FIRST STEPS, INC.

FINANCIAL STATEMENTS AND INDEPENDENT AUDITOR'S REPORT

June 30, 2009 and 2008

FIRST STEPS, INC.

TABLE OF CONTENTS

FRASIER, DEAN & HOWARD, PLLC

CERTIFIED PUBLIC ACCOUNTANTS

3310 WEST END AVENUE, SUITE 550
NASHVILLE, TENNESSEE 37203
PHONE 615-383-6592, FAX 615-383-7094

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, 2009 and 2008, 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, 2009 and 2008, 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 October 7, 2009, 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 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.

Frasier, Dean & Howard, PLLC

October 7, 2009

FIRST STEPS, INC.
STATEMENTS OF FINANCIAL POSITION
June 30, 2009 and 2008

	2009	2008
Assets		
Current assets:		
Cash and cash equivalents	$ 1,462,648	$ 696,120
Investments, net of permanently restricted funds	78,023	248,344
Accounts and grants receivable	106,315	85,600
Prepaid expenses	-	10,133
Total current assets	1,646,986	1,040,197
Property and equipment:		
Land	-	286,531
Building improvements and playground	119,236	1,755,571
Furniture and equipment	53,047	197,689
	172,283	2,239,791
Less: accumulated depreciation	(106,722)	(1,232,132)
Property and equipment, net	65,561	1,007,659
Investments, permanently restricted	500,000	500,000
Total assets	$ 2,212,547	$ 2,547,856
Liabilities and Net Assets		
Current liabilities:		
Accounts payable	$ 17,914	$ 13,763
Accrued expenses	11,000	9,200
Accrued salaries and benefits	80,254	52,673
Total current liabilities	109,168	75,636
Mortgage payable	-	269,785
Total liabilities	109,168	345,421
Net assets:		
Unrestricted	1,583,379	1,696,995
Temporarily restricted	20,000	5,440
Permanently restricted	500,000	500,000
Total net assets	2,103,379	2,202,435
Total liabilities and net assets	$ 2,212,547	$ 2,547,856

See accompanying notes.

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

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Public support and revenues:				
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)	-	-
Total public support and revenues	1,570,510	14,560	-	1,585,070
Expenses:				
Program services	1,325,264	-	-	1,325,264
Supporting services	220,433	-	-	220,433
Fundraising	138,429	-	-	138,429
Total expenses	1,684,126	-	-	1,684,126
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	$ 1,583,379	$ 20,000	$ 500,000	$ 2,103,379

See accompanying notes.

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

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
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	2,084,227	2,034	-	2,086,261
Expenses:				
Program services	1,641,729	-	-	1,641,729
Supporting services	227,562	-	-	227,562
Fundraising	144,789	-	-	144,789
Total expenses	2,014,080	-	-	2,014,080
Change in net assets	70,147	2,034	-	72,181
Net assets - beginning of year,	1,626,848	3,406	500,000	2,130,254
Net assets - end of year	$ 1,696,995	$ 5,440	$ 500,000	$ 2,202,435

See accompanying notes.

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

	Program Services	Supporting Services	Fundraising	Total
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	$1,325,264	$ 220,433	$ 138,429	$ 1,684,126

See accompanying notes.

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

	Program Services	Supporting Services	Fundraising	Total
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	$1,641,729	$ 227,562	$ 144,789	$ 2,014,080

See accompanying notes.

FIRST STEPS, INC.
STATEMENTS OF CASH FLOWS
For the years ended June 30, 2009 and 2008

