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## INSOLVENCY TEST AS EVIDENCE IN SHARIA BANKRUPTCY CASES

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### Abstract

The Indonesian bankruptcy law does not make insolvency a primary requirement for bankruptcy decision-making. Bankruptcy is based on the fulfillment of cumulative elements stipulated in Article 2 of the Bankruptcy and Suspension of Debt Payment Obligations Law (UUK-PKPU), even if the debtor is still solvent. This contrasts with Sharia bankruptcy, which places insolvency as a crucial substance in bankruptcy. This research is normative legal research with a substantive analysis approach. The results show that applying an insolvency test as evidence in Sharia bankruptcy cases is urgent and becomes a primary condition for upholding the ethics and fundamental principles of Sharia economic dispute resolution. In Islamic economics, bankruptcy (taflis) is the last resort (ultimum remedy) to resolve all disputes.

**Keywords:** *Bankruptcy, Insolvency, Test Insolvency*

### A. INTRODUCTION

Bankruptcy is when a financially troubled debtor is declared bankrupt by the Commercial Court. Hikmahanto Juwana argues that recent changes to the Bankruptcy Law favor creditors. The law now requires a debtor to have at least two debts, with one overdue, to be declared bankrupt. This amendment doesn't need the debtor to be insolvent, which goes against the universal Bankruptcy Law

philosophy that aims to address the issues of both debtors and creditors when a debtor can't pay their debts. The term insolvency in the English dictionary means the inability to pay debts.<sup>1</sup> According to Fridmen, Jack P. in Munir Fuady, insolvency is "the inability to fulfill financial obligations at maturity (maturity), such as in business, or an excess of liabilities compared to assets within a certain time."<sup>2</sup>

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<sup>1</sup> Peter Salim, *Slim's Ninth Collegiate English – Indonesian Dictionary*, (Jakarta: Modern English Press, 2000), p. 754.

<sup>2</sup> Munir Fuady, *Hukum Pailit dalam Teori dan Praktek*, (Bandung: Citra Aditya Bakti, 1999), p. 135

The implementation of bankruptcy decisions by the Commercial Court is often debated due to concerns that it undermines the principle of business continuity, which is central to the Bankruptcy Law. The core issue lies in differing interpretations of the law's provisions, particularly the elements of bankruptcy in Article 2 and the requirement for simple evidence in Article 8 paragraph (4) of the Bankruptcy Law.

In bankruptcy law, the concept of debt is often seen as the *raison d'être*<sup>3</sup> For bankruptcy which then leads to claims of collection or right to payment<sup>4</sup>. An important aspect of bankruptcy law is the degree of insolvency, which requires clear testing parameters. Before declaring bankruptcy, a debtor should undergo a cash flow test. In Russia, for example, the process includes stages like supervision, financial rehabilitation, external administration, liquidation, and amicable arrangement before declaring bankruptcy.<sup>5</sup> So that the justification for insolvency has a strong evidence base<sup>6</sup>.

The issue of insolvency (insolvency) is an important matter in bankruptcy law because a court can only issue a bankruptcy decision if the debtor is in a state of insolvency.

According to Paulus Aluk Fajar Dwi Santo<sup>7</sup> The "insolvency test" should be considered in bankruptcy proceedings for two reasons. First, there have been unusual bankruptcy decisions by commercial courts, such as those involving Manulife, Prudential, and Telkomsel, which are not truly bankrupt since their assets far exceed their debts. To determine a debtor's solvency, one should evaluate if they can pay due debts and if their assets substantially surpass their liabilities. If both conditions are met, the debtor is considered solvent. The broad definition of debt in Law Number 37 of 2004 requires complex evidence, complicating bankruptcy approvals by commercial court judges. Provisions like action Paulina, proof of fictitious creditors, and negligence lawsuits against directors add to this complexity. The "insolvency test" is a suitable alternative for determining bankruptcy. In Islamic economic law, Ibn Rushd states that a person can be declared bankrupt if their debt exceeds their assets, meaning they only have minimal amounts for minor expenses.

