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

June 30, 2006 and 2005

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
First Steps, Inc.

We have audited the accompanying statements of financial position of First Steps, Inc. (a nonprofit organization) as of June 30, 2006 and 2005, 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, 2006 and 2005, 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

August 25, 2006

FIRST STEPS, INC.
STATEMENTS OF FINANCIAL POSITION
June 30, 2006 and 2005

ASSETS		2006	2005
Current assets:			
Cash and cash equivalents	\$	215,073	\$ 98,070
Investments		95,649	108,315
Accounts and grants receivable		82,796	83,783
Total current assets		<u>393,518</u>	<u>290,168</u>
Property and equipment:			
Vehicles		-	19,855
Building improvements and playground		106,054	110,439
Furniture and equipment		71,641	82,562
		177,695	212,856
Less: accumulated depreciation		<u>(106,799)</u>	<u>(128,567)</u>
Property and equipment, net		<u>70,896</u>	<u>84,289</u>
Total assets	\$	<u><u>464,414</u></u>	<u><u>\$ 374,457</u></u>
LIABILITIES AND NET ASSETS			
Current liabilities:			
Accounts payable	\$	22,146	\$ 8,418
Accrued expenses		8,800	8,400
Accrued salaries and benefits		60,792	55,495
Total current liabilities		<u>91,738</u>	<u>72,313</u>
Net assets:			
Unrestricted		352,676	273,144
Temporarily restricted		20,000	29,000
Total net assets		<u>372,676</u>	<u>302,144</u>
Total liabilities and net assets	\$	<u><u>464,414</u></u>	<u><u>\$ 374,457</u></u>

See accompanying notes.

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

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
Public support and revenues:			
Department of Mental Health and 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>
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>
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 ACTIVITIES
For the year ended June 30, 2005

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
Public support and revenues:			
Department of Mental Health and Developmental Disabilities grant	\$ 435,500	\$ -	\$ 435,500
Department of Human Services contracts and grants	295,089	-	295,089
Contributions	221,645	29,000	250,645
United Way	206,991	-	206,991
Program service fees	168,921	-	168,921
In-kind contributions	64,000	-	64,000
Tennessee Early Intervention Services	31,823	-	31,823
Special events	22,598	-	22,598
Investment income	6,487	-	6,487
Loss on disposal of property and equipment	(471)	-	(471)
	<u>1,452,583</u>	<u>29,000</u>	<u>1,481,583</u>
Total public support and revenues			
	20,000	(20,000)	-
Net assets released from restrictions			
	<u>1,472,583</u>	<u>9,000</u>	<u>1,481,583</u>
Expenses:			
Program services	1,207,425	-	1,207,425
Supporting services	117,141	-	117,141
Fundraising	91,579	-	91,579
	<u>1,416,145</u>	<u>-</u>	<u>1,416,145</u>
Total expenses			
	56,438	9,000	65,438
Change in net assets			
	216,706	20,000	236,706
Net assets - beginning of year			
	<u>\$ 273,144</u>	<u>\$ 29,000</u>	<u>\$ 302,144</u>
Net assets - end of year			

See accompanying notes.

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

	<u>Program Services</u>	<u>Supporting Services</u>	<u>Fundraising</u>	<u>Total</u>
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	-	-	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.
STATEMENT OF FUNCTIONAL EXPENSES
For the year ended June 30, 2005

	<u>Program Services</u>	<u>Supporting Services</u>	<u>Fundraising</u>	<u>Total</u>
Salaries	\$ 791,393	\$ 76,080	\$ 74,945	\$ 942,418
Employee benefits	172,329	8,581	11,518	192,428
Total salaries and employee benefits	963,722	84,661	86,463	1,134,846
Rent (includes in-kind of \$56,100)	53,143	5,635	-	58,778
Professional services	33,891	11,008	-	44,899
Food	38,038	-	-	38,038
Supplies	26,809	2,412	-	29,221
Maintenance	16,504	2,013	-	18,517
Travel	13,596	4	-	13,600
Insurance	11,331	604	-	11,935
Communications	8,417	1,864	-	10,281
Utilities	8,553	954	-	9,507
Conferences	3,098	2,574	-	5,672
Special events expenses	-	-	5,116	5,116
Miscellaneous	305	2,531	-	2,836
Bad debts	2,677	-	-	2,677
Licenses	2,540	95	-	2,635
Transportation	2,276	-	-	2,276
Advertising	1,822	-	-	1,822
Dues	293	1,220	-	1,513
Total expenses before depreciation	1,187,015	115,575	91,579	1,394,169
Depreciation	20,410	1,566	-	21,976
Total expenses	<u>\$ 1,207,425</u>	<u>\$ 117,141</u>	<u>\$ 91,579</u>	<u>\$ 1,416,145</u>

See accompanying notes.

