

IMPLEMENTING VALUE PRICING

RONALD J. BAKER, FOUNDER

VERASAGE INSTITUTE



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*I bargained with Life for a penny,
And life would pay no more,
However I begged at evening
When I counted my scanty store.
For Life is a just employer,
He gives you what you ask,
But once you have set the wages,
Why, you must bear the task.
I worked for a menial's hire,
Only to learn, dismayed,
That any wage I had asked of Life,
Life would have willingly paid.*

—Jessie B. Rittenhouse, “My Wage,”
The Door of Dreams (1918)

PART I: PRICE PSYCHOLOGY

Billing is like golf—It's a game played on a six-inch course between your ears

—Charles and Joseph Larson, *Innovative Billing and Collection Methods That Work*

It is worth reiterating that pricing is a major marketing decision. And since we know that people tend to buy emotionally, and justify intellectually, the study of pricing psychology is a worthwhile task. I have benefited from the wisdom of Timothy Beauchemin, and his audio cassette program entitled *Five Star Client Service System*. In this program, Tim teaches that CPAs should run their practices like 5-Star restaurants. He also offers the two characteristics of price psychology, which are:

- 1) Price Leverage**
- 2) Price Emotion**

Price Leverage

Price leverage is not so much an advantage possessed by one party over the other, but more a question of who has the most (or least) price sensitivity at a given point in time. As we have mentioned, before an engagement has begun, the CPA possesses the price leverage. This is because the customer is able and willing to do business with you (otherwise you wouldn't have made it this far in the process) and they desire (or badly need) the service.

Think of the psychological factors when the customer is confronted with an IRS audit. The time to negotiate and set the price for your representation is not after you have completed the audit, but before. Once you complete an engagement (or particular project), the price leverage shifts to the customer and you are left trying to recoup any portion of your price the customer is willing to pay.

Price leverage also works with Change Orders, a topic we will deal with in the next section. Contractors are notorious for utilizing Change Orders. If the project is changed in the middle, the contractor will notify the customer and a Change Order will be issued (mechanics also engage in this practice). At the time of a Change Order, the pricing leverage, again, is on the side of the contractor—he's already started the job, is familiar with it, and the switching costs are usually prohibitive at this stage. The same applies to the auto mechanic. Change Orders are an extremely effective mechanism for keeping in contact with the customer, and retaining your price leverage when projects do not turn out as originally planned.

Price Emotions

There are three primary price emotions that each customer will encounter at various times through the purchasing cycle. They are:

- 1) **Price Resistance**
- 2) **Price Anxiety**
- 3) **Payment Resistance**

Price resistance is the proverbial “sticker shock.” As long as you are dealing with people, you will encounter price resistance. The best way to overcome it is by educating the customer as to the value you provide. Price resistance is usually encountered at the beginning of the negotiating process and thus it is easy to identify. I have found that in most instances CPAs can overcome this emotion. After all, the customer is dealing with a CPA, they expect us to be more expensive than a PA or an EA. If price resistance can not be conquered through you educating the customer, then I would seriously suggest that you not take the engagement. You do not want to work for people who don't understand, or refuse to pay for, the value you provide.

Price anxiety is also known as buyer's remorse. It's a well know fact that luxury automobile advertisements are targeted at existing owners, not so much potential owners. This is because after a such a large purchase, customers want reassurance that they made a good decision. This is a significant psychological emotion that all customers will go through, especially after entering into a Fixed Price Agreement with your firm. You overcome price anxiety by constantly staying in touch with your customers and assuring them that they made the right decision in hiring you. You

can also offer a 100% money back guarantee, that dramatically lowers price anxiety, and we will discuss this in the next section.

Payment resistance is simply the customer's unwillingness to cut the check. Who likes to pay their bills? Payment resistance is overcome by involving the customer in the design, price and payment terms of your service. Once people are committed to a Fixed Price Agreement, they are more likely to cut the check in accordance with the agreement. All of the experience I have had with FPAs—and the experiences of other CPAs who utilize them—have been very positive with respect to accounts receivable collections. In fact, my only accounts receivable difficulties are with customers whom I did not negotiate price and payment terms up-front.

