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## A DUE DILIGENCE TOOL FOR SAVINGS AND CREDIT COOPERATIVES (SACCOs)



**July 2006**

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# Rural SPEED

Rural Savings Promotion & Enhancement of Enterprise Development

## A DUE DILIGENCE TOOL FOR SACCOS

The author's views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.

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## BACKGROUND

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### Introduction

This manual is a tool for a quick and focused assessment of savings and credit cooperative organizations (SACCOs). It is meant to be used as a handbook for assessing the performance and institutional health of SACCOs by officers of various stakeholders such as:

- Development/ working partner organizations
- Banks in their screening of SACCOs for a relationship
- Apexes involved with SACCOs
- Government and its agencies
- Institutional rating agencies
- The SACCOs themselves (management and board)
- Consultants and other technical assistance providers.

The tool should be helpful in assessing the institutions in a timely way (one day per SACCO) in an environment of weak regulations of the financial sector and accounting profession, such as is the case in Uganda. The use of this tool is not intended to replace statutory or internal audits of the institutions or their regulation by the respective authorities. It is only intended to help the assessor carry out due diligence in a fairly systematic, comprehensive but concise way. The tool is further not meant to replace the detailed appraisal of any SACCO, which could take a week or several days for each SACCO

### How to Use the Tool

The tool, presented in section 4 of this manual, is divided into three parts, which should be used as follows:

*The Qualifiers* – These are five vital aspects that an institution should have in place, as a minimum qualification to be considered a SACCO. As you start assessing the institution, you need to check that the institution qualifies on the basis of all the five attributes. If it does not qualify on any of the attributes, drop the application or proposal because you are dealing with a time waster that will not easily turn into a sensible working partner.

*The Raters* – These are attributes on which a SACCO that passes the qualifier screening stage should be rated. They should be scored and aggregated to form the basis on which the institutional health and performance should be determined. Thus the raters rank the institutions that pass the *Qualifier* test. The following general guideline should be followed:

- Call the SACCO to be visited and inform them of the assessment visit at least 2 days in advance, clarifying the documents they have to get ready
- During the visit, do a quick assessment on the attributes in the tool, through interviews and record examination
- Point-score each attribute according to the your fairest judgment
- Turn the total score into a percentage

### Who Should Use the Tool

Users of this tool need to be financially literate (above average knowledge of financial accounting, budgeting, internal audit and control procedures etc). They also need to have experience in the micro-finance or banking sector, especially in the areas of credit operations. Persons who do not have these attributes may use this tool, but might need significant training and might take far more than one day assessing one SACCO using the tool.

## THE TOOL

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### Qualifiers

For the purpose of this tool, the qualifiers are the minimum or basic conditions that have to be met for a SACCO to be considered eligible to be assessed. If the answer to any of these questions is “No”, the SACCO should be immediately dropped and no further assessment of it should be carried out. The only possible answers to each of the questions in this Qualifier section of the tool are “Yes” or “No”. Answers like “almost”, “quite well”, “significantly”, “to a larger extent” etc; should not be used here.

Does the SACCO have (please tick Yes or No):

	Yes	No
1. A Valid registration certificate from the Department for Cooperatives? <sup>1</sup>		
2. Identifiable place of business where they carry out their activities?		
3. At least one full time staff?		
4. Financial services as its core business?		
5. Active loans and savings operations?		
6. An active Board/ Committee Directors?		

### *Decision at this stage:*

Did you tick Yes for all the above?

-----Yes (please continue with the assessment)

----- No (please drop the application and stop further assessment.)

