

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

June 30, 2010 and 2009

FIRST STEPS, INC.

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INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying statements of financial position of First Steps, Inc. (a nonprofit organization) as of June 30, 2010 and 2009, and the related statements of activities, functional expenses, and cash flows for the years then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of First Steps, Inc. as of June 30, 2010 and 2009, 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 27, 2010, on our consideration of the Organization's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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

Frazier, Dem & Hardy PLLC

Nashville, Tennessee

September 27, 2010

FIRST STEPS, INC.
STATEMENTS OF FINANCIAL POSITION
June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Assets		
Current assets:		
Cash and cash equivalents	\$ 1,434,458	\$ 1,462,648
Investments, net of permanently restricted funds	172,591	78,023
Accounts and grants receivable	<u>390,419</u>	<u>106,315</u>
Total current assets	<u>1,997,468</u>	<u>1,646,986</u>
Property and equipment:		
Building improvements and playground	91,347	119,236
Furniture and equipment	43,237	53,047
Escrow deposit	<u>50,000</u>	<u>-</u>
	184,584	172,283
Less: accumulated depreciation	<u>(74,961)</u>	<u>(106,722)</u>
Property and equipment, net	<u>109,623</u>	<u>65,561</u>
Investments, permanently restricted	<u>500,000</u>	<u>500,000</u>
Total assets	<u><u>\$ 2,607,091</u></u>	<u><u>\$ 2,212,547</u></u>
Liabilities and Net Assets		
Current liabilities:		
Accounts payable	\$ 29,037	\$ 17,914
Accrued expenses	-	11,000
Accrued salaries and benefits	<u>82,320</u>	<u>80,254</u>
Total current liabilities	111,357	109,168
Net assets:		
Unrestricted	1,745,734	1,583,379
Temporarily restricted	250,000	20,000
Permanently restricted	<u>500,000</u>	<u>500,000</u>
Total net assets	<u>2,495,734</u>	<u>2,103,379</u>
Total liabilities and net assets	<u><u>\$ 2,607,091</u></u>	<u><u>\$ 2,212,547</u></u>

See accompanying notes.

FIRST STEPS, INC.
STATEMENT OF ACTIVITIES
For the year ended June 30, 2010

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

See accompanying notes.

FIRST STEPS, INC.
STATEMENT OF ACTIVITIES
For the year ended June 30, 2009

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Public support and revenue:				
Department of Education contracts and grants	\$ 790,767	\$ -	\$ -	\$ 790,767
Program service fees	377,013	-	-	377,013
Contributions	247,342	20,000	-	267,342
United Way	127,674	-	-	127,674
Department of Human Services contracts and grants	48,233	-	-	48,233
In-kind contributions	56,100	-	-	56,100
Special events	67,220	-	-	67,220
Investment loss, net	(129,569)	-	-	(129,569)
Loss on disposal of asset	(19,710)	-	-	(19,710)
Net assets released from restrictions	5,440	(5,440)	-	-
	<u>1,570,510</u>	<u>14,560</u>	<u>-</u>	<u>1,585,070</u>
Total public support and revenue				
Expenses:				
Program services	1,325,264	-	-	1,325,264
Supporting services	220,433	-	-	220,433
Fundraising	138,429	-	-	138,429
	<u>1,684,126</u>	<u>-</u>	<u>-</u>	<u>1,684,126</u>
Total expenses				
Change in net assets	(113,616)	14,560	-	(99,056)
Net assets - beginning of year	1,696,995	5,440	500,000	2,202,435
Net assets - end of year	<u>\$ 1,583,379</u>	<u>\$ 20,000</u>	<u>\$ 500,000</u>	<u>\$ 2,103,379</u>

See accompanying notes.

FIRST STEPS, INC.
STATEMENT OF FUNCTIONAL EXPENSES
For the year ended June 30, 2010

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

See accompanying notes.