	2009	2008
Cash flows from operating activities:		
Change in net assets	$ (99,056)	$ 72,181
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Contribution of common stock	-	(9,538)
Depreciation	67,058	87,754
Loss on disposal of asset	19,710	-
Realized and unrealized losses on investments, net	134,858	28,235
Changes in operating assets and liabilities:		
Accounts and grants receivable	(20,715)	(7,404)
Prepaid expenses	10,133	(4,737)
Accounts payable	4,151	(27,979)
Accrued expenses	1,800	(12,689)
Accrued salaries and benefits	27,581	(3,923)
Net cash provided by operating activities	145,520	121,900
Cash flows from investing activities:		
Proceeds from sale of investments	117,058	396,262
Purchase of investments	(81,595)	(239,130)
Proceeds from sale of property and equipment	870,677	-
Purchase of property and equipment	(15,347)	(12,511)
Net cash provided by investing activities	890,793	144,621
Cash flows from financing activities:		
Payments on long-term debt	(269,785)	-
Net cash used in financing activities	(269,785)	-
Net increase in cash and cash equivalents	766,528	266,521
Cash and cash equivalents - beginning of year	696,120	429,599
Cash and cash equivalents - end of year	$ 1,462,648	$ 696,120
Supplemental disclosure:		
Contribution of common stock	$ -	$ 9,538
Interest paid	$ 12,722	$ 19,242

See accompanying notes.

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

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 statements of financial position. Unrealized gains and losses are included in the statement 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, 2009 and 2008.

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.

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.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

During 2008, the Staff of the Financial Accounting Standards Board ("FASB") issued Proposed FASB Staff Position No. FAS 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds* ("FSP 117-1"). The FSP clarifies that a nonprofit organization should classify the portion of a donor-restricted endowment fund that is not permanently restricted by the donor or by law as temporarily restricted net assets (time restricted) until it is appropriated for expenditure and donor-imposed purpose restrictions, if any, are met. When the purpose restrictions, if any, on the portion of donor-restricted endowment funds are met and the appropriation has occurred, temporarily restricted net assets are reclassified to unrestricted net assets. FSP FAS 117-1 also required additional disclosures applicable to all nonprofit organizations. Those disclosures provide: a) a description of the organization's policies for making appropriations for expenditures from endowment funds (i.e. the organization's endowment spending policies), b) a description of the organization's investment policies for endowment funds, c) a description of the organization's endowment by net asset class at the end of the period in total and by type of endowment fund, d) a reconciliation of the beginning and ending balances of endowment funds in total and by net asset class, and e) a description of the organization's interpretation of the law(s) underlying the net asset classification of donor-restricted endowment funds. The Organization has implemented this pronouncement and is now providing the expanded disclosures as of June 30, 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:

	2009	2008
Mutual funds (including $500,000 permanently restricted)	$ 533,023	$ 665,344
Municipal bonds	-	75,000
Certificate of deposit (4.25%, matures 4/9/2010)	37,000	-
Preferred stock	8,000	8,000
	$ 578,023	$ 748,344

NOTE 2 – INVESTMENTS (Continued)

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

	2009	2008
Interest and dividends	$ 5,289	$ 14,288
Realized and unrealized gains (losses), net	(134,858)	(42,523)
	$ (129,569)	$ (28,235)

NOTE 3 – MORTGAGE PAYABLE

	2009	2008
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 was due. The mortgage was retired in connection with the sale of the related property.	$ -	$ 269,785

NOTE 4 – NET ASSETS

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

	2009	2008
Software upgrades	$ -	$ 5,000
Children's programs	-	440
Nurse practitioner	20,000	-
	$ 20,000	$ 5,440

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 each of the years ended June 30, 2009 and 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 years ended June 30, 2009 and 2008 was $15,404 and $12,406, respectively. The contribution to the plan was equal to 2% of eligible employees' compensation in 2009 and 2008.

NOTE 7 – CONCENTRATIONS

The Organization receives a significant amount of its support through grants from the Tennessee Department of Education ("DOE"). In 2009, the DOE accounted for approximately 49% 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 $104,433 and $82,953 at June 30, 2009 and 2008, respectively.

The Organization had cash deposits of $752,104 and $369,121 in excess of federally insured limits as of June 30, 2009 and 2008, respectively.

NOTE 8 – OPERATING LEASE COMMITMENTS

The Organization leased certain administrative office space and office equipment during 2009 under operating lease agreements. Rent expense for the years ended June 30, 2009 and 2008 was $13,271 and $19,576, 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, 2009 are as follows:

Year ended June 30	
2010	$ 11,604
2011	11,348
2012	11,092
2013	11,092
2014	-
	$ 45,136

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 $10,531 and $12,756 at June 30, 2009 and 2008, respectively.

