

Shariah Equities Screening Methodology (Based on AAOIFI Shariah Standard No. 21)

At **Shariah Equities**, we uphold the Shariah standards set forth by the **Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)**. AAOIFI is an international body that establishes standards for Islamic finance, including guidelines for determining Shariah-compliant shares and financial instruments. These standards are rigorously followed on our platform to ensure compliance with Islamic principles.

How Do We Determine Shariah Compliance?

To evaluate whether a stock is Shariah-compliant, we apply the AAOIFI Shariah Standard No. 21, which governs financial papers, shares, and bonds. This standard provides a two-fold approach: screening business activities and financial ratios. The screening process is supported by our team of Shariah scholars and experts in Islamic finance.

Step 1: Business Activities Screen

AAOIFI Prohibition of Haram Activities:

AAOIFI prohibits investment in companies involved in activities that contradict Islamic law. These include:

Interest-Based Activities: Companies involved in conventional banking, insurance, or other interest-based financial services are non-compliant.

Alcohol and Pork: Companies deriving income from the production, distribution, or sale of alcohol or pork products are prohibited.

Gambling and Speculation: Companies engaged in gambling, betting, or speculative activities are not Shariah-compliant.

Immoral Activities: This includes companies involved in pornography, adult entertainment, or unethical media practices.

Other Prohibited Sectors: AAOIFI also excludes companies producing or trading in tobacco, weapons, and impermissible entertainment activities.

Revenue Tolerance Limit:

AAOIFI allows a tolerance level for companies whose core business is permissible but earn a minor portion of their revenue from non-compliant activities. A company may generate **no more than 5% of its total revenue** from non-compliant activities (e.g., selling alcohol in a supermarket). If the revenue exceeds this threshold, the company is marked as non-compliant.

Step 2: Financial Ratio Screen

AAOIFI's Financial Guidelines:

Once a company passes the business activities screen, we apply the financial ratio screens outlined by AAOIFI. These ratios ensure that a company's financial practices align with Shariah law.

The following three financial ratios are applied:

1. Debt to Market Cap Ratio:

A company's total interest-bearing debt should not exceed **30% of its market capitalization**. This ensures that the company remains financially stable and limits exposure to interest-bearing loans.

Calculation:

Interest-Bearing Debt Ratio = Total Debt/Market Cap

2. Interest-Bearing Securities:

- A company's investments in interest-bearing securities, such as bonds or other debt instruments that generate interest, should not exceed **30% of its market capitalization**.

Calculation:

Interest-Bearing Securities Ratio = Cash + Cash Equivalents + Deposits\Market Cap

3. Non-Permissible Income Ratio:

The percentage of income generated from non-permissible activities, such as interest or other impermissible sources, should not exceed **5% of the company's total income**.

Calculation:

Non-Permissible Income Ratio = Non-Permissible Income\Total Income

Basis for the 30% and 5% Thresholds

The basis for these thresholds is derived from the AAOIFI standards and Islamic jurisprudence.

The 30% threshold for financial screening is derived from Islamic teachings. The basis of this threshold comes from a hadith narrated by Saad Bin Abi Waqas:

"I became seriously ill at Mecca, and the Prophet (صلى الله عليه وسلم) came to visit me. I said, 'O Allah's Messenger (صلى الله عليه وسلم)! I shall leave behind me a good fortune, but my heir is my only daughter; shall I bequeath two-thirds of my property to be spent in charity and leave one-third (for my heir)?' He said, 'No.' I said, 'Shall I bequeath half and leave half?' He said, 'No.' I said, 'Shall I bequeath one-third and leave two-thirds?' He said, 'One-third, and one-third is much.'" (Al-Bukhari, *hadith #5659*)

Islamic scholars have interpreted this hadith to establish that one-third is a significant proportion when determining permissible and impermissible limits in Shariah rulings. Consequently, AAOIFI uses this principle to define the 30% thresholds for interest-bearing debt and securities in their financial screening process.

Additionally, the 5% tolerance for non-compliant revenue aligns with the leniency that Islamic scholars provide in cases where companies have minimal involvement in non-permissible activities.

Conclusion

By following AAOIFI's Shariah Standard No. 21, **Shariah Equities** provides users with a transparent and accurate screening process. We aim to make it easier for investors to identify Shariah-compliant investment opportunities while upholding the integrity of Islamic finance principles.

For any queries related to our screening process, feel free to contact us:

Email: info@shariahequities.in

Phone: +91 9000706786

This methodology ensures that every listed company on our platform meets AAOIFI standards, offering clarity and peace of mind to Shariah-conscious investors.