

**FIRST STEPS, INC.**

**FINANCIAL STATEMENTS AND  
INDEPENDENT AUDITOR'S REPORT**

**June 30, 2008**

# 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 statement of financial position of First Steps, Inc. (a nonprofit organization) as of June 30, 2008, and the related statements of activities, functional expenses, and cash flows for the year 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 audit.

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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of First Steps, Inc. as of June 30, 2008, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 21, 2008 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 important for assessing the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements of First Steps, Inc. taken as a whole. The accompanying schedule of expenditures of state awards is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

*Fraser, Dean & Howard PLLC*

October 21, 2008

**FIRST STEPS, INC.**  
**STATEMENT OF FINANCIAL POSITION**  
**June 30, 2008**

**Assets**

Current assets:	
Cash and cash equivalents	\$ 696,120
Investments, net of permanently restricted funds	248,344
Accounts and grants receivable	85,600
Prepaid expenses	<u>10,133</u>
Total current assets	<u>1,040,197</u>
Property and equipment:	
Land	286,531
Building improvements and playground	1,755,571
Furniture and equipment	<u>197,689</u>
	2,239,791
Less: accumulated depreciation	<u>(1,232,132)</u>
Property and equipment, net	<u>1,007,659</u>
Investments, permanently restricted	<u>500,000</u>
Total assets	<u><u>\$ 2,547,856</u></u>

**Liabilities and Net Assets**

Current liabilities:	
Accounts payable	\$ 13,763
Accrued expenses	9,200
Accrued salaries and benefits	<u>52,673</u>
Total current liabilities	75,636
Mortgage payable	<u>269,785</u>
Total liabilities	<u>345,421</u>
Net assets:	
Unrestricted	1,696,995
Temporarily restricted	5,440
Permanently restricted	<u>500,000</u>
Total net assets	<u>2,202,435</u>
Total liabilities and net assets	<u><u>\$ 2,547,856</u></u>

See accompanying notes.

**FIRST STEPS, INC.**  
**STATEMENT OF ACTIVITIES**  
**For the year ended June 30, 2008**

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Public support and revenues:				
Department of Education contracts and grants	\$ 786,870	\$ -	\$ -	\$ 786,870
Program service fees	581,738	-	-	581,738
Contributions	311,281	5,440	-	316,721
United Way	230,233	-	-	230,233
Department of Human Services contracts and grants	76,220	-	-	76,220
In-kind contributions	56,100	-	-	56,100
Special events	55,283	-	-	55,283
Tennessee Early Intervention Services	4,257	-	-	4,257
Investment loss, net	(28,235)	-	-	(28,235)
Other income	7,074	-	-	7,074
Net assets released from restrictions	3,406	(3,406)	-	-
Total public support and revenues	<u>2,084,227</u>	<u>2,034</u>	<u>-</u>	<u>2,086,261</u>
Expenses:				
Program services	1,641,729	-	-	1,641,729
Supporting services	227,562	-	-	227,562
Fundraising	144,789	-	-	144,789
Total expenses	<u>2,014,080</u>	<u>-</u>	<u>-</u>	<u>2,014,080</u>
Change in net assets	<u>70,147</u>	<u>2,034</u>	<u>-</u>	<u>72,181</u>
Net assets - beginning of year, as previously reported	469,345	-	-	469,345
Contribution of net assets from Outlook Nashville, Inc.	<u>1,157,503</u>	<u>3,406</u>	<u>500,000</u>	<u>1,660,909</u>
Net assets - beginning of year, as restated	<u>1,626,848</u>	<u>3,406</u>	<u>500,000</u>	<u>2,130,254</u>
Net assets - end of year	<u>\$ 1,696,995</u>	<u>\$ 5,440</u>	<u>\$ 500,000</u>	<u>\$ 2,202,435</u>

See accompanying notes.