PART II: THE FPA AND CHANGE ORDERS

*Ultimately, a business is defined by that for which it collects revenue,
and it collects revenue only for that which it decides to charge*

—B. Joseph Pine II and James H. Gilmore,
The Experience Economy: Work is Theatre and Every Business a Stage

*Like money, price talks. It changes perceptions. Price changes the actual experience of
using the service: A high price actually improves the experience. **Watch what your
price says. Push price higher. Higher prices don't just talk, they tempt***

—Harry Beckwith, *The Invisible Touch: The Four Keys to Modern Marketing*

Sample Fixed Price Agreement

November 8, 2005

Dear Customer:

In order to document the understanding between us as to the scope of the work that ABC, CPAs will perform, we are entering into this **Fixed Price Agreement** with XYZ, Inc. To avoid any misunderstandings, this Agreement defines the services we will perform for you as well as your responsibilities under this Agreement.

2006 PROFESSIONAL SERVICES

ABC will perform the following services for XYZ during 2006:

- Δ 2005 W-2s/1099s and 4th Quarter Payroll Tax Reports and Workers Comp Report
- Δ 1st, 2nd & 3rd Quarter Payroll 2006 Reports and Workers Comp Reports and Fiscal Year Sales Tax Return
- Δ 2005 Year-end Accounting Adjustments and Closing of 2005 Books
- Δ 2005 XYZ S Corporation Tax Returns
- Δ 2006 Tax Planning
- Δ 2005 Financial Statement Compilation
- Δ Unlimited Access 2006*

TOTAL 2006 PROFESSIONAL SERVICES \$XXX

*Included in the Unlimited Access are the following services to be provided by ABC to XYZ:

- Δ Unlimited meetings, to discuss operations of XYZ, business matters, tax matters and any other topic at the discretion of XYZ or its employees and/or agents.
- Δ Unlimited phone support for XYZ personnel and/or independent contractors and agents regarding accounting assistance, transaction analysis, etc.

Because our Fixed Price Agreement provides ongoing access to the accounting, tax and business advice you need on a fixed-price basis, you are not inhibited from seeking timely advice by the fear of a meter running endlessly. Our program is built around one price pricing, as opposed to hourly rates, and offers you access to the accumulated wisdom of the firm through CPAs with substantial experience, who can help enhance your company's future and achieve its business goals.

While the fixed price entitles your company to unlimited consultation with us, if your question or issue requires additional research and analysis beyond the consultation, that work will be subject to an additional price negotiation before the service is to be performed.

Unanticipated Services

Furthermore, the parties agree that if an unanticipated need arises (such as, but not limited to, an audit by a taxing agency, a financial statement review or compilation required as part of a lender financing agreement, or any other exogenous service not anticipated in this agreement by the parties) that ABC hereby agrees to perform this additional work at a mutually agreed upon price. This service will be billed separately to XYZ utilizing a Change Order.

Service and Price Guarantee

Our work is guaranteed to the complete satisfaction of the customer. If you are not completely satisfied with the services performed by ABC, we will, at the option of XYZ, either refund the price, or accept a portion of said price that reflects XYZ's level of satisfaction. Upon final payment of your invoice, we will assume you have been satisfied. Furthermore, if you ever receive an invoice without first authorizing the service and/or the price, you are not obligated to pay for that service.

Payment Terms

The following payment plan is hereby agreed to by XYZ and ABC:

Δ January 31, 2006	\$ XX
Δ February 28, 2006	XX
Δ March 31, 2006	XX
Δ April 30, 2006	XX
Δ May 31, 2006	XX
Δ June 30, 2006	XX
Δ July 31, 2006	XX
Δ August 31, 2006	XX
Δ September 30, 2006	XX

Δ	October 31, 2006	XX
Δ	November 30, 2006	XX
Δ	December 31, 2006	<u>XX</u>
TOTAL 2006 PAYMENTS		<u>\$XXX</u>

To assure that our arrangement remains responsive to your needs, as well as fair to both parties, we will meet throughout 2006 and, if necessary, revise or adjust the scope of the services to be provided and the prices to be charged in light of mutual experience. **[Optional clause—effective for new customers, or veteran customers you are transitioning to an FPA].**

Furthermore, it is understood that either party may terminate this Agreement at any time, for any reason, within 10 days of written notice to the other party. It is understood that any unpaid services that are outstanding at the date of termination are to be paid in full within 10 days from the date of termination.

