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## Implementation of insolvency test reviewed from the principle of legal certainty

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### Abstract

Basically, bankruptcy is a final resort for debtors who are in a state of insolvency where the debtor is no longer able to carry out obligations to its creditors. However, bankruptcy often occurs for companies that are still solvent, simply because they do not want to pay their debts because the bankruptcy law in Indonesia does not adopt an insolvency test in bankruptcy applications when viewed from the principle of business continuity. One of the paradigms of bankruptcy law is the value of justice so that the law can provide its true purpose, namely providing benefits, usefulness and legal certainty. Please note that the insolvency test is open access to financial reports that can be proven by financial due diligence on bankruptcy applications. This research will discuss how important it is to apply the insolvency test in bankruptcy applications when viewed from bankruptcy law in Indonesia, which is based on the principles of legal certainty and business continuity. Researchers see many pros and cons or conflicts between accounting and bankruptcy law on legal implementation if the insolvency test is implemented in bankruptcy applications in Indonesia. The law should be relied upon to fulfill the value of justice for debtors and creditors proportionally, but in this case there is a comparison between bankruptcy law and the insolvency test.

**Keywords:** Insolvency test, bankruptcy, accounts payable and receivable

### 1. Introduction

People often state that bankruptcy or going bankrupt is a general seizure of all the debtor's assets to achieve peace between the debtor and the creditors so that the assets can be divided fairly among the creditors. It is necessary to know in advance about insolvency, which measures the health of a business actor from a financial perspective. In accounting, a business actor is insolvent if his assets are smaller than his liabilities, which means that with smaller assets, it is impossible for the debtor to pay off his debts (financial distress). This situation often leads to legal proceedings aimed at restructuring or liquidating the business. (Ahmad Yani, 2002) <sup>[1]</sup>.

Insolvency can be caused by various factors, including poor financial management, economic downturns, or unexpected expenses that exceed the business's revenue. It is crucial for businesses to monitor their financial health regularly to identify signs of financial distress early. Proper financial management strategies, such as maintaining adequate cash flow, managing debt levels, and monitoring financial ratios, can help prevent insolvency. Additionally, there are different types of bankruptcy proceedings, such as Chapter 7 and Chapter 11 in the United States, each with its own implications for the debtor and creditors. Chapter 7 involves the liquidation of assets, while Chapter 11 focuses on reorganizing the business to allow it to continue operations while repaying its debts. Understanding these proceedings and seeking timely legal and financial advice can make a significant difference in managing insolvency effectively.

#### 1.1 There are two indicators of financial distress when a debtor experiences insolvency, namely:

- **Technical insolvency:** The debtor cannot fulfill his obligations when they fall due.
- **Bankruptcy:** Negative net worth in a conventional balance sheet or the present value of expected cash flow is smaller than the liabilities.

When viewed from the legal side, insolvency is a consequence of the debtor's inability or unwillingness to pay off debts. Legally, an insolvent position must not be proven through accounting.

### 1.2 According to Friedman, insolvency is defined as:

1. Inability to meet financial obligations when due as in business, or;
2. Excess liabilities compared to assets within a certain time. (Munir Fuady, 2007) <sup>[2]</sup>

However, there are also those who say that insolvency is an economic standard that has become the basis for the principle of bankruptcy law "the debtor must be insolvent" in other words this principle shows a strong relationship between the concept of bankruptcy and the economic concept of insolvency.

Article 168 Paragraph 1 of the Bankruptcy and Suspension of Debt Payment Obligations Law Number 37 of 2004 (Bankruptcy Law) also states that insolvency occurs if there is no peace and by law the bankrupt estate is in a state of being unable to pay all debts that must be paid.

### 1.3 Procedurally, in a bankruptcy process, the bankrupt estate is considered to be in a state of being unable to pay if:

1. In the verification meeting, no peace was offered; or
2. If the peace offered has been rejected.
3. The ratification of the peace has definitely been rejected.

Without proof of the above elements, the bankrupt estate cannot be called or declared to be in a state of being unable to pay.

Based on Bankruptcy Law, there are requirements for declaring bankruptcy if there are 2 (two) or more creditors and the debt has matured and can be collected, which means that the creditor has the right to obtain the mature receivables. Indonesia has no "insolvency test" before submitting a bankruptcy application. Bankruptcy Law contains the principle of business continuity, where debtors who are still prospective are allowed to continue their business (Munir Fuady, 2005) <sup>[3]</sup>.

However, in this case, several questions arise from debtors, "even though I am said to be unwilling to pay my debt, I cannot be said to be bankrupt because I am not yet insolvent?" In Dutch legal provisions, there is no question of unwillingness and inability, which are a single fact that the debtor violates the requirements to pay off his debts to creditors.

So further this research will discuss in the main discussion how important the insolvency test is in bankruptcy law in Indonesia and how it is applied if the insolvency test is applied in bankruptcy law in Indonesia, where the public does not know much about the insolvency test and the conflict between the insolvency test and bankruptcy law in bankruptcy applications. Based on the facts presented above, the Author wrote a scientific article entitled Implementation of Bankruptcy Law and PKPU Against the Application of Insolvency Test Reviewed from the Principle of Legal Certainty and the Principle of Business Continuity. With a focus on formulating the problem: Is it necessary to conduct an insolvency test in bankruptcy law in Indonesia and How will the law be implemented if the insolvency test

is applied in bankruptcy law in Indonesia?