Jurisprudence experts state that, in Islam, bankruptcy occurs when a person's debt exceeds their assets. Ibn Rushd in *Bidayatul Mujtahid* explains that *iflas* (bankruptcy) happens if a

<sup>3</sup> M. Hadi Shubhan, 2008. *Hukum Kepailitan: Prinsip, Norma, dan Praktik di Peradilan*, Jakarta: Kencana, p. 34-35.

<sup>4</sup> Sutan Remy Sjahdeini, 2002. *Hukum Kepailitan: Memahami Faillissementsverordening Juncto Undang-Undang Nomor 4 Tahun 1998*. Jakarta: Pustaka Utama Grafiti, p. 105

<sup>5</sup> Hogan Lovells, 2011. *Russian Law Aspects of Insolvency*. New York: MOSLIBO

<sup>6</sup> Bambang Pratama, *Kepailitan Dalam Putusan Hakim Ditinjau Dari Perspektif*

*Hukum Formil dan Materiil (Kajian Putusan Nomor 02/Pailit/2012/PN.SMG dan Nomor 522K/Pdt.Sus/2012)*, Jurnal Komisi Yudisial, Jurnal Yudisial Vol. 7 No. 2 August 2014, p. 159

<sup>7</sup> <https://business-law.binus.ac.id/2014/12/21/alternatif-insolvency-test-sebagai-model-pembuktian-proses-kepailitan/>, accessed on monday, 2 August 2020

person's debt surpasses their assets or if they have no property at all. Scholars agree that a judge can declare someone bankrupt if they cannot pay their debts. Any remaining assets should be used to settle these debts according to Islamic law.<sup>8</sup>

Ibn Rushd emphasized that a debtor's financial condition is crucial in determining bankruptcy. A debtor is considered insolvent if their debt exceeds their assets. Before declaring bankruptcy, a thorough examination of the debtor's situation is essential. Scholars, except for Malikiyah, require two conditions for declaring bankruptcy: insolvency and a petition from creditors to the judge. Ibn Rushd and the majority of scholars prioritize insolvency before declaring bankruptcy. This contrasts with Indonesian law, where insolvency is not a prerequisite and occurs after the bankruptcy decision according to Law No. 37 of 2004. In Islamic economics, insolvency must be detected before declaring bankruptcy. Based on the background, the authors are interested in exploring why Indonesian bankruptcy law does not incorporate the concept of insolvency in bankruptcy decisions, examining the role of insolvency in Sharia bankruptcy law, and determining the appropriate model and framework for implementing the insolvency test in Sharia bankruptcy cases.

## **B. RESEARCH METHODS**

The research on the insolvency test as an instrument for proving bankruptcy under Sharia contracts is a type of normative legal research. Normative legal research focuses on legal rules, norms, and principles.

According to Soejono Soekonto, this research involves exploring legal principles, systematics, synchronization of regulations, comparative law, and legal history. The approach used is conceptual, aiming to build comprehensive arguments about legal principles in specific cases by refining or discovering concepts. The method employed is Substantive Analysis, which involves describing and analyzing legal sources to develop a framework and model for implementing the insolvency test as evidence in Sharia-based bankruptcy cases.

The research utilizes three types of legal materials: primary, secondary, and tertiary. Primary legal materials include regulations related to the research, such as Law No. 37 of 2004 on Bankruptcy and Debt Payment Postponement, the *Failissements-Verordening*, and *Kitab Bidayatul Mujtahid ibn Rusyd*. Secondary legal materials encompass all non-official legal publications, such as books, dissertations, journals, papers, and other scientific writings. Tertiary legal materials are supporting resources that provide guidance and explanations for primary and secondary materials, such as dictionaries and encyclopedias.