If you agree that the above adequately sets forth XYZ's understanding of our mutual responsibilities, please authorize this Agreement and return it to our office. A copy is provided for your records.

We would like to take this opportunity to express our appreciation for the opportunity to serve you.

Very Truly Yours,

BY: _____
Allan Somnolent, Partner, ABC, CPAs

Agreed to and accepted:

BY: _____ DATE: _____
Customer, President, XYZ, Inc.

Sample Change Order

Customer:

Date:

Project Description [and estimated completion date, if appropriate]:

Price: \$_____

We believe it is our responsibility to exceed your expectations. This Change Order is being prepared because the above project was not anticipated in our original Fixed Price Agreement, dated xx/xx/xx. The price for the above project has been mutually agreed upon by Customer XYZ, and ABC, CPAs. It is our goal to ensure that XYZ is never surprised by the price for any ABC service, and therefore we have adopted the Change Order Policy. The price above is due and payable upon completion of the project described [or, payable up front, if agreed upon, or in installments, etc.—whatever you and the customer agree to].

If you agree with the above project description and the price, please authorize and date the Change Order below. A copy is enclosed for your records. Thank you for letting us serve you.

Sincerely,

Allan Somnolent, Partner, ABC, CPAs

Agreed to and accepted:

BY: _____
Customer, President, XYZ

Date: _____

PART III: CHECKLIST FOR EXAMINING CLOSED FILES

Customer Name:

Year (or period):

Partner-In-Charge:

Description of services rendered:

Was there a fixed price agreement? ☐ Yes ☐ No

Was there an engagement letter? ☐ Yes ☐ No

Pricing method that was used?

Were the desired results obtained for the customer? ☐ Yes ☐ No

Explain the value received by the customer:

How could we have done a better job for the customer?

What could the firm have done differently in servicing this customer?

Should any processes, procedures or systems be implemented as a result of this engagement? ☐ Yes ☐ No

Are there any generic forms, letters, memos or other written communications that may be utilized on similar engagements? ☐ Yes ☐ No

Will the firm repeat this engagement for this customer? ☐ Yes ☐ No

Was this engagement profitable for the firm? ☐ Yes ☐ No

Has customer satisfaction been obtained for this engagement? ☐ Yes ☐ No

If Yes, how (formal survey, oral communication, etc.)?

Is it documented in the file and in the customer profile in the firm's database? ☐ Yes ☐ No

If No, why not?

Were any opportunities for cross-selling services discovered? ☐ Yes ☐ No

If Yes, describe the additional services provided:

Would you use the same pricing method if you had to do over again? ☐ Yes ☐ No

What technology, if any, was used on the engagement?

Could this engagement have been provided by any other member of the firm more efficiently? ☐ Yes ☐ No

If Yes, by whom?

Why?

SELECTED BIBLIOGRAPHY AND SUGGESTED READING

Baker, Ronald J. *Pricing On Purpose: Creating and Capturing Value*. New Jersey: John Wiley & Sons, Inc., 2006 (forthcoming). www.wiley.com

Baker, Ronald J. *Professional's Guide to Value Pricing, Sixth Edition*. Chicago: CCH Incorporated, 2005. To order: 1-800-248-3248, or visit CCH's Web site at <http://tax.cchgroup.com>.

Baker, Ronald J. and Paul Dunn. *The Firm of the Future: A Guide for Accountants, Lawyers, and Other Professional Services*. New Jersey: John Wiley & Sons, Inc., 2003. www.wiley.com

Baker, Ronald J. *Burying the Billable Hour*. London, United Kingdom: The Association of Chartered Certified Accountants, 2001. Visit the ACCA's Web site at: www.accaglobal.com/hom.

