accounted for 5% and 15%, 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 DMH of \$0 and \$51,908 at June 30, 2007 and 2006, respectively. Contracts and grants receivable from DHS amounted to \$6,439 and \$24,539 at June 30, 2007 and 2006, respectively.

Cash and investments include funds deposited in FDIC insured bank accounts. Balances on deposits may at times exceed amounts covered by FDIC insurance. Management believes that risk of loss is mitigated by maintaining deposits in high quality financial institutions.

**NOTE 7 – OPERATING LEASE COMMITMENT**

The Organization leases its administrative office space and certain office equipment. The Organization entered into the administrative office lease in June 2006 for a 24-month term. Rent expense for the years ended June 30, 2007 and 2006 was \$17,047 and \$4,200, respectively.

**FIRST STEPS, INC.**  
**NOTES TO FINANCIAL STATEMENTS (Continued)**  
**June 30, 2007 and 2006**

**NOTE 7 – OPERATING LEASE COMMITMENT (Continued)**

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, 2007 are as follows:

| Year ended<br><u>June 30</u> |                  |
|------------------------------|------------------|
| 2008                         | \$ 16,462        |
| 2009                         | 512              |
| 2010                         | 512              |
| 2011                         | 256              |
| 2012                         | <u>-</u>         |
|                              | <u>\$ 17,742</u> |

**NOTE 8 – 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; accordingly, the net assets of the Organization do not include these investments.

The Organization does anticipate receiving periodic investment earnings on its pro-rata share of the Foundation's assets. The balance of the endowment fund held for the benefit of the Organization totals \$12,516 and \$8,450 at June 30, 2007 and 2006, respectively.

**NOTE 9 – MERGER**

Effective July 1, 2007, the Organization completed a merger with Outlook Nashville, Inc., an organization that provided education and care for children with special needs and medical conditions alongside their typically developing peers in an inclusive environment. The Organization assumed all assets and liabilities of Outlook Nashville, Inc. with the Organization being the surviving Corporation. The merger was accounted for in a manner similar to a pooling of interests. At June 30, 2007, Outlook Nashville, Inc. had assets and liabilities of approximately \$1,984,482 and \$323,573, respectively. For the year ended June 30, 2007, Outlook Nashville, Inc. had revenues and expenses of approximately \$1,269,409 and \$1,345,836, respectively.