**FIRST STEPS, INC.**  
**STATEMENT OF FUNCTIONAL EXPENSES**  
**For the year ended June 30, 2008**

	<u>Program Services</u>	<u>Supporting Services</u>	<u>Fundraising</u>	<u>Total</u>
Salaries	\$ 967,815	\$ 96,000	\$ 104,000	\$ 1,167,815
Employee benefits	195,640	19,200	20,800	235,640
Total salaries and employee benefits	1,163,455	115,200	124,800	1,403,455
Occupancy (includes in-kind of \$56,100)	113,591	26,303	-	139,894
Professional services	55,022	15,900	-	70,922
Utilities	31,555	21,385	-	52,940
Supplies	43,142	2,972	-	46,114
Insurance	30,427	2,929	-	33,356
Travel	26,285	724	-	27,009
Communications	21,428	4,785	-	26,213
Food	24,378	-	-	24,378
Maintenance	18,744	4,068	-	22,812
Special events expenses (rental, postage)	-	-	19,989	19,989
Interest	19,242	-	-	19,242
Contract labor	9,884	6,380	-	16,264
Miscellaneous	2,037	7,409	-	9,446
Conferences	4,376	2,544	-	6,920
Advertising	990	1,363	-	2,353
Bad debts	1,778	-	-	1,778
Dues	629	1,062	-	1,691
Licenses	1,160	390	-	1,550
Total expenses before depreciation	1,568,123	213,414	144,789	1,926,326
Depreciation	73,606	14,148	-	87,754
Total expenses	<u>\$ 1,641,729</u>	<u>\$ 227,562</u>	<u>\$ 144,789</u>	<u>\$ 2,014,080</u>

See accompanying notes.

**FIRST STEPS, INC.**  
**STATEMENT OF CASH FLOWS**  
**For the year ended June 30, 2008**

Cash flows from operating activities:	
Change in net assets	\$ 72,181
Adjustments to reconcile change in net assets to net cash provided by operating activities:	
Contribution of common stock	(9,538)
Depreciation	87,754
Realized and unrealized losses on investments, net	28,235
Changes in operating assets and liabilities:	
Accounts and grants receivable	(7,404)
Other assets	(4,737)
Accounts payable	(27,979)
Accrued expenses	(12,689)
Accrued salaries and benefits	<u>(3,923)</u>
Net cash provided by operating activities	<u>121,900</u>
Cash flows from investing activities:	
Proceeds from sale of investments	396,262
Purchase of investments	(239,130)
Purchase of property and equipment	<u>(12,511)</u>
Net cash provided by investing activities	<u>144,621</u>
Net increase in cash and cash equivalents	266,521
Cash and cash equivalents - beginning of year, as restated	<u>429,599</u>
Cash and cash equivalents - end of year	<u><u>\$ 696,120</u></u>
Supplemental disclosure:	
Contribution of common stock	<u><u>\$ 9,538</u></u>
Interest paid	<u><u>\$ 19,242</u></u>

See accompanying notes.



**FIRST STEPS, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2008**

**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.

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.

**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.

**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.

**FIRST STEPS, INC.**  
**NOTES TO FINANCIAL STATEMENTS (Continued)**  
**June 30, 2008**

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

**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, 2008.

**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.

**FIRST STEPS, INC.**  
**NOTES TO FINANCIAL STATEMENTS (Continued)**  
**June 30, 2008**

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

**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.

**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, 2008, are summarized as follows:

Mutual funds (including \$500,000 permanently restricted)	\$ 665,344
Municipal bonds	75,000
Preferred stock	<u>8,000</u>
	<u>\$ 748,344</u>

The following schedule summarizes the investment returns for the year ended June 30, 2008:

Interest and dividends	\$ 14,288
Realized and unrealized gains (losses), net	<u>(42,523)</u>
	<u>\$ (28,235)</u>

**FIRST STEPS, INC.**  
**NOTES TO FINANCIAL STATEMENTS (Continued)**  
**June 30, 2008**

**NOTE 3 – MORTGAGE PAYABLE**

Mortgage payable to a financial institution bearing interest at 7%, requiring monthly payments of interest only through August 30, 2009, at which time all remaining principal and interest is due.

\$ 269,785

Future principal maturities on the mortgage payable are as follows:

Year ending <u>June 30,</u>	
2008	\$ -
2009	269,785
2010	-
2011	-
2012	<u>-</u>
	<u>\$ 269,785</u>

**NOTE 4 – NET ASSETS**

Temporarily restricted net assets are available for the following purposes at June 30, 2008:

Software upgrades	\$ 5,000
Children's programs	<u>440</u>
	<u>\$ 5,440</u>

Permanently restricted net assets are comprised of the Massey Foundation gift 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.