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RONALD J. BAKER

Profile and Contact Information

Mission: “To, once and for all, bury the billable hour in the accounting profession”

Ronald J. Baker started his accounting career in 1984 with KPMG Peat Marwick’s Private Business Advisory Services in San Francisco. Today, he is the founder of VeraSage Institute, a think tank dedicated to teaching Value Pricing to professionals around the world.

As a frequent speaker at CPA events and conferences, and a consultant to CPA firms on implementing Total Quality Service and Value Pricing, his work takes him around the world. He has been an instructor with the California CPA Education Foundation since 1995 and has authored nine courses for them: *How to Build a Successful Practice with Total Quality Service*; *The Shift From Hourly Billing to Value Pricing*; *Value Pricing Graduate Seminar*; *You Are What You Charge For: Success in Today’s Emerging Experience Economy (with Daniel Morris)*; *Alternatives to the Federal Income Tax*; *Trashing the Timesheet: A Declaration of Independence*; *Everyday Economics*; *The Firm of the Future*; and *Everyday Ethics: Doing Well by Doing Good*.

He is the author of the best-selling marketing book ever written specifically for the CPA profession, *Professional’s Guide to Value Pricing, Sixth Edition*, published by CCH, INC. The book has been ranked #1 on amazon.com in Australia and New Zealand. Also, *Burying the Billable Hour*, *Trashing the Timesheet*, and *You Are Your Customer List*, published by The Association of Chartered Certified Accountants in the United Kingdom. His most recent book, *The Firm of the Future: A Guide for Accountants, Lawyers, and Other Professional Services*, co-authored with Paul Dunn, was published in April 2003 by John Wiley & Sons, Inc. His latest book, *Pricing on Purpose: Creating and Capturing Value*, will be published in January 2006 by John Wiley & Sons, Inc.

Ron has toured the world, spreading his Value Pricing message to over 70,000 professionals. He has been appointed to the AICPA’s Group of One Hundred, a think tank of leaders to address the future of the profession, and named on Accounting Today’s 2001, 2002, 2003, 2004 and 2005 Top 100 Most Influential People in the profession. In 2004 he received the Award for Instructor Excellence from the California CPA Education Foundation.

He graduated in 1984 from San Francisco State University with a Bachelor of Science in accounting and a minor in economics. He is a graduate of Disney University, Cato University, and the University of Chicago Graduate School of Business course: *Pricing: Strategy and Tactics*. He is a member of the Professional Pricing Society and presently resides in Petaluma, California.

To order the Value Pricing book, visit Aspen's Web site at <http://tax.cchgroup.com>, or phone (800) 248-3248. To order *The Firm of the Future* and/or *Pricing on Purpose*, visit www.wiley.com.

Get the books, *Burying the Billable Hour*, *Trashing the Timesheet*, and *You Are Your Customer List*, published by The Association of Chartered Certified Accountants. These books are available for free (in pdf format) at: www.accaglobal.com/home. Type in “Burying the Billable Hour” and/or “Trashing the Timesheet” and/or “You Are Your Customer List” in the site’s ‘search’ function.

For more information on the California CPA Education Foundation Courses offered by VeraSage Institute, contact the California CPA Education Foundation at: (800) 922-5272 or visit its Web site at www.educationfoundation.org.

For more information on the dates and locations of the events, conferences and CPE seminars presented by VeraSage Institute, please visit our Web site at www.verasage.com.

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DECLARATION OF INDEPENDENCE

Action January 1, 2001.

The UNANIMOUS DECLARATION

of the FOUNDERS of

VeraSage Institute

of the ACCOUNTING PROFESSION ASSEMBLED,

WHEN in the Course of Economic Evidence, it becomes necessary for one group of Professionals to dissolve the Traditional Bands which have connected them with another, and to assume among the Powers of the Free Market, the separate and equal Station to which the Laws of Economics entitle them, a decent Respect to the Opinions of the Profession requires that they should declare the causes which impel them to the Separation.