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<sup>1</sup> An institution that is, at the time of the assessment, changing its form from NGO or any other into a cooperative will for this purpose be deemed to be registered as a cooperative society

## RATERS

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On each of the following attributes (*save for the six aspects relating to financial transparency*), please score 0 to 2, with 0 representing the lowest score (poor) and 2 representing the highest score (good) for each. The notches are in increments of “0.5”. As an example, the first item under Governance Effectiveness & Strategy herein would be score as follows:

- 0 if control lies completely beyond the membership, board and management*
- 0.5 If the board has minimal control but the SACCO is heavily controlled externally*
- 1.0 If management, the board and members have control over some strategic issues and others are controlled externally – control is more-or-less 50:50 between external and internal*
- 1.5 If the board has most of the strategic control but the SACCO is minimally controlled externally*
- 2 if all aspects of the SACCO are fully controlled by management, board and members.*

For the six aspects relating to financial transparency, adjust the above scoring scheme to 0, 2, 4 and 6

On the basis of the above two-tiered scoring scheme, the maximum scores add to 100 and thus the actual aggregate score of each SACCO assessed will be a percentage.

### Governance Effectiveness and Strategy

Assessment Questions	Max Score	Score	Remarks
<i>Does The Sacco Have...</i>			
1.1 Full control of its affairs resting on the membership, board and management, with no external superior authority?	2		
1.2 An able board, with the right skills and dedication to move it forward?	2		
1.3 A clear governance structure?	2		
1.4 Well laid out and followed responsibility and accountability practices for all organs & persons?	2		
1.5 A clear ownership structure?	2		
1.6 A focus on the savings and credit business?	2		
1.7 A strategic/ business plan, supporting the mission that is followed?	2		
1.8 Beneficial linkages with external Partners	2		
1.9 Its by-laws, constitution, or such other internal governance guidance documents?	2		

**Assessment Guidelines: Governance**

Assessment Area	Means of Verification
1.1	Check for evidence: records of major decisions taken without reference to outsiders. Probe management and board to ascertain if there is any external control.
1.2	List of board members & their qualifications/ experience; board minutes showing regularity of meetings. Check that least some members have high school education or higher.
1.3	Check that there is an organisational structure with the board reporting to the AGM and management reporting to the board; no parallel organ with equal powers as the board, and that there is an audit committee, operations/ loans committee and other necessary committees in place. Check that the board might not have implied power concentration by virtue of blood-based, faith-based or other relationships that could compromise independence of board members.
1.4	Check for i) existence of operations/ loan committee, supervision or similar committees ii) a written statement of responsibilities of management, committees, board, AGM. Sample Mgt reports to the board and board reports to the AGM, and evidence of follow-ups for total accountability where applicable. Check whether the loans to directors as a proportion of total loans are tracked, and if so, that it does not exceed say 5% of the total loan portfolio. And that these loans are not in arrears.
1.5	Check that the members own, and know that the institution is theirs; they have share certificates entitling them to vote in the AGM, and that there is an up-to-date share holders' register.
1.6	Interview the manager or other key staff on the proportion of their time spent on the finance (savings and loans) business; ascertain that there is no other main business of the SACCO apart from financial services.
1.7	Examine a copy of the plan and enquire on the activities therein so far accomplished
1.8	Check that the SACCO is a member of AMFIU, UCA, AMFIA or such other <i>sound practice</i> apex/ network organization.
1.9	Evidence: Physical presence of these documents and a quick check that they are complied with

**Management Effectiveness**

2.1 Management staff with suitable qualifications and experience to manage the SACCO?	<b>2</b>		
2.2 A balance of focus between profit & development in the SACCO operations?	<b>2</b>		
2.3 Observable business growth?	<b>2</b>		

**Assessment Guidelines: Management Effectiveness**

2.1	Check that the manager has at least a diploma in business or coop plus 5 yrs experience. Accountant, diploma in accounting or business plus 2 yrs experience
2.2	Check for i) continual efforts at member development and benefits (improving members' economic welfare and institutional profitability) – the plans and activities of the SACCO include member training.
2.3	i) Percentage and absolute growth in the number of members in a year. 30% or more is good, 15% to 29% average, lower than 15% marginal ii) Percentage and absolute growth in the loan portfolio in a year - % guidelines as above iii) Percentage and absolute growth in the volume of savings in a year –% guidelines as above.

