

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

**June 30, 2004 and 2003**

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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, 2004 and 2003, 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 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, 2004 and 2003, 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 17, 2004, on our consideration of First Steps, Inc.'s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audit was performed 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 federal and state awards is presented for the 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.

*Frasier, Dean & Howard, PLLC*

September 17, 2004

**FIRST STEPS, INC.**  
**STATEMENTS OF FINANCIAL POSITION**  
June 30, 2004 and 2003

**ASSETS**

	<u>2004</u>	<u>2003</u>
Current assets:		
Cash and cash equivalents	\$ 92,948	\$ 104,077
Investments	54,223	32,536
Accounts receivable	30,044	21,443
Grants receivable	37,392	2,801
Prepaid expenses	-	-
	<u>214,607</u>	<u>160,857</u>
Total current assets		
Property and equipment:		
Vehicles	19,855	44,646
Building improvements and playground	107,939	35,971
Furniture and equipment	82,512	96,045
	<u>210,306</u>	<u>176,662</u>
Less: accumulated depreciation	<u>(117,491)</u>	<u>(135,064)</u>
	<u>92,815</u>	<u>41,598</u>
Property and equipment, net		
Total assets	<u>\$ 307,422</u>	<u>\$ 202,455</u>

**LIABILITIES AND NET ASSETS**

Current liabilities:		
Accounts payable	\$ 14,984	\$ 19,137
Accrued expenses	8,000	7,700
Accrued salaries and benefits	47,732	34,567
	<u>70,716</u>	<u>61,404</u>
Total current liabilities		
Net assets:		
Unrestricted	216,706	116,051
Temporarily restricted	20,000	25,000
	<u>236,706</u>	<u>141,051</u>
Total net assets		
Total liabilities and net assets	<u>\$ 307,422</u>	<u>\$ 202,455</u>

See accompanying notes.

**FIRST STEPS, INC.**  
**STATEMENT OF ACTIVITIES**  
For the year ended June 30, 2004

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
Public support and revenues:			
Department of Mental Health and Developmental Disabilities grant	\$ 401,082	\$ -	\$ 401,082
Contributions	330,712	20,000	350,712
Department of Human Services contracts and grants	327,883	-	327,883
Program service fees	143,107	-	143,107
In-kind contributions	121,841	-	121,841
United Way	109,678	-	109,678
Special events	49,708	-	49,708
Other	29,455	-	29,455
Gain on disposal of property and equipment	5,730	-	5,730
Investment income	1,801	-	1,801
	<u>1,520,997</u>	<u>20,000</u>	<u>1,540,997</u>
Total public support and revenues			
	25,000	(25,000)	-
Net assets released from restrictions			
	<u>1,545,997</u>	<u>(5,000)</u>	<u>1,540,997</u>
Expenses:			
Program services	1,248,410	-	1,248,410
Supporting services	115,855	-	115,855
Fundraising	81,077	-	81,077
	<u>1,445,342</u>	<u>-</u>	<u>1,445,342</u>
Total expenses			
	100,655	(5,000)	95,655
Change in net assets			
	<u>116,051</u>	<u>25,000</u>	<u>141,051</u>
Net assets - beginning of year			
	<u>\$ 216,706</u>	<u>\$ 20,000</u>	<u>\$ 236,706</u>
Net assets - end of year			

See accompanying notes.

**FIRST STEPS, INC.**  
**STATEMENT OF ACTIVITIES**  
For the year ended June 30, 2003

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
Public support and revenues:			
Department of Mental Health and Developmental Disabilities grant	\$ 401,082	\$ -	\$ 401,082
Department of Human Services contracts and grants	265,998	-	265,998
Contributions	129,142	25,000	154,142
Program service fees	151,797	-	151,797
United Way	108,183	-	108,183
Special events	78,602	-	78,602
In-kind contributions	57,300	-	57,300
Other	6,337	-	6,337
Investment income (loss)	(929)	-	(929)
Loss on disposal of property and equipment	(1,076)	-	(1,076)
	<hr/>	<hr/>	<hr/>
Total public support and revenues	1,196,436	25,000	1,221,436
Net assets released from restrictions	32,950	(32,950)	-
	<hr/>	<hr/>	<hr/>
	1,229,386	(7,950)	1,221,436
	<hr/>	<hr/>	<hr/>
Expenses:			
Program services	1,180,685	-	1,180,685
Supporting services	127,060	-	127,060
Fundraising	35,973	-	35,973
	<hr/>	<hr/>	<hr/>
Total expenses	1,343,718	-	1,343,718
	<hr/>	<hr/>	<hr/>
Change in net assets	(114,332)	(7,950)	(122,282)
Net assets - beginning of year	230,383	32,950	263,333
	<hr/>	<hr/>	<hr/>
Net assets - end of year	<u>\$ 116,051</u>	<u>\$ 25,000</u>	<u>\$ 141,051</u>

See accompanying notes.