We hold these Truths to be self-evident, that all Value is Subjective, the Customer is sole arbiter of the Value which we in the Profession create, and Price determines Costs, not the opposite—That to secure these Truths, Policies and Procedures are instituted among members of the Profession, and that whenever any Policy becomes destructive of these Principles, it is the Right of the Profession to alter or to abolish it, and to institute new Policies, laying its foundation on such Principles as to them shall seem most likely to effect their Professionalism, Dignity, Self-respect, and Happiness. Prudence, indeed, will dictate that Traditions long established should not be changed for light and transient Causes; and accordingly all Experience hath shewn, that the Professions are more disposed to suffer than to right themselves by abolishing the Policies and Procedures to which they are accustomed. But when a long Train of Pernicious Effects evinces a Design to reduce them under absolute Despotism, it is their Right, it is their Duty, to throw off such Traditions, and to provide new Procedures for their future Security. Such as been the patient Sufferance of these Founders; and such is now the Necessity which constrains them to alter the former anachronistic Systems of Firm Management. The History of the present Time Accounting is a History of repeated Injuries and Deleterious Effects, all having in direct Object the Establishment of an absolute Tyranny over this Profession. To prove this, let Facts be submitted to a Candid World.

Time Accounting is a descendant of the thoroughly discredited Marxian Labor Theory of Value, which has never adequately explained Value in a Free Market and has no jurisdiction to control the Pricing of Intellectual Capital of which the Profession is engaged in Creating.

Time Accounting has foisted onto the profession the implicit assertion that $\text{Time} \times \text{Rate} = \text{Value}$. This Equation is emphatically false, and is in need of being rejected as without Reason. The Notion that Time is Money is hereby directly rejected.

Time Accounting misaligns the interests of the Professional and the Customer whom it is pledged to Serve.

Time Accounting has focused the Profession solely on hours, not Value, thereby keeping the Professional Mired in Mediocrity at the expense of Entrepreneurial Excellence in the pursuit of opportunities.

Time Accounting places the voluntary transaction risk entirely on the Customer, in direct defiance of the Customer's interests the Profession has pledged to Serve.

Time Accounting fosters a production mentality, not an Entrepreneurial Spirit, thereby hindering the Profession in its attempt to innovate and contribute to the dynamism of the Free Market.

Time Accounting has called together Management and Partners at Places unusual, uncomfortable, and distant from the Professionals and Customers they are bound to Serve, for the sole Purpose of fatiguing them into Compliance with these arbitrary Measures.

Time Accounting creates a subsidy system whereby some Customers will pay for the learning curve of others, and the allocation of Value to any one Customer is completely arbitrary and capricious.

Time Accounting transmits no useful information, as it is definitely not a Critical Success Factor or a Key Performance Indicator for any member of the Profession, as defined by the Customer whom it is Pledged to Serve.

Time Accounting produces information that is Suspect and subject to inaccuracies and nonfeasance.

Time Accounting has made Owners dependent on Its will alone for the Tenure, Promotion, and the Amount of Payment of Professional Salaries rendered, irrespective of the Value they Create.

Time Accounting has erected a Multitude of new Ominous forms, and internal Bureaucracies, and sent hither Swarms of Officers, Nefarious Cost Accountants, and Superfluous

Activity Based Costing Neophytes to harass our People, and eat out their Substance, in fifteen minute increments, and sometimes less.

Time Accounting encourages the Hoarding of Hours with no attention paid to the internal efficacious utilization of a Firm's Resources.

Time Accounting has conspired with others to subject us to a Measurement foreign to the Laws of Economics, and unacknowledged by our Self Evident Truths; giving Its Assent to the importance of pretended consequences.

Time Accounting focuses on Efforts, not Results. Customers don't buy efforts, and they don't buy hours, making Time Accounting a measurement of precisely the wrong things.

Time Accounting has become a tool, enhanced by modern technology, already rife with circumstances of Cruelty and Perfidy, scarcely paralleled in any other industry, and totally unworthy of a Proud, and Intellectual Capital based, Profession.

Time Accounting penalizes Technological Advances, as the Profession continues to invest in more and efficient technology, in order to produce more work in less Time, thus lowering Revenue in a Time Accounting Pricing Paradigm.