**Product Development and Delivery**

3.1 Variable and adaptable products?	2		
3.2 Documented operational policies and procedures	2		
3.3 Efficiency in service delivery mechanisms?	2		

**Assessment Guidelines: Product Development and Delivery**

3.1	Check for evidence of different loan and savings products within the SACCO, with varying loan periods, interest and other loan/ savings features
3.2	Check for existence of policies and procedures manuals for loans and savings, delinquency management, portfolio reporting etc.
3.3	Lead time between loan application and disbursement (5 quick samples); ease of access to savings by the savers. Up to 2 week good; up to 3 weeks fair; over three week poor.

**Asset and Liability Management**

4.1 Effective delinquency management?	2		
4.2 Safety of clients' deposits?	2		
4.3 Moderate gearing?	2		
4.4 Prudence in intermediation	2		
4.5 Proper assessment of borrowers and anti- concentration	2		
4.6 Clear documentation of loans, savings, other assets and liabilities	2		

**Assessment Guidelines: Asset and Liability Management**

4.1	i) evidence from records that loans are aged and PAR or equivalent portfolio quality measure is consistently tracked ii) PAR (30 days) of 5% or less for a full year, running – good; PAR >5%<10%, fair; PAR >10%, poor
4.2	i) Check for the use of safe cash custody (strong room, strong safes etc); safety of tills, savings deposits and withdrawals promptly recorded and passbooks updated instantly with each transaction ii) Check for insurance cover of cash at premises and in transit
4.3	Overall debt/equity ratio not exceeding 2:1, good. D/E > 3:1 up to 4:1 fair; over 4:1; poor
4.4	i) Savings cash cover(total liquid assets/average savings volume) 50% or higher, good >30 but <50%, fair; lower than 30%, poor ii) Quick Ratio (average liquid assets/average current liabilities) guidelines as for cash-savings cover above.
4.5	Documented loan appraisal template or questionnaire, used in practice
4.6	Well organized and up-to-date Loans ledger, Savings Ledger, Shareholders' register, Fixed asset register, Loans payable accounts – and all the related contract and internal appraisal documents

**Accounting and Financial Management**

5.1 A proper book-keeping system?	2		
5.2 A suitable accounting system?	2		
5.3 Proper financial management principles?	2		
5.4 Documented accounting & financial management manual	2		

**Assessment Guidelines: Accounting and Financial Management**

5.1	Evidence: i) use of a full double entry system ii) active cash book, general ledger, assets register, loans & savings ledgers, or automated accounting computer package iii) previous two days' postings into the accounts(quick glance)
5.2	i)Periodic (monthly or quarterly) income statement and balance sheet produced regularly; ii) date of the latest BS and income statement; iii) annual audited accounts produced (audits by professionals rather than Dept for Coops)
5.3	i) full long term and monthly budgets ii) evidence of budgetary control in all expenditure ii) variance analysis embedded in management accounts
5.4	Evidence: Physical presence of the manual and a quick check to ascertain that it is followed.

**Financial Sustainability**

6.1 Measures of sustainability consistently monitored?	2		
6.2 Good levels of operational and financial sustainability?	2		
6.3 Profitability and sustainability embedded in business plans	2		

**Assessment Guidelines: Financial Sustainability**

6.1	i) Operational sustainability tracked and documented regularly ii) Financial sustainability tracked and documented regularly iii) A loan loss reserve at least equivalent to the PAR (30 days and over) is taken into account in calculating both OSS and FSS
6.2	i) OSS at least 100%= fair 120%-150% good, over 150%= excellent ii) FSS at least 90%=fair100%,- 130% good, over 130 excellent iii) A loan loss reserve at least equivalent to the PAR (30 days and over) is taken into account in calculating both OSS and FSS (as in 6.1 above)
6.3	OSS, FSS or net operating profits clearly targeted in the business plan, and the levels monitored consistently by management

**Rural Outreach**

7.1 Rural operations	2		
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**Assessment Guidelines: Rural Outreach**

7.1	Percentage of members/clients outside a 10 km radius of Kampala, Jinja, Entebbe, Mbale and Mbarara: Over 70% good, 50% to 69% fair, under 50% marginal
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**Prudence and Transparency in Product Pricing**