**NOTE 5 – IN-KIND CONTRIBUTIONS**

The Organization received total in-kind contributions of \$56,100 during the year ended June 30, 2008, which was comprised of in-kind rent.

**NOTE 6 – 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 year ended June 30, 2008 was \$12,406. The contribution to the plan is equal to 2% of eligible employees' compensation in 2008.

**FIRST STEPS, INC.**  
**NOTES TO FINANCIAL STATEMENTS (Continued)**  
**June 30, 2008**

**NOTE 7 – CONCENTRATIONS**

The Organization receives a significant amount of its support through grants from the Tennessee Department of Education (“DOE”) and the Tennessee Department of Human Services (“DHS”). In 2008, the DOE accounted for 37% of the Organization’s total public support and revenues. In 2008, the DHS accounted for 4% 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 \$82,953 at June 30, 2008. Contracts and grants receivable from DHS amounted to \$1,866 at June 30, 2008.

Cash and investments include funds deposited in FDIC insured bank accounts. Balances on deposits may at times exceed federally insured limits.

**NOTE 8 – OPERATING LEASE COMMITMENTS**

The Organization leased certain administrative office space and office equipment during 2008 under operating lease agreements. Rent expense for the year ended June 30, 2008 was \$13,639.

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, 2008 are as follows:

Year ended June 30	
2009	\$ 4,152
2010	512
2011	256
2012	-
2013	-
	<u>\$ 4,920</u>

Effective October 1, 2007, the Organization entered into a lease agreement whereby certain portions of its Tuggle Avenue facility are leased to the Department of Education for use as office space. This agreement was initially for one year. However, effective October 1, 2008, the agreement was extended for three years.

**FIRST STEPS, INC.**  
**NOTES TO FINANCIAL STATEMENTS (Continued)**  
**June 30, 2008**

**NOTE 8 – OPERATING LEASE COMMITMENTS (Continued)**

Future minimum rentals to be received under this agreement in excess of one year as of June 30, 2008 are as follows:

Year ended <u>June 30</u>	
2009	\$ 63,184
2010	66,343
2011	69,660
2012	17,625
2013	<u>-</u>
	<u>\$ 216,812</u>

**NOTE 9 – 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 \$12,756 at June 30, 2008.

**NOTE 10 – MERGER WITH OUTLOOK NASHVILLE, INC.**

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.

Net assets were received from merger with Outlook Nashville, Inc. as follows:

Assets received from Outlook Nashville, Inc. merger:

Cash	\$ 82,664
Receivables	68,030
Investments	824,796
Property and equipment	1,003,596
Other assets	<u>5,396</u>
	<u>1,984,482</u>

**FIRST STEPS, INC.**  
**NOTES TO FINANCIAL STATEMENTS (Continued)**  
**June 30, 2008**

**NOTE 10 – MERGER WITH OUTLOOK NASHVILLE, INC. (Continued)**

Liabilities assumed from Outlook Nashville, Inc. merger:

Accounts payable and accrued expenses

53,788

Long-term debt

269,785

323,573

Net assets received from merger with Outlook Nashville, Inc.

\$ 1,660,909

**FIRST STEPS, INC.**  
**SCHEDULE OF EXPENDITURES OF STATE AWARDS**  
Year Ended June 30, 2008

Grantor/Program Name	State Grant Number	Receivable at June 30, 2007	Cash Receipts	Expenditures/Revenue Recognized	Receivable at June 30, 2008
<b>State of Tennessee, Department of Education</b>					
TEIS	Z 08-22708-00	\$ -	\$ 574,148	\$ 630,500	\$ 56,352
TEIS - State	GR-08-223160	-	129,769	156,370	26,601
Total Department of Education		-	703,917	786,870	82,953
<b>State of Tennessee, Department of Human Services</b>					
Families First Certificate Program	n/a	6,439	60,614	58,135	3,960
USDA Child and Adult Care Food Program	03-47-60382-004	273	20,452	18,085	(2,094)
Total Department of Human Services		6,712	81,066	76,220	1,866
		\$ 6,712	\$ 784,983	\$ 863,090	\$ 84,819

NOTE:

For purposes of the Schedule, expenditures for state programs are recognized on the accrual basis of accounting. Grant revenues are recognized when the related program expenditures are incurred.