## **C. RESULTS AND DISCUSSION**

### **1. Controversy Over the Application of Insolvency in Bankruptcy Law in Indonesia**

The main objective of amending Law No. 37 of 2004 on bankruptcy and PKPU is to protect

<sup>8</sup> Ika Yunia Fauzia, *Mendeteksi Kebangkrutan Secara Dini Perspektif Ekonomi Islam*, *Ekuitas*, Journal

the interests of both debtors and creditors by safeguarding bankruptcy assets from seizure and ensuring debt repayment. The Indonesian Bankruptcy Law includes the principle of *pari passu pro-rate parte*, meaning that assets serve as joint collateral for creditors and proceeds are shared proportionally among them, except for creditors legally entitled to priority.

These principles are regulated in Article 176 and Article 189 paragraph (4) of the Civil Code. The division of the types of creditors, according to Hoff<sup>9</sup>, is in line with the elucidation of Article 2 paragraph (1) of the UUK-PKPU, namely separatist creditors (secured creditors), preferred creditors, and unsecured creditors. By dividing the types of creditors, the creditor position is guaranteed by law. The purpose of dividing the types of creditors is so that creditors who are proven to have receivables from the same debtor are avoided from seizing the debtor's assets.

The term bankruptcy correlates with the word insolvency, the meaning of this word in the Black's Law Dictionary is "The condition of being unable to pay debts as they fall due or in the usual course of business. This refers to a situation where an individual or legal entity cannot pay their debt when it is due. In U.S. bankruptcy law, a "claim" can have the following consequences:

1. The right to payment, whether or not it is reduced to

judgment, and regardless of whether it is liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.

2. The right to an equitable remedy for breach of performance if the breach results in a right to payment, regardless of the judgment status or whether it is fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

An insolvency claim can lead to a bankruptcy decision, but insolvency alone does not automatically result in bankruptcy. Insolvency is case-specific and influenced by external factors affecting the debtor or company. To determine if an insolvency condition warrants bankruptcy, it must first be evaluated through a cash flow test or a balance sheet test.<sup>10</sup> The test for determining insolvency is known as a 'solvency test'. In the United States, this term is commonly used, whereas European countries refer to it as 'capital maintenance'. This concept is derived from the consensus of European Union countries and is specified in Article 43 of the Council of the European Communities from 1976.<sup>11</sup>

Companies generally measure insolvency conditions using both qualitative and quantitative approaches, with testing parameters

<sup>9</sup> Hoff, Jerry & Gregory J. Churcil. 2000. *Indonesian Bankruptcy Law*. Jakarta: Tata Nusa, p. 27

<sup>10</sup> Siti Anisah, 2009. "Studi Komparasi terhadap Perlindungan Kepentingan Kreditur dan Debitur dalam Hukum Kepailitan". *Journal of Law*, special edition, Vol. 16: 37)

<sup>11</sup> Josef Arminger, 2013. "Solvency-Tests- An Alternative to The Rules for Capital Maintenance Within The Balance Sheet in The European Union". *ACRN Journal of Finance and Risk Perspectives*, Vol. 2. Issue 1. p.1-8.: 1-2

including industry risk, management risk, financial flexibility, credibility, competitiveness, operating risk, common business performance analysis parameters, firm default, reorganization parameters, pricing, differentiation parameters, marketing parameters, delivery parameters, and productivity. Even in recent developments, measurements of the state of insolvency have been computed, so that it can be predicted and is more objective.

In Ireland, the obligation to test insolvency in bankruptcy law is governed by The Companies Acts 1963-2001, the Rules of the Superior Courts, Ord 74 (SI 15/1986), and related jurisprudence. There are two tests for establishing insolvency: (a) the 'cash flow' test, which demonstrates the company's inability to pay debts as they come due, and (b) the 'balance sheet' test, which shows that the company's asset value is insufficient to cover its liabilities, including contingent and prospective liabilities for certain statutory purposes.

In every bankruptcy case, the degree of insolvency of the debtor must be tested for accuracy. While the UUK-PKPU mandates this, the insolvency phase only officially begins after the judge issues a bankruptcy decision. However, in practice, the debtor's insolvency may result from factors like misfortune, dishonesty, or illegal actions.<sup>12</sup> So bankruptcy law must play a role in resolving this situation.