8.1 All direct and indirect overhead costs taken into account in determining interest rates and fees	<b>2</b>		
8.2 Market rates charged by competitors taken into account in determining interest rates and fees	<b>2</b>		
8.3 All interest rates and charges displayed and fully disclosed to the client before they decide to borrow	<b>2</b>		

**Assessment Guidelines: Prudence and Transparency in Product Pricing**

8.1	Evidence: operating net profits realised; costing statement for product pricing available
8.2	i) Management and staff knows what competitors charge, and keeps track ii) SACCO’s interest rate and charges fairly comparable with those of competitors or peers in the market
8.3	Evidence: i) visible display of charges in the banking hall; in brochures or flyers, available to each prospective and existing member/ client before they make up their minds to join or transact.

**Financial Transparency**

9.1 General Ledger	<b>6</b>		
9.2 Customer savings	<b>6</b>		
9.3 Loan/ Credit Ledger	<b>6</b>		
9.4 Income	<b>6</b>		
9.5 Expenditure	<b>6</b>		
9.6 Loan loss provisions	<b>6</b>		
<b>TOTAL SCORE</b>	<b>100</b>		

**Assessment Guidelines: Financial Transparency**

Under each accounting area, choose one or two aspects to verify, and then proceed as explained in the “method” column below.

<b>Accounting Area</b>	<b>Items To Check</b>	<b>Method</b>
9.1 General Ledger	1.Fixed asset purchase records  2.Loans payable account  3.Share capital/ equity accounts  4.Bank account balances/	Ask for the most recent fixed asset acquisition; check that the source documents are in place, posting to the ledger was properly done (or to the asset register)  Pick one or two loans payable; check that the initial loan amount and the latest repayment installment are both properly posted  Check the share holder’ register and compare it with the share capital account in the ledger.  Check on the date and accuracy of the any two bank

	records	reconciliation statements.
9.2 Customer Savings	<p>1. Consistency of the customer's savings pass book and respective ledger card.</p> <p>2. Interest payable on savings</p> <p>3. Savings withdrawal records</p> <p>4. Savings deposit records.</p>	<p>Get a customer at random and ask for his/her pass book; do a spot-check of the balance therein against that customers' ledger card.</p> <p>Check that interest is calculated and posted to the savers' accounts as per policy. Pick any one savings account and check the accuracy of interest calculation.</p> <p>At random, pick two savings accounts and for each trace a withdrawal transaction back to the source documents</p> <p>At random, pick two savings accounts and for each, trace a deposit transaction back to the source documents</p>
9.3 Loan/ Credit Ledger	<p>1. Consistency of the customer's loan pass book and respective ledger card.</p> <p>2. Interest receivable on loans</p> <p>3. Interest payable on loans</p> <p>4. Loans ledger records.</p>	<p>Get a customer at random and ask for his/her loan pass book; do a spot-check of the balance therein against that customers' ledger card.</p> <p>Check that interest is calculated and posted to income and appropriate asset accounts as per policy.</p> <p>Check that interest is calculated and posted to the appropriate liability or expense accounts as per policy.</p> <p>Pick one loan debit or credit entry and follow it backwards to the source documents, to ascertain the accuracy of posting</p>
9.4 Income	<p>1. Accuracy of reported interest income</p> <p>2. Prudence in income recognition</p> <p>3. Accuracy in reporting of non-interest income</p>	<p>Check the interest receivable account for the previous period. Compare the balance as at the last date of the period with the amount of interest income posted to the income statement for that period.</p> <p>Check, from the aged loan portfolio and that loan loss provisions have been done as per policy, and that the figure has been appropriately charged to the P/L</p> <p>Pick any non-interest income in the P and L, and check the consistency of the account balance at the end of the last period with the relevant line item figure reported in the income statement for that period</p>
9.5 Expenditure	Accuracy of expenditure reported in the income statement. Could choose any	Take three expense items, e.g. rent, salaries and communication, and note the closing account balances for the last reporting period. Compare the