FIRST STEPS, INC.
STATEMENT OF FUNCTIONAL EXPENSES
For the year ended June 30, 2009

	<u>Program Services</u>	<u>Supporting Services</u>	<u>Fundraising</u>	<u>Total</u>
Salaries	\$ 797,920	\$ 97,923	\$ 101,436	\$ 997,279
Employee benefits	181,017	10,892	13,890	205,799
Total salaries and employee benefits	978,937	108,815	115,326	1,203,078
Occupancy (includes in-kind of \$56,100)	96,111	9,233	-	105,344
Utilities	30,300	20,204	-	50,504
Professional services	29,973	11,412	-	41,385
Miscellaneous	1,505	31,839	-	33,344
Supplies	28,835	2,970	-	31,805
Travel	25,181	523	-	25,704
Special events expenses (rental, postage)	-	-	23,103	23,103
Communications	16,344	4,776	-	21,120
Insurance	16,007	4,962	-	20,969
Food	17,592	-	-	17,592
Maintenance	12,253	3,737	-	15,990
Interest	12,722	-	-	12,722
Conferences	5,012	3,917	-	8,929
Advertising	199	1,883	-	2,082
Dues	373	1,075	-	1,448
Licenses	990	410	-	1,400
Bad debts	549	-	-	549
Total expenses before depreciation	1,272,883	205,756	138,429	1,617,068
Depreciation	52,381	14,677	-	67,058
Total expenses	<u>\$1,325,264</u>	<u>\$ 220,433</u>	<u>\$ 138,429</u>	<u>\$1,684,126</u>

See accompanying notes.

FIRST STEPS, INC.
STATEMENTS OF CASH FLOWS
For the years ended June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Cash flows from operating activities:		
Change in net assets	\$ 392,355	\$ (99,056)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	14,464	67,058
Loss on disposal of asset	2,590	19,710
Realized and unrealized (gains) losses on investments, net	(65,992)	134,858
Changes in operating assets and liabilities:		
Accounts and grants receivable	(284,104)	(20,715)
Prepaid expenses	-	10,133
Accounts payable	11,123	4,151
Accrued expenses	(11,000)	1,800
Accrued salaries and benefits	2,066	27,581
Net cash provided by operating activities	<u>61,502</u>	<u>145,520</u>
Cash flows from investing activities:		
Proceeds from sale of investments	150,915	117,058
Purchase of investments	(179,491)	(81,595)
Escrow deposit	(50,000)	-
Proceeds from sale of property and equipment	-	870,677
Purchase of property and equipment	<u>(11,116)</u>	<u>(15,347)</u>
Net cash (used in) provided by investing activities	<u>(89,692)</u>	<u>890,793</u>
Cash flows from financing activities:		
Payments on long-term debt	<u>-</u>	<u>(269,785)</u>
Net cash used in financing activities	<u>-</u>	<u>(269,785)</u>
Net (decrease) increase in cash and cash equivalents	(28,190)	766,528
Cash and cash equivalents - beginning of year	<u>1,462,648</u>	<u>696,120</u>
Cash and cash equivalents - end of year	<u><u>\$ 1,434,458</u></u>	<u><u>\$ 1,462,648</u></u>
Supplemental disclosure:		
Interest paid	<u><u>\$ -</u></u>	<u><u>\$ 12,722</u></u>

See accompanying notes.

FIRST STEPS, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2010 and 2009

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.

Accounting Standards Codification

The Financial Accounting Standards Board Accounting Standards Codification (“FASB ASC”) became the sole authoritative source of generally accepted accounting principles in the United States of America for periods ending after September 15, 2009. The FASB ASC incorporates all authoritative literature previously issued by a standard setter. Adoption of the FASB ASC had no effect on the Organization’s financial position, activities, net assets or cash flows.

Financial Statement Presentation

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

Unrestricted net assets – Net assets that are not subject to donor-imposed stipulations.

Temporarily restricted net assets – Net assets subject to donor-imposed stipulations that may or will be met, either by actions of the Organization and/or the passage of time. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the 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, 2010 and 2009

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investments

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

Fair Values

The Organization has an established process for determining fair values. Fair value is based upon quoted market prices, where available. If listed prices or quotes are not available, fair value is based upon internally developed models or processes that use primarily market-based or independently-sourced market data and third party information. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. Furthermore, while the Organization believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies, or assumptions, to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. Generally accepted accounting principles have a three-level valuation hierarchy for fair value measurements. A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The three levels are explained as follows:

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

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

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

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, 2010 and 2009.

FIRST STEPS, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
June 30, 2010 and 2009

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.