A weakness of Indonesian bankruptcy law is that it does not assess the debtor's financial health. Even if a debtor is solvent, they can still be declared bankrupt if they meet basic evidentiary requirements, such as having two or more creditors and at least one due debt. Under these conditions, the judge must grant the bankruptcy request without considering the debtor's actual financial condition. The law does not treat insolvency as a key criterion for bankruptcy, leading to situations where financially sound companies can be declared bankrupt without undergoing an insolvency test. Consequently, insolvency is not a strict prerequisite for bankruptcy decisions under the current legal framework.

Under Indonesian bankruptcy law, there are two pathways to the insolvency stage.<sup>13</sup>:

1. **Automatic Insolvency:** This occurs after a bankruptcy declaration if no agreement is reached in a debt reconciliation meeting, if an agreement is not approved in the verification meeting, or if an agreement approved by the verification meeting does not receive homologation from the judge, or if a homologated agreement is rejected by the appellate judge.
2. **Through PKPU:** If a reconciliation plan is not accepted by creditors, not ratified by the commercial court, or if no agreement is

<sup>12</sup> Thomas H Jackson, 1986. *The Logic and Limits of Bankruptcy Law*. Cambridge: Harvard University Press. p.13

<sup>13</sup> Hervana Wahyu Prihatmaka etc, *Insolvensi Dalam Hukum Kepailitan Di Indonesia (Studi Putusan*

*No.48/Pailit/2012/Pn.Niaga.Jkt.Pst Antara PT. Telekomunikasi Selular Vs PT. Primajaya Informatika)*, Joernal Fiat Justisia, Vol. 8 No. 2, April-June 2014, p. 333

reached within 270 days after the provisional postponement decision, the supervisory judge will notify the commercial court and declare the debtor bankrupt, marking the entry into the insolvency phase.

According to international standards, if a debtor is solvent but fails to pay overdue debts, creditors cannot file a bankruptcy suit with the Commercial Court. Bankruptcy claims can only be made if the debtor is insolvent. For a solvent debtor who does not pay their debts, creditors must file a regular civil suit with the District Court. The controversy over applying insolvency tests in Indonesian bankruptcy law stems from the passive role of judges in the judicial system. According to Ricardo Simanjuntak, implementing insolvency tests as required by the *Failissements-Verordening* is challenging in Indonesia due to the judge's limited authority to gather evidence. Bankruptcy proof relies on the debtor's financial report, which is often inaccessible to creditors unless the debtor is a public company. Since financial health assessments crucial to insolvency tests can only be performed using the company's financial statements, this method is difficult to apply in Indonesia, where only public companies' financial reports are readily available.

Ricardo Simanjuntak<sup>14</sup> Further argued that Indonesia could not adopt the insolvency test system because to

be categorized as insolvent, the company that was going to be bankrupt had to lose continuously and its capital was eroded by more than 50%. This situation must be proven beforehand by the bankruptcy applicant. The report on capital is only in the company's financial record. This document is very unlikely to be obtained easily by a bankruptcy applicant. In fact, according to Hadi Subhan<sup>15</sup>, an insolvency test is very unnecessary in bankruptcy law in Indonesia. There are two reasons for this. First, in terms of the legal structure, it is very difficult to collect debts if using a default suit, the time can be very long, and a decision that is legally enforceable even though it is still difficult to execute. Second, culturally in Indonesia, debt is permissive, where people easily owe to other parties so to balance this culture, the law must be repressive. Therefore, Indonesia does not adopt the concept of insolvency test.

## 2. Position of Insolvency in Sharia Bankruptcy Law

In practice, the business world often associates Insolvency with Bankruptcy. The word bankruptcy is used to describe the Insolvency procedure. The definition of insolvency according to the Dictionary of Business Term<sup>16</sup> is more defined as the inability to pay off financial obligations when they are due or liabilities are greater than

<sup>14</sup><https://www.hukumonline.com/berita/baca/lt521f1b9bec281/indonesia-tak-bisa-anut-insolvency-test/>, accessed on Thursday, 30 July 2020.