Time Accounting's Hourly Rates are set by paying attention to competitors, who have no quantifiable interest in the success of any competing enterprise, thereby depriving a Firm's Owners from being compensated for the Value They create.

Time Accounting is a Cost-plus Pricing method that has been thoroughly discredited throughout its inglorious history, and is no longer relevant in a world where wealth is created by Free Minds in Free Markets. It is not the Customer's duty to provide the Profession with a Desirable Net Income; it is the duty of the Profession to Provide a Service that is so good, the Customer Dutifully Pays a Profit in Recognition of what was done for them. Profit is a Lagging Indicator, at best, and is a Result of a Job well done. In a Free Market, costs do not determine price, rather, price determines costs.

Time Accounting defies the imperative rule of private, Free Market Transactions; that is, the Price is known to the Customer before they purchase a product or service. The Profession defies this well known Law at its Own Peril.

Time Accounting does not Differentiate one firm in the Profession from another. Rather, it transforms the Crown Jewels of any one Firm—the human and social capital, experience, wisdom, professional judgement and intellect—into one completely arbitrary Hourly Rate, viewed as a Commodity by the Public.

Time Accounting imposes an arbitrary ceiling on the Income Potential of the Profession, as there is only a fixed quantity of hours in any given day, week, month, year or life. This ceiling has been imposed by Time Accounting, not the Public the Profession is Pledged to Serve.

Time Accounting diminishes the Quality of Life of the Professional, by viciously segregating His or Her Time into Billable and Non Billable segments. Rather than being a device for tracking the Inventory of Time, Time Accounting has become the Inventory.

In every stage of these Oppressions we have Petitioned, Pleaded and Exhorted the Profession's Leaders and Consultants for Redress in the most humble Terms: Our repeated Petitions have been answered only by repeated Injury and Ridicule. A Master, whose Character is thus marked by every act which may define a Tyrant, is unfit to be the arbitrary Ruler of a free Profession in a Free Market.

Nor have we been wanting in Attentions to Leaders and Consultants of the Profession around the world. We have warned them from Time to Time of Attempts by their anachronistic Practices to extend an unwarrantable Jurisdiction over us. We have reminded them of the Circumstances of our Emigration and Conception of a new Pricing Paradigm and Measurement System. We have appealed to their native Justice and Magnanimity, and we have conjured them by the Ties of our common Knowledge and Interests to disavow these Usurpations, which, would inevitably interrupt our Connections and Correspondence and hinder the Future of our Profession. They too have been deaf to the Voice of Justice, Economics, and of Consanguinity. We must, therefore, acquiesce in the Necessity, which denounces our Separation, and hold them, as we hold the rest of the Profession, wrong in the Marketplace of Ideas.

We, therefore, the Representatives of the VeraSage Institute, in GENERAL CONGRESS, Assembled, appealing to the Supreme Judge of the World for the Rectitude of our Intentions, do, in the Name, and by Authority of the good People of this Institute, solemnly Publish and Declare, That this Institute is, and of Right ought to be, FREE AND INDEPENDENT FROM THE TYRANNY OF TIME; that it is absolved from all Allegiance to the Past Traditions as they relate to Time Accounting, and that all Measurements and Procedures between them are and ought to be totally dissolved; and that as FREE AND INDEPENDENT PROFESSIONALS, they have full Power to Price on Purpose and for Value, levy Ideas in the Free Market, contract Alliances, establish Commerce, engage in Capitalist Acts between Consenting Adults, and to do all other Acts and Thoughts which INDEPENDENT PROFESSIONALS may of right do. And for the support of this Declaration, with a firm Reliance on the Protection of divine Providence, we mutually pledge to each other our Lives, our Fortunes, our Energies, and our sacred Honor.

Signed by Order and in BEHALF of VeraSage Institute,

RONALD J. BAKER, California

JUSTIN H. BARNETT, California

DANIEL D. MORRIS, California

PAUL O'BYRNE, Britain

PAUL KENNEDY, Britain

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