**FIRST STEPS, INC.**  
**STATEMENT OF FUNCTIONAL EXPENSES**  
For the year ended June 30, 2004

	<u>Program Services</u>	<u>Supporting Services</u>	<u>Fundraising</u>	<u>Total</u>
Salaries	\$ 821,407	\$ 74,815	\$ 58,776	\$ 954,998
Employee benefits	195,410	11,435	10,472	217,317
Total salaries and employee benefits	1,016,817	86,250	69,248	1,172,315
Rent (includes in-kind of \$56,100)	52,644	5,852	-	58,496
Food	40,750	-	-	40,750
Professional services	30,590	10,082	-	40,672
Supplies	21,772	1,936	-	23,708
Communications	11,018	2,793	-	13,811
Insurance	10,998	1,152	-	12,150
Concert expenses	-	-	11,829	11,829
Maintenance	10,488	1,138	-	11,626
Travel	10,900	170	-	11,070
Utilities	8,787	977	-	9,764
Conferences	1,825	1,923	-	3,748
Transportation	3,192	-	-	3,192
Bad debts	2,931	-	-	2,931
Licenses	2,290	125	-	2,415
Miscellaneous	1,683	419	-	2,102
Advertising	626	969	-	1,595
Dues	84	503	-	587
Total expenses before depreciation	1,227,395	114,289	81,077	1,422,761
Depreciation	21,015	1,566	-	22,581
Total expenses	<u>\$ 1,248,410</u>	<u>\$ 115,855</u>	<u>\$ 81,077</u>	<u>\$ 1,445,342</u>

See accompanying notes.

**FIRST STEPS, INC.**  
**STATEMENT OF FUNCTIONAL EXPENSES**  
For the year ended June 30, 2003

	<u>Program Services</u>	<u>Supporting Services</u>	<u>Fundraising</u>	<u>Total</u>
Salaries	\$ 745,947	\$ 85,721	\$ 23,104	\$ 854,772
Employee benefits	169,043	12,902	3,798	185,743
Total salaries and employee benefits	914,990	98,623	26,902	1,040,515
Professional services	52,926	5,489	-	58,415
Rent (includes in-kind of \$56,100)	51,780	5,610	-	57,390
Food	38,571	-	-	38,571
Supplies	30,995	1,698	-	32,693
Insurance	18,374	1,586	-	19,960
Maintenance	18,252	-	-	18,252
Communications	11,620	1,852	-	13,472
Travel	10,782	30	-	10,812
Concert expenses	-	-	9,071	9,071
Utilities	8,870	-	-	8,870
Miscellaneous	3,940	1,273	-	5,213
Conferences	3,349	557	-	3,906
Transportation	2,798	-	-	2,798
Licenses	1,600	784	-	2,384
Bad debts	2,344	-	-	2,344
Advertising	1,342	602	-	1,944
Dues	60	707	-	767
Total expenses before depreciation	1,172,593	118,811	35,973	1,327,377
Depreciation	8,092	8,249	-	16,341
Total expenses	<u>\$ 1,180,685</u>	<u>\$ 127,060</u>	<u>\$ 35,973</u>	<u>\$ 1,343,718</u>

See accompanying notes.



**FIRST STEPS, INC.**  
**STATEMENTS OF CASH FLOWS**  
For the years ended June 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Cash flows from operating activities:		
Change in net assets	\$ 95,655	\$ (122,282)
Adjustments to reconcile changes in net assets to net cash provided by (used in) operating activities:		
Depreciation	22,581	16,341
In-kind contribution of property and equipment	(64,936)	(1,200)
Realized and unrealized (gains) losses on investments, net	(682)	2,163
(Gain) loss on disposal of property and equipment	(5,730)	1,076
Changes in operating assets and liabilities:		
Accounts receivable	951	(6,504)
Grant receivable	(44,143)	62,410
Prepaid expenses	-	4,736
Accounts payable	(4,153)	4,614
Accrued expenses	300	(150)
Accrued salaries and benefits	13,165	(1,903)
Net cash provided by (used in) operating activities	<u>13,008</u>	<u>(40,699)</u>
Cash flows from investing activities:		
Proceeds from sale of investments, net	-	50,226
Proceeds from sale of property and equipment	6,200	-
Purchase of investments	(21,005)	-
Purchase of property and equipment	(9,332)	(3,471)
Net cash (used in) provided by investing activities	<u>(24,137)</u>	<u>46,755</u>
Cash flows from financing activities:		
Proceeds from line of credit borrowings	55,000	-
Payments on line of credit	(55,000)	-
Net cash provided by financing activities	<u>-</u>	<u>-</u>
Net (decrease) increase in cash and cash equivalents	(11,129)	6,056
Cash and cash equivalents - beginning of year	<u>104,077</u>	<u>98,021</u>
Cash and cash equivalents - end of year	<u>\$ 92,948</u>	<u>\$ 104,077</u>
Supplemental disclosure:		
Non-cash property and equipment additions	<u>\$ 64,936</u>	<u>\$ 1,200</u>
Interest paid	<u>\$ 754</u>	<u>\$ -</u>

See accompanying notes.