<sup>15</sup><https://www.hukumonline.com/berita/baca/lt59f1abb87e6fe/gagasan-insolvency->

[test-tidak-relevan-untuk-revisi-uu-kepailitan/](https://www.hukumonline.com/berita/baca/lt59f1abb87e6fe/gagasan-insolvency-test-tidak-relevan-untuk-revisi-uu-kepailitan/), accessed on Thursday, 30 July 2020.

<sup>16</sup> Jack P. Friedman, *Dictionary of Business and Economics Terms*, Peterson's Guides US, 2012

their assets within a certain time<sup>17</sup>. This definition illustrates that insolvency is a condition when the debtor's debts exceed all of his financial assets so that the debtor cannot pay all of his debts.

According to Goodman Law, insolvency can be a basis for declaring bankruptcy, but it may also be temporary and resolvable, meaning it does not always lead to bankruptcy. In other words, while insolvency can justify a bankruptcy claim, a legal entity or individual declared bankrupt must be in a state of insolvency<sup>18</sup>. A debtor who fails to pay a debt to a creditor may not necessarily be insolvent; they might simply be unwilling to pay despite having the financial capacity to do so. The failure to repay could stem from a lack of willingness rather than an inability to pay<sup>19</sup>.

Article 57, paragraph 1 of the UUK-PKPU defines insolvency as "inability to pay," but does not use it as a requirement for bankruptcy. This creates ambiguity and multiple interpretations, as UUK-PKPU does not mandate that a debtor must be insolvent for bankruptcy to occur. The law appears to prioritize creditor interests, allowing a court to declare a debtor bankrupt if a bankruptcy claim is filed, regardless of the debtor's insolvency status. Insolvency describes a debtor's financial state, while bankruptcy is a legal status.

Debtors must be declared bankrupt by the court despite being insolvent, meaning insolvency alone does not automatically lead to bankruptcy.<sup>20</sup>

A debtor's failure to pay a debt to one creditor does not necessarily indicate insolvency but could be due to reasons related to the creditor, such as the creditor's failure to meet their contractual obligations (mora creditors) or unresolved debts owed to the debtor. If a debtor is still paying other creditors, they should not be subject to bankruptcy proceedings in the Commercial Court but rather in a civil court. Bankruptcy or insolvency laws in many countries require a debtor to be declared insolvent by a court before being declared bankrupt.<sup>21</sup>

In Islamic economics, insolvency is closely tied to the concept of bankruptcy or "taflis." A person is considered bankrupt (iflas) if they are in one of two conditions: first, their debt consumes all their assets, leaving nothing to pay their debts, or second, they have no assets at all. In Islam, bankruptcy is referred to as "mufliis," derived from "al-falas," meaning lacking property. An individual is considered mufliis if their assets are insufficient to cover their debts, or if their assets are encumbered by debt. Even if a person has property, they are deemed mufliis if their assets are tied up to repay debts, rendering them essentially

<sup>17</sup> Antonius I Gusti Ngurah Putu Berna Adiputra, R.A. Retno Murni, & I Made Pria Dharsana. (2014). *Pengaturan Pencegahan Kepailitan Melalui Kombinasi Insolvency Test, Reorganisasi Perusahaan dan Penundaan Kewajiban Pembayaran Utang*. Kertha Pertiwi, Scientific Journal of the Master of Notary at Udayana University, Volume 10, Oktober 2014, p. 68

<sup>18</sup> Op.cit. Diana, p. 262

<sup>19</sup> Sutan Remi Sjahdeini. (2016). *Sejarah, Asas, dan Teori Hukum Kepailitan Memahami Undang-Undang No. 37 Tahun 2004 tentang Kepailitan dan Penundaan Kewajiban Pembayaran*. Second Edition, Jakarta: Prenadamedia Group, p. 153

<sup>20</sup> Ibid, p. 53

<sup>21</sup> Op.cit, Diana Surjanto, *Urgensi Pengaturan...*, p.261

without usable assets. This status reflects their future condition, where their assets are depleted or restricted to only meet essential needs.