On January 1, 2009, the Organization adopted FASB ASC guidance concerning the accounting for income taxes recognized in an entity's financial statements. This guidance prescribes a minimum probability threshold that a tax position must meet before a financial statement benefit is recognized. The minimum threshold is defined as a tax position that is more likely than not to be sustained upon examination by the applicable taxing authority, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The tax benefit to be recognized is measured as the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. The guidance must be applied to all existing tax positions upon initial adoption. The Organization does not believe there are any uncertain tax positions at June 30, 2010. Additionally, the Organization has not recognized any tax related interest and penalties in the accompanying financial statements. Federal tax years that remain open for examination include the years ended June 30, 2008 through June 30, 2010. Adoption of this pronouncement had no impact on the Organization's 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, 2010 and 2009

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 statements 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.

Permanently Restricted Endowment Funds

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

FIRST STEPS, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
June 30, 2010 and 2009

NOTE 2 – INVESTMENTS

Investments are stated at fair value with fair value determined based on active markets (Level 1) and consist of the following at June 30:

	<u>2010</u>	<u>2009</u>
Short Duration Fixed Income Fund	\$ 32,016	\$ 30,460
Core Fixed Income Fund	176,249	158,293
Large Cap US Equity Fund	159,410	142,166
Small / Mid Cap US Equity Fund	81,818	70,586
International Equity Fund	127,730	114,730
Public Real Estate Equity Fund	25,488	16,788
Certificate of deposits (maturing though December 2011)	30,000	37,000
Corporate bonds	31,880	-
Preferred stock	8,000	8,000
	<u>\$ 672,591</u>	<u>\$ 578,023</u>

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

	<u>2010</u>	<u>2009</u>
Interest and dividends	\$ 11,066	\$ 5,289
Realized and unrealized gains (losses), net	<u>65,992</u>	<u>(134,858)</u>
	<u>\$ 77,058</u>	<u>\$ (129,569)</u>

NOTE 3 – NET ASSETS

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

	<u>2010</u>	<u>2009</u>
McWhorter Family Children's Center	\$ 250,000	\$ -
Nurse practitioner	<u>-</u>	<u>20,000</u>
	<u>\$ 250,000</u>	<u>\$ 20,000</u>

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

	<u>2010</u>	<u>2009</u>
Investments to be held for production of income:		
General endowment	<u>\$ 500,000</u>	<u>\$ 500,000</u>

FIRST STEPS, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
June 30, 2010 and 2009

NOTE 3 – NET ASSETS (Continued)

The interest earned on permanently restricted net assets is available to First Steps on an unrestricted basis.

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

The Uniform Prudent Management Institutional Funds Act ("UPMIFA") was enacted in Tennessee effective July 1, 2007. The Board of Directors has interpreted the UPMIFA as requiring that the Organization classify as permanently restricted net assets a) the original value of donor-restricted gifts to the permanent endowment, b) the original value of subsequent donor-restricted gifts to the permanent endowment, and c) accumulations (interest, dividends, capital gain/loss) to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are approved for expenditure by the Organization in a manner consistent with the standard of prudence prescribed by UPMIFA.

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

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor restricted endowment funds	\$ -	\$ -	\$ 500,000	\$ 500,000

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

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

FIRST STEPS, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
June 30, 2010 and 2009

NOTE 3 – NET ASSETS (Continued)

Endowment Net Asset Composition by Type of Fund as of June 30, 2009:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor restricted endowment funds	\$ -	\$ -	\$ 500,000	\$ 500,000

Changes in Endowment Net Assets for the fiscal year ended June 30, 2009:

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

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

First Steps has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Under this policy, as approved by the Board of Directors, the endowment assets are to be invested in cash and cash equivalents, fixed income, equities and publicly traded real estate. In order to ensure proper levels of diversification of investments, equity and fixed income vehicles are each capped at 50% of total investment.

To satisfy its long-term rate-of-return objectives, First Steps relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Organization targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

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

FIRST STEPS, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
June 30, 2010 and 2009

NOTE 4 – IN-KIND CONTRIBUTIONS

The Organization received total in-kind contributions of \$56,100 during each of the years ended June 30, 2010 and 2009, which was comprised of in-kind rent.