**FIRST STEPS, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2004 and 2003**

**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 quality early intervention services for children with and without disabilities, as well as support and guidance for their families. The Organization operates two separate facilities in the Nashville area.

**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, 2004 and 2003.

**FIRST STEPS, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2004 and 2003**

**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, 2004 and 2003**

**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.

**Reclassifications**

Certain reclassifications have been made to 2003 balances to conform with 2004 presentation.

**NOTE 2 – INVESTMENTS**

Investments at fair value, as of June 30, 2004 and 2003, are summarized as follows:

	<u>2004</u>	<u>2003</u>
Mutual funds	<u>\$ 54,223</u>	<u>\$ 32,536</u>

The following schedule summarizes the investment returns for the years ended June 30, 2004 and 2003:

	<u>2004</u>	<u>2003</u>
Interest and dividends	\$ 1,119	\$ 1,234
Realized and unrealized (losses) and gains, net	<u>682</u>	<u>(2,163)</u>
	<u>\$ 1,801</u>	<u>\$ (929)</u>

**FIRST STEPS, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2004 and 2003**

**NOTE 3 – RESTRICTIONS ON NET ASSETS**

Temporarily restricted net assets are available for the following purposes at June 30, 2004 and 2003:

	<u>2004</u>	<u>2003</u>
Next fiscal year operations	<u>\$ 20,000</u>	<u>\$ 25,000</u>

**NOTE 4 – IN-KIND CONTRIBUTIONS**

The Organization received in-kind contributions of \$121,841 and \$57,300 during the years ended June 30, 2004 and 2003, respectively. In 2004, \$65,741 consisted of donated playground equipment, office equipment and office supplies. In 2003, \$1,200 consisted of donated office equipment. The remaining 2004 activity and 2003 activity of \$56,100 represents rent for use of one of the facility locations. The Organization operates 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, 2004 and 2003 was \$26,233 and \$24,796, respectively. The contribution to the plan is equal to 4% of eligible employees' compensation in 2004 and 2003.

**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 2004 and 2003, the DMR accounted for 26% and 33%, respectively, of the Organization's total public support and revenues. In 2004 and 2003, the DHS accounted for 21% and 22%, 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 \$33,435 and \$3,835 at June 30, 2004 and 2003, respectively. Contracts and grants receivable from DHS amounted to \$21,516 and \$10,808 at June 30, 2004 and 2003, respectively.

Cash and investments include funds deposited in FDIC insured bank accounts. Balances on deposit 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.

**FIRST STEPS, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2004 and 2003**

**NOTE 7 – LINE OF CREDIT**

The Organization has 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 is secured by the assets of the Organization and matures on January 31, 2005. There were no borrowings outstanding at June 30, 2004 and 2003.

## **ADDITIONAL INFORMATION**

**FIRST STEPS, INC.**  
**SCHEDULE OF EXPENDITURES OF FEDERAL AND STATE AWARDS**  
For the year ended June 30, 2004

<u>Program</u>	<u>CFDA No.</u>	<u>Grantor's Number</u>	<u>Balance Receivable June 30, 2003</u>	<u>Cash Receipts</u>	<u>Expenditures</u>	<u>Other Adjustments</u>	<u>Balance Receivable June 30, 2004</u>
<b><u>Federal Awards:</u></b>							
<b><u>U.S. Department of Agriculture</u></b>							
USDA Child and Adult Care Food Program *	10.558	03-47-60382-00-4	\$ 2,801	\$ 2,801	\$ -	\$ -	\$ -
USDA Child and Adult Care Food Program * (Passed through Department of Human Services, State of Tennessee)	10.558, 10.559	DA-0400069-00	-	46,215	50,172	-	3,957
Total U.S. Department of Agriculture			2,801	49,016	50,172	-	3,957
Total Federal Awards			\$ 2,801	\$ 49,016	\$ 50,172	\$ -	\$ 3,957
<b><u>State Awards:</u></b>							
<b><u>Department of Mental Health and Developmental Disabilities</u></b>							
Early Intervention Program	n/a	Z-04-016434-00	\$ -	\$ 367,647	\$ 401,082	\$ -	\$ 33,435
Total Department of Mental Health and Developmental Disabilities			-	367,647	401,082	-	33,435
Total State Awards			\$ -	\$ 367,647	\$ 401,082	\$ -	\$ 33,435
Total Federal and State Awards			\$ 2,801	\$ 416,663	\$ 451,254	\$ -	\$ 37,392

**Basis of presentation:**

The accompanying schedule of expenditures of state awards includes the state grant activity of First Steps, Inc. and is presented on the accrual basis of accounting.

\* Grant represents pass-through federal funds.





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

To the Board of Directors  
First Steps, Inc.

We have audited the financial statements of First Steps, Inc. as of and for the year ended June 30, 2004, and have issued our report thereon dated September 17, 2004. 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.

Compliance

As part of obtaining reasonable assurance about whether First Steps, Inc.'s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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 that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered First Steps, Inc.'s internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the board of directors, management, others within the organization, and awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

*Frasier, Dean & Howard, PLLC*  
September 17, 2004