In Islamic economics, insolvency and bankruptcy (*taflis*) are interconnected, with insolvency being the precursor to *taflis*. Insolvency represents the core condition that leads to bankruptcy. In this view, an insolvent debtor automatically becomes bankrupt, unlike in the UUK-PKPU framework where bankrupt debtors are not necessarily insolvent. A *taflis* decision is made by a judge when it is determined that the debtor is deeply in debt with no assets remaining, except for those needed to settle their debts.

This has the legality of a narration from Muadz bin Jabal which was used as a reference and evidence by Jumhur scholars including Imam Malik and Syafi'i which reads: "*That the debt was large at the time of the Prophet Muhammad*

*and his assets were not sufficient to pay off to people who owed money*"<sup>22</sup>. The debtor's financial history justifies the sale of their assets to repay creditors if the debtor has long been unable to settle their debts. This history also provides grounds for a judge to issue a bankruptcy decision and detain the debtor if their assets are insufficient to cover all their debts. From an Islamic perspective, insolvency is the primary requirement for declaring a debtor bankrupt (*taflis*). A debtor cannot be declared bankrupt solely based on requests from one or more creditors; the debtor's financial health must first be assessed to determine if recovery is possible. In modern Sharia economics, *taflis* is considered a last resort, implemented only after unsuccessful attempts at rescheduling, restructuring, or reconditioning the debtor's financial situation<sup>23</sup>. In Islamic bankruptcy law, the terms solvent or insolvent

<sup>22</sup> HR. Ad-Daruqutni (4/230), Al Hakim (2/58), and he has authentic value, and determined by Adz-Dzahabi dan HR. Al Baihaqi (6/48' 50). In another narration Abdurrahman bin Ka'ab bin Malik narrated the hadith by saying, "Mu'adz bin Jabal was one of the most noble youths among the youths of his people, and he at that time did not hold (property) anything, but he continued to be given debt. until all of his assets are used to pay off debts. Prophet Muhammad speaking to people who owed him (in a history, they did not leave anything for him), so that if someone was left (without paying a debt) for someone (others) they would have left Mu'adz for the sake of Rasulullah SAW. Then Rasulullah saw, sold his property for them until Mu'adz was in a condition with nothing. In another narration, "He restricted Mu'adz's authority, and sold his assets related to debts, and divided them among the people who owed them.

<sup>23</sup> There are three steps taken by banks in order to make efforts to save customers to

avoid bad credit, namely rescheduling (rescheduling), namely changing the schedule for credit payments by extending the repayment period by reducing installment expenses such as the financing tenor from 5 months to one year. Secondly, restructuring is a change in part or all of the unlimited credit terms as long as it does not involve changes in the credit ceiling, such as changing the structure from term credit to installment credit with the amount adjusted to the customer's ability, such as adding capital to customers because the bank considers the customer's business to have good prospects. bright. The third is rearrangement (reconditioning), namely changes in credit terms related to the addition of credit facilities and there is a conversion of some of the arrears of installments for interest into new loan principal which can be accompanied by rescheduling or re-requirements such as lowering interest rates from 20% to 18% a year or exempting. interest but still pay off the principal until it is paid off.



relate to whether the debtor is financially healthy. This concept, as interpreted by Ibn Rushd in *Bidayatul Mujtahid*, includes both physical and mental health. A debtor who is ill (not feigning illness) may be granted a time extension to settle their debt, allowing them to recover their health and return to their activities.

In modern Islamic economics, "health" encompasses not just individual physical and mental well-being but also the financial health of fiscal institutions. A solvent debtor is financially healthy. Islamic bankruptcy practices are lenient, allowing extended payment periods for insolvent (financially unhealthy) debtors. This approach reflects the ethical principles of Islamic economics, which aim to balance the interests of both debtors and creditors as collaborative partners in mutual support.