NOTE 10 – PERMANENTLY RESTRICTED NET ASSETS

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

	2009	2008
Investments to be held for production of income:		
General endowment	$ 500,000	$ 500,000

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. As required by U.S. generally accepted accounting principles, 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, 2009:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor restricted endowment funds	$ -	$ -	$ 500,000	$ 500,000

NOTE 10 – PERMANENTLY RESTRICTED NET ASSETS (Continued)

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

Endowment Net Asset Composition by Type of Fund as of June 30, 2008:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor restricted endowment funds	$ -	$ -	$ 500,000	$ 500,000

Changes in Endowment Net Assets for the fiscal year ended June 30, 2008:

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. At June 30, 2009, the fair value of assets associated with individual donor-restricted endowment funds exceeded required levels.

NOTE 10 – PERMANENTLY RESTRICTED NET ASSETS (Continued)

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.

NOTE 11 – 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	5,396
	1,984,482

NOTE 11 – 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

SUPPLEMENTAL INFORMATION

FIRST STEPS, INC.
SCHEDULE OF EXPENDITURES OF STATE AWARDS
Year Ended June 30, 2009

Grantor/Program Name	CFDA Number	State Grant Number	Receivable at June 30, 2008	Cash Receipts	Expenditures/ Revenue Recognized	Receivable at June 30, 2009
State of Tennessee, Department of Education						
TN Early Intervention Services	n/a	Z 09-214809-00	$ 56,352	$ 585,428	$ 630,267	$ 101,191
TN Early Intervention Services - Ayudando Ninos	n/a	GR-08-223160-01	26,601	183,859	160,500	3,242
Total Department of Education			82,953	769,287	790,767	104,433
State of Tennessee, Department of Human Services						
Families First Certificate Program	n/a	n/a	3,960	33,716	30,600	844
USDA Child and Adult Care Food Program	10.558	03-47-60382-004	(2,094)	14,501	17,633	1,038
Total Department of Human Services			1,866	48,217	48,233	1,882
			$ 84,819	$ 817,504	$ 839,000	$ 106,315

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.

FRASIER, DEAN & HOWARD, PLLC

CERTIFIED PUBLIC ACCOUNTANTS

3310 WEST END AVENUE, SUITE 550
NASHVILLE, TENNESSEE 37203
PHONE 615-383-6592, FAX 615-383-7094

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, 2009, and have issued our report thereon dated October 7, 2009. 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a certain deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Organization's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles, such that there is more than a remote likelihood that a misstatement of the Organization's financial statements that is more than inconsequential will not be prevented or detected by the Organization's internal control. We consider the following deficiency to be a significant deficiency in internal control over financial reporting.

Financial Reporting

The Committee of Sponsoring Organizations ("COSO") framework for effective internal control over financial reporting involves the identification and analysis of the risks of material misstatement to the Organization's audited financial statements. The Organization has utilized the year-end audit as a method to assist it in making final adjustments to its internal accounting records in order to present them in accordance with accounting principles generally accepted in the United States of America. Statement on Auditing Standards ("SAS") No. 112, *Communicating Internal Control Related Matters in an Audit*, effective for periods ending after December 15, 2006, heightened communication requirements regarding internal controls. Under SAS No. 112, material audit adjustments are required to be communicated as significant deficiencies. It should be noted that adjustments for 2009 primarily related to the sale of the Tuggle Avenue property. Management should consider establishing a year-end close process that does not require adjustments that are identified through its year-end audit.

Management response: Management has historically relied on the auditors to compile the financial statements using data supplied by the Director of Finance. The Director of Finance will work closely with the auditors to develop a year end process that relies less on the auditors.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Organization's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiency described above is not a material weakness.

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*.

The Organization's response to the finding identified in our audit is described above. We did not audit the Organization's response and, accordingly, we express no opinion on it.

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, Dean & Howard, PLLC

Nashville, Tennessee
October 7, 2009