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, 2010 and 2009 was \$16,533 and \$15,404, respectively. The contribution to the plan was equal to 2% of eligible employees' compensation in 2010 and 2009.

NOTE 6 – CONCENTRATIONS

The Organization receives a significant amount of its support through grants from the Tennessee Department of Education ("DOE"). In 2010, the DOE accounted for approximately 42% 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 \$138,426 and \$104,433 at June 30, 2010 and 2009, respectively.

The Organization had cash deposits of \$0 and \$752,104 in excess of federally insured limits as of June 30, 2010 and 2009, respectively.

NOTE 7 – OPERATING LEASE COMMITMENTS

The Organization leased certain administrative office space and office equipment during 2010 under operating lease agreements. Rent expense for the years ended June 30, 2010 and 2009 was \$27,180 and \$13,271, 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, 2010 are as follows:

Year ended June 30,	
2011	\$ 11,348
2012	11,092
2013	11,092
2014	<u>-</u>
	<u>\$ 33,532</u>

FIRST STEPS, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
June 30, 2010 and 2009

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 \$11,803 and \$10,531 at June 30, 2010 and 2009, respectively.

NOTE 9 – SUBSEQUENT EVENTS

The Organization evaluated subsequent events through September 27, 2010 when these financial statements were available to be issued. Other than described in the following paragraph, the Organization is not aware of any significant events that occurred subsequent to the statement of financial position date but prior to the filing of this report that would have a material impact on the financial statements.

On July 13, 2010, the Organization acquired a building to serve as its principal facility for programs and administration at a cost of \$2,225,000. The purchase was financed through the issuance of a \$1,050,000 promissory note payable to a financial institution that requires interest at 5.38%, with monthly principal and interest payments of \$6,423 through July 2015, at which time all remaining principal and interest will be due.

SUPPLEMENTAL INFORMATION

FIRST STEPS, INC.
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS AND STATE FINANCIAL ASSISTANCE
For the year ended June 30, 2010

Federal Grantor / Pass-Through Grantor	CFDA Number	State Contract Number	Receivable at June 30, 2009	Cash Receipts	Expenditures/ Revenue Recognized	Receivable at June 30, 2010
<u>Federal Awards</u>						
State of Tennessee, Department of Human Services						
USDA Child and Adult Care Food Program	10.558	03-47-60382-004	\$ 1,038	\$ 17,360	\$ 17,654	\$ 1,332
State of Tennessee, Department of Education						
Special Education - Grants for Infants and						
Families - Recovery Act	84.393A	DGA-C000008	-	1,209	31,617	30,408
Total Federal Awards			1,038	18,569	49,271	31,740
<u>State Financial Assistance</u>						
State of Tennessee, Department of Education						
TN Early Intervention Services	n/a	Z 09-214809-00	101,191	101,191	-	-
TN Early Intervention Services	n/a	DGA-C000008	-	531,875	630,000	98,125
TN Early Intervention Services - Ayudando Ninos	n/a	GR-08-223160-01	3,242	3,242	-	-
TN Early Intervention Services - Ayudando Ninos	n/a	7244	-	149,507	159,400	9,893
Total Department of Education			104,433	785,815	789,400	108,018
State of Tennessee, Department of Human Services						
Families First Certificate Program	n/a	n/a	844	22,020	22,505	1,329
Total State Financial Assistance			105,277	807,835	811,905	109,347
Total Federal Awards and State Financial Assistance			\$ 106,315	\$ 826,404	\$ 861,176	\$ 141,087

Basis of Presentation:

Note: The accompanying Schedule of Expenditures of Federal Awards and State Financial Assistance summarizes the expenditures of First Steps, Inc. under programs of the federal and state governments for the year ended June 30, 2010. The schedule is presented using the accrual basis of accounting. Grant revenues are recognized when the related program expenditures are incurred.



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CERTIFIED PUBLIC ACCOUNTANTS

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

To the Board of Directors of
First Steps, Inc.

We have audited the financial statements of First Steps, Inc. (a nonprofit organization) as of and for the year ended June 30, 2010, and have issued our report thereon dated September 27, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Organization's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws,

regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

Frasier, Dem & Hound, PLLC

Nashville, Tennessee
September 27, 2010