### 3. Insolvency Test as an Instrument of Evidence in a Sharia Bankruptcy Case

Islamic banking is expanding and gaining recognition, and like conventional financial institutions, it faces various inherent risks. Poorly managed or undetected risks can lead to significant losses, including decreased bank soundness or bankruptcy. Bankruptcy is typically defined as a company's inability to generate profits, leading to liquidation or closure. This failure often results from cash flow falling below expectations or from income

being insufficient to cover capital costs. Financial failure, or insolvency, is characterized by negative net worth on the balance sheet or present value and expected cash flows that do not meet liabilities.

In Islamic financial institutions, bankruptcy and liquidation are usually preceded by symptoms of a decline in financial levels (financial distress) caused by the company being delisted due to net income and negative equity book value in a row after the company was merged.<sup>24</sup> Meanwhile, Kahya and Theodossiou<sup>25</sup> Categorized financial distress based on the debt default criteria, namely the occurrence of failure to pay debts or indications of debt default by renegotiating with creditors or other financial institutions.

Economic conditions in Indonesia are often susceptible to crises, and declining profits in Islamic banks increase the risk of financial difficulties or bankruptcy. Errors in forecasting a company's future operations can lead to significant losses. Therefore, a reliable bankruptcy prediction model is crucial for lenders, investors, governments, accountants, and management to mitigate these risks and make informed decisions.<sup>26</sup>

In its development, various methods have emerged in predicting bankruptcy as an anticipation and early warning system for financial distress. The factors of capital and financial risk play an important role in

<sup>24</sup> Luciana, S.A., 2006, *Prediksi Kondisi Financial Distress Perusahaan Go Public Dengan Menggunakan Analisis Multinomial Logit*, Joernal economic and finance: Vol. XII No. 1

<sup>25</sup> Kahya E. and Theodossiou P, *Predicting corporate financial distress: A Time-*

*Series CUSUM Methodology*. Review of Quantitative Finance and Accounting, 13,4; ABI/INFORM Global 1999, p. 323.

<sup>26</sup> Zu'amah, S, 2005, *Perbandingan Ketepatan Klasifikasi Model Prediksi Kepailitan Berbasis Akrual dan Berbasis Aliran Kas*, SNA VIII : p. 441-459.

explaining the phenomenon of bankruptcy / corporate financial stress. With early detection, companies, investors, and creditors (financial institutions) as well as the government can take anticipatory steps so that the impact does not spread.<sup>27</sup>

Several studies on the prediction of bankruptcy of Islamic banks in Indonesia include Endri using the Z-Score model which states the result is less than 1.81 (all Islamic banks are categorized as unsafe). According to Endri<sup>28</sup>, the Z-Score model is not suitable if used to predict the possibility of bankruptcy in the Islamic banking industry because the Z-Score model was formed from an empirical study of the manufacturing industry which is certainly very different from the Islamic banking industry. However, Rohmah<sup>29</sup> said that all Islamic banks in Indonesia are in the healthy (safe) category.

Several bankruptcy detection models, including the Altman Z-score (1968), Springate (1978), Zmijewski (1983), and Grover model, have been evaluated. Among these, the Altman model is considered the best predictor, though it is only slightly better than the Springate model. The Springate model performs better than the Zmijewski model<sup>30</sup>. However, the Zmijewski model is not suitable for predicting a company delisting on the

BEI (Indonesia Stock Exchange).<sup>31</sup> The overall model used is of course aimed at protecting the soundness of Islamic banking and avoiding bankruptcy.

Islamic Bankruptcy Law primarily addresses individuals rather than Islamic financial institutions. However, its principles are still applicable as long as they align with the Qur'an and Sunnah. Key principles include allowing tolerance for debtors deemed insolvent to assess their financial health and potential for recovery. Bankruptcy in Islam is considered a last resort (*ultimum remedium*), used only after other rescue efforts have failed.

The UUK-PKPU's principle of proof favors creditor protection over debtor interests, emphasizing business continuity. A debtor or financial institution can be declared bankrupt if it meets cumulative requirements, such as having debts to two or more creditors that are due and collectible, regardless of their insolvency status. Applying this principle to sharia bankruptcy disputes would conflict with basic sharia norms and principles.