	<p>of the following:</p> <ul style="list-style-type: none"> <li>-Rent</li> <li>-Electricity</li> <li>-Salaries</li> <li>-Communication</li> <li>-Stationery/ supplies</li> <li>-Fuel and motor-vehicle running expenses</li> <li>-Security</li> </ul>	<p>balance as at the last date of the period with the amount of interest income posted to the income statement for that period.</p>
9.6 Loan loss provisions	<p>1.Accuracy of treatment of loan loss provision in the P and L</p> <p>2.Accuracy of calculation of provisions</p>	<p>Check the previous period's loan loss provisions, and ascertain that the figure has gone to reduce the gross loan amount and the profit.</p> <p>Check that the provision policy is used in making provisions, and that loans are properly aged and provided for.</p>

**SUMMARY OF SCORES BY ASSESSMENT AREA**

<b>Assessment Area</b>	<b>Max Score</b>	<i>Score</i>
Governance Effectiveness and Strategy	18	
Management Effectiveness	6	
Product Development and Delivery	6	
Asset and Liability Management	12	
Accounting and Financial Management	8	
Financial Sustainability	6	
Outreach	2	
Prudence and transparency in product pricing	6	
Financial Transparency	36	
<b>TOTAL</b>	<b>100</b>	

**Score Interpretation Guidelines**

<b>Score</b>	<b>Interpretation</b>
Over 80%	A promising institution with a nearly all the requisite structures and systems in place thus there is potential for high performance in most areas
70-79	A fairly promising institution with most of the requisite structures and systems in place, though in need of improvement. Performance and impact could be greatly enhanced through focused and well targeted technical and/ or financial assistance
60-69%	Average institutional health and performance. Careful discretion needs to be exercised in determining whether or not the institution is suitable
50-59	Poor health and performance. Deep rooted weaknesses are likely to hinder any potential impact of BDS, technical or financial assistance.
Below 50%	Just a non-starter; do not enter the relationship.

## APPENDIX I QUALITATIVE NON-RATERS

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The following options, though not used in the rating within the tool, are optional considerations for assessors who would like to delve deeper than the guidelines of the one day tool. They should be used as additional rather than mainstream determinants in the decision to work with a SACCO. Ordinarily, the assessor may not need to use them in the determination of SACCOs to work with, but may use them to determine areas of weakness that need to be addressed for the SACCOs that qualify on the basis of the rating criteria under 4.2 above.

- ***Governance effectiveness & Strategic focus of the SACCO***
  - Adequate separation of duties among organs
  - An effective board succession policy and practice
  - Board manual used as a reference point.
  - Appropriate skill mix at the board
  - Independence of individual directors
  - Member interest in governance issues
- ***Strategic focus***
  - Extent to which the SACCOs Vision & Mission are shared among its members, board, leaders, management and staff
  - Work plans stemming from SACCO's business strategy or plan
- ***Management effectiveness***
  - Business orientation
  - Transparency & honesty
  - Staff development & management succession
  - Continual aptitude improvement / human resource development
  - Planning & monitoring effectiveness.
- ***Product Development and delivery***
  - Continual innovations
  - Suitable delivery mechanisms
  - Client participation in product development
- ***Asset-and- Liability Management***
  - Clear borrower records
  - Budgetary controls
  - Clear loan tracking & recovery system
  - Minimum investments in fixed assets
  - Liquidity and cash management
  - Cost – effectiveness
  - Accessibility by the client
  - Proper recording and accounting
  - Minimize costs of funding
  - Timely servicing
- ***Customer care*** – the tool will address the following areas:
  - Value addition
  - Loan sizes
  - Processes
  - Customer focused culture
  - Staff training and sensitization in customer care

- **Financial sustainability**
  - Structures that support sustainability
  - Invest in scale & efficiency
  - Preference for independence
- **Outreach**
  - Double pronged mission (profit and development)
  - Mix of clients (poor and not-so-poor)
  - Gender equity in membership (exp numbers of women served compared to men)

## **APPENDIX II WORK METHODOLOGY FOR THE ASSESSMENT**

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### **Work Flow**

The work plan for the one-day assessment needs to follow a fairly defined and systematic sequence summarized below:

- Call the manager of the SACCO to be visited and inform him/her of the assessment visit at least 2 days in advance, clarifying the documents they have to get ready, the stakeholder that the assessor would like to meet and the exact time of the start and end of the meetings, as well as the venue of the meeting. If possible, send the Usage and Confidentiality Agreement in advance
- On arrival at the SACCO, execute the confidentiality agreement
- During the visit, do a quick assessment on the attributes in the tool, through interviews and record examination. In doing this, follow the guidelines in the footnotes of the tool (notes that will guide the tool user on details of point-scoring on each aspect)
- Use your knowledge and experience to cross-check and verify vital information as need arises
- Point-score each attribute according to the your fairest judgment, and in line with the scoring scheme in the tool
- Turn the total score into a percentage
- Decide on the suitability (health and performance) of the institution according to the interpretation guideline in 2.1 above.
- Make brief notes and memoir that you consider vital to support your assessment and conclusion
- Write a brief report embracing all the above and make the necessary recommendation(s). Ensure that the following disclaimer text appears in the introduction of the report:

*This report is based on a one-day, limited due diligence and is in no way a substitute for external audit, internal audit or extended/in-depth due diligence in circumstances where any of these would be required*

### **Persons to Meet at the SACCO**

Different SACCOS have different titles for people holding similar functions. Thus this recommendation focuses on the function rather than the title of the office. For each one-day assessment, the assessor will need to meet the following at a minimum:

- i - Overall SACCO Manager
- ii -
- iii - Finance Manager (accountant, book-keeper, accounts clerk etc as the case might be)
- iv - Chair or member of the audit committee
- v - Board Chair or another board member
- vi - Operations manager, supervisor or credit officer
- vii - One ordinary member (non-board, non-staff member)/customer of the SACCO. This person will be chosen at random during the business day of the SACCO, to avoid management choosing and pre-briefing him/her

**APPENDIX III INFORMATION USAGE AND CONFIDENTIALITY AGREEMENT**

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This agreement (herein after called the “Agreement”) is made on the ..... day of..... (Month), ..... (Year) between ..... Savings and Credit Society (hereafter called the SACCO) and ..... (Hereafter called the Assessor).

Whereas the Assessor has been requested by to carry out a due diligence on the SACCO and whereas the SACCO has agreed to furnish the Assessor with all the information on its activities, status and performance that the Assessor might reasonably require to carry out the said due diligence, it is now agreed by the Assessor and the SACCO as follows:

SACCO’s Responsibilities

1. *Provision of complete information:* the SACCO hereby commits itself that it will give full and complete information on all areas and aspects of assessment that the assessor wants to address.
2. *Provision of accurate information:* the SACCO hereby commits itself that all the information so disclosed or availed to the Assessor will be true and accurate, and warrants that all the information given to the Assessor will be authentic and verified in-house before it is given to the Assessor.
3. *Ensuring independence of other interviewees:* The SACCO management hereby commits itself to restrain from influencing other respondents involved in this due diligence process, and warrants that no response from any non-managers of the SACCO will have been influenced directly or indirectly by management.

Assessor’s Responsibilities

1. *Duty of care:* the Assessor hereby undertakes and commits to keep all the information received from the SACCO with strict and utmost confidence so that no third party will access such information
2. *Non-disclosure to third parties:* the Assessor shall not, under any circumstances, disclose any information that has come into his/ her possession by virtue of the activities pursuant to this agreement. No disclosure, intentionally or inadvertently, shall be done by the Assessor without prior written permission of the SACCO.
3. *Restriction in the use of information availed to the Assessor by the SACCO:* the Assessor shall use the information obtained from the SACCO pursuant to this agreement solely for the stated purposes of the due diligence and for no other reason.

**Signed by:**

Name: \_\_\_\_\_ Position: \_\_\_\_\_

Signature: \_\_\_\_\_ Date: \_\_\_\_\_

Organization name and address:

\_\_\_\_\_  
Name of Assessor:

\_\_\_\_\_  
Signature: \_\_\_\_\_ Date: \_\_\_\_\_