FIRST STEPS, INC.
STATEMENTS OF CASH FLOWS
For the years ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:		
Change in net assets	\$ 70,532	\$ 65,438
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Depreciation	17,687	21,976
Contribution of common stock	-	(49,141)
In-kind contribution of property and equipment	-	(7,900)
Realized and unrealized losses (gains) on investments, net	1,602	(1,875)
(Gain) loss on disposal of property and equipment	(7,200)	471
Changes in operating assets and liabilities:		
Accounts and grants receivable	987	(16,347)
Accounts payable	13,728	(6,566)
Accrued expenses	400	400
Accrued salaries and benefits	5,297	7,763
Net cash provided by operating activities	<u>103,033</u>	<u>14,219</u>
Cash flows from investing activities:		
Proceeds from sale of investments, net	15,461	49,141
Proceeds from sale of property and equipment	14,100	75
Purchase of investments	(4,397)	(52,217)
Purchase of property and equipment	<u>(11,194)</u>	<u>(6,096)</u>
Net cash provided by (used in) investing activities	<u>13,970</u>	<u>(9,097)</u>
Net increase in cash and cash equivalents	117,003	5,122
Cash and cash equivalents - beginning of year	<u>98,070</u>	<u>92,948</u>
Cash and cash equivalents - end of year	<u>\$ 215,073</u>	<u>\$ 98,070</u>
Supplemental disclosure:		
Non-cash property and equipment additions	<u>\$ -</u>	<u>\$ 7,900</u>
Contribution of common stock	<u>\$ -</u>	<u>\$ 49,141</u>

See accompanying notes.

FIRST STEPS, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2006 and 2005

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 U.S. generally accepted accounting principles. 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, 2006 and 2005.

FIRST STEPS, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2006 and 2005

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
June 30, 2006 and 2005

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, 2006 and 2005, are summarized as follows:

	<u>2006</u>	<u>2005</u>
Mutual funds	<u>\$ 95,649</u>	<u>\$ 108,315</u>

The following schedule summarizes the investment returns for the years ended June 30, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Interest and dividends	\$ 4,397	\$ 4,612
Realized and unrealized gains (losses), net	<u>(1,602)</u>	<u>1,875</u>
	<u>\$ 2,795</u>	<u>\$ 6,487</u>

NOTE 3 – RESTRICTIONS ON NET ASSETS

Temporarily restricted net assets are available for the following purposes at June 30, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Next fiscal year operations	\$ 20,000	\$ 25,000
Other	<u>-</u>	<u>4,000</u>
	<u>\$ 20,000</u>	<u>\$ 29,000</u>

FIRST STEPS, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2006 and 2005

NOTE 4 – IN-KIND CONTRIBUTIONS

The Organization received in-kind contributions of \$56,100 and \$64,000 during the years ended June 30, 2006 and 2005, respectively. Additionally, in-kind rent amounted to \$56,100 for the years ended June 30, 2006 and 2005. In 2005, \$7,900 consisted of donated office equipment and office supplies. The Organization operated its other location in a former school building with no fair market rental value assigned.

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, 2006 and 2005 was \$16,374 and \$13,156, respectively. The contribution to the plan is equal to 2% of eligible employees' compensation in 2006 and 2005.

NOTE 6 – CONCENTRATIONS

The Organization receives a significant amount of its support through grants from the Tennessee Department of Mental Health and Developmental Disabilities ("DMR") and the Tennessee Department of Human Services ("DHS"). In 2006 and 2005, the DMR accounted for 28% and 29%, respectively, of the Organization's total public support and revenues. In 2006 and 2005, the DHS accounted for 15% and 20%, 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 DMR of \$51,908 and \$51,103 at June 30, 2006 and 2005, respectively. Contracts and grants receivable from DHS amounted to \$24,539 and \$24,592 at June 30, 2006 and 2005, 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 – LINE OF CREDIT

The Organization had a line of credit allowing for maximum borrowings of \$100,000, with interest at the bank's index rate due monthly. The line of credit was secured by the assets of the Organization and matured on January 31, 2006. There were no borrowings outstanding at June 30, 2006 and 2005.

FIRST STEPS, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2006 and 2005

NOTE 8 – 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, 2006 and 2005 was \$4,200 and \$0, 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, 2006 are as follows:

Year ended <u>June 30</u>	
2007	\$ 17,362
2008	16,462
2009	512
2010	512
2011	<u>256</u>
	<u>\$ 35,104</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 \$8,450 and \$0 at June 30, 2006 and 2005, respectively.