In resolving bankruptcy disputes under Sharia contracts, the simple proof of evidence used by UUK-PKPU should be re-evaluated. The insolvency test should be included as a key evidence and

<sup>27</sup> Junaidi, *Pengukuran Tingkat Kesehatan dan Gejala Financial Distres Pada Bank Umum Syariah di Indonesia*, Joernal KINERJA, Volume 20, No.1, 2016, p. 42-52

<sup>28</sup> Endri, 2009, *Prediksi Kebangkrutan Bank Untuk Menghadapi Dan Mengelola Perubahan Lingkungan Bisnis: Analisis Model Altman's Z-Score*. *Perbanas Quarterly Review*, 2 (1).

<sup>29</sup> Rohmah. S., 2015, *Prediksi kebangkrutan BUS menurut metode Altman Z-Score*,

*Keuangan dan Perbankan Syariah: Research Proceedings SPeSIA*

<sup>30</sup> Fiqul Wadiah Warsidi, "ANALYSIS OF THE REALITY OF FORTUNE AND PROFIT ACCORDING TO ISLAMIC ECONOMICS," *Asean Comparative Education Research Journal on Islam and Civilization* Vol 6, No (2023).

<sup>31</sup> Op.Cit, Junaidi, p. 43

determinant for bankruptcy decisions. This test, which assesses the debtor's ability to pay debts through cash flow and balance sheet analysis, must be passed before a bankruptcy application is considered by the Sharia Commercial Court, as recommended by M. Hadi Subhan.<sup>32</sup>, so that it will be known whether the condition of the assets is smaller than the liability or in other words the company's debt is greater than the company's assets.

The insolvency test can utilize various early bankruptcy detection methods, including the Altman Z-score (1968), Springate model (1978), Zmijewski model (1983), and Grover model. These models help predict the financial health and distress levels of debtors or Islamic financial institutions. By applying these tests, the solvency of Islamic financial institutions can be accurately assessed to determine if bankruptcy is warranted.

Incorporating the insolvency test as a key requirement for bankruptcy decisions aligns with Sharia principles (taflis). During the evidentiary stage, judges must require creditors and debtors to demonstrate the debtor's insolvency, either through the company's balance sheet or previous insolvency test results. Judges may also consult financial experts to interpret these results and clarify the debtor's condition. This approach aims to reduce controversy in the bankruptcy filing process.

Applying the insolvency test in Sharia bankruptcy cases aligns with Sharia economic dispute resolution's fundamental norms and principles. Incorporating this test as part of the evidence helps prevent premature bankruptcy decisions, which could significantly impact debtors and companies. Islam emphasizes ethics and morality in debt resolution, and bankruptcy (taflis) should be considered only as a last resort (ultimum remedium) for dispute resolution.

#### D. CONCLUSION

Indonesian bankruptcy law does not prioritize insolvency as a main requirement for bankruptcy due to two factors: the passive role of judges in collecting corporate financial evidence challenges in debt collection and prolonged settlement times. Culturally, the permissiveness around debt necessitates a more repressive legal approach. The UUK-PKPU's summary proof concept allows bankruptcy if cumulative requirements are met, regardless of the debtor's financial health, unlike Sharia bankruptcy, which mandates insolvency as a core condition for bankruptcy. In Sharia bankruptcy, insolvency automatically leads to bankruptcy upon creditor request. Therefore, incorporating insolvency tests as evidence in Sharia bankruptcy cases is crucial for adhering to Sharia principles and ensuring ethical debt resolution.

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<sup>32</sup> M. Hadi Subhan, 2014, *Hukum Kepailitan: Prinsip, Norma, dan Praktik Peradilan*, Pustaka Grafika, Jakarta, p.144. in Luh ayu Maheswari Prabaningsih and Made Nurmawati, *Pengaturan Insolvensi Tes Dalam*

*Penjatuhan pailit Terhadap Perusahaan*, Scientific Articles of Business Law Specialization Program, Faculty of Law, Udayana University p. 6.

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