## 2. Research Methods

The approach used in this research is a normative juridical method. The juridical approach refers to laws and regulations, focusing on analyzing legal norms and their applications within the legal framework. This method is essential for understanding how existing laws are structured, interpreted, and applied to various legal issues. By examining legal texts, statutes, and judicial decisions, the juridical approach helps in assessing the effectiveness and scope of legal provisions in addressing specific matters. On the other hand, the normative approach involves studying case studies, which is also known as doctrinal legal research. This approach emphasizes the theoretical and normative aspects of law by analyzing legal doctrines, principles, and scholarly writings. It seeks to understand how legal norms and theories are applied in practical scenarios and their impact on legal practice and interpretation. Normative research often involves reviewing academic literature, legal commentaries, and case law to develop a comprehensive understanding of legal concepts and their practical implications. Combining these two approaches allows for a thorough examination of legal issues from both theoretical and practical perspectives. This methodology provides a well-rounded analysis by integrating legal theory with practical application, thereby offering valuable insights into the effectiveness of legal norms and their role in the legal system. Through this integrated approach, the research aims to contribute to the development of legal theory and practice by highlighting areas where existing laws may need reform or further clarification.

## 3. Results and Discussion

### 3.1 Implementation of insolvency test reviewed from the principle of legal certainty

Limited Liability Company (LLC) is a vital business entity widely available worldwide, including Indonesia. The presence of an LLC as a business vehicle contributes to almost all areas of human life. This was also stated by Richard A. Posner, who said that the form of a Limited Liability Corporation (LLC) is the right solution or choice. Because in an LLC, legal principles and business practices run together in a balanced way, which can answer problems in the financial process and its accountability. Various literature on companies states that LLCs carry out many economic activities. For a company, debt is not bad as long as the company can still pay it back.

For a company, debt is not bad as long as the company can still pay it back. Companies like this are usually called solvent companies that can pay their debts. Conversely, if a company can no longer pay its debts, it is called insolvent, meaning unable to pay. Bankruptcy begins with a debtor who does not pay off his debt on time for a certain reason. This results in the debtor's assets, both movable and immovable, both existing and future, which are collateral for his debts, being sold to become a source of debt repayment. When the obligation cannot be fulfilled, one solution to this problem is declaring bankruptcy. R. Subekti stated that bankruptcy is a joint effort to obtain fair payment for all creditors (R. Subekti, 1994) <sup>[5]</sup>.

In Article 2 Paragraph 1 of Bankruptcy Law, the wording is cumulative, meaning that the requirements for a debtor to be

declared bankrupt must meet all the abovementioned elements. If the requirements are met, the Judge "must declare bankruptcy," not "can declare bankruptcy," so that in this case, the Judge is not given room to provide a broad "judgment" as in other cases.

This is reinforced by the provisions in Article 8 Paragraph 4 of Bankruptcy Law, that a request for a declaration of bankruptcy must be granted if there are facts or circumstances that simply prove that the requirements for being declared bankrupt, as referred to in Article 2 Paragraph 1, have been fulfilled.

The function of bankruptcy is as a collective proceeding tool, meaning that without bankruptcy law, each creditor will compete individually to claim the debtor's assets for their interests. Therefore, bankruptcy law overcomes the so-called collective action problem arising from each creditor's individual interests.

The purpose of bankruptcy law is also to provide a means for debtors to exit their businesses, as in the principle of commercial exit from financial distress. Thus, bankruptcy law indirectly functions to sort out which business actors are inefficient in running their businesses.

In addition, bankruptcy law can provide a mechanism for creditors to jointly determine whether the debtor company should continue its business or not, which can force minority creditors to follow the flow because of the voting procedure.

It should be noted that before the reform in 1998, the legal basis for deciding insolvency was to stop paying, which many experts define as an insolvency test. Thus, the insolvency test tends not to be used in *faillissements* overordering as the only regulation governing bankruptcy.

When viewed from the legal side of the procedure, the evidence to prove that the debtor is genuinely insolvent will be closely related to evidence of financial statements in accounting. However, if the debtor company is closed, only the debtor knows the financial statements, which means that creditors cannot access the debtor's financial statements.

### **3.2 This is regulated as in Article 1865 of the Civil Code or Article 163 HIR**

"Anyone who claims to have any right or who refers to a fact to support such right, or who objects to another party's right, shall prove the existence of such right, or such fact".

So, if the creditor files a bankruptcy petition against the debtor based on the insolvency test, then the creditor is the one who is required to prove whether the debtor is insolvent, which means that the Judge will give the burden of proof to the creditor to confirm that the debtor is insolvent. The creditor is required to notify the Court of the debtor's financial report, which is very unlikely to occur in bankruptcy procedural law in Indonesia.

In the bankruptcy petition requirements of the Bankruptcy Law, the debtor must have a minimum of 1 (one) debt that can be collected and have 2 (two) or more creditors, but the debtor is unable to pay off or does not want to pay off his debt to the creditor will be considered insolvent arising from the implementation of the Contract Law Article 1338 of the Civil Code:

"All legally executed agreements shall bind the individuals who have concluded them by law. They cannot be revoked otherwise than by mutual agreement, or pursuant to reasons which are legally declared to be sufficient. They shall be executed in good faith." This means that in the agreement

the debtor must carry out his obligation to pay his debt to the creditor based on the 2 (two) conditions of the Bankruptcy Law in the bankruptcy petition. (Rudy A Lontoh, 2001)<sup>[7]</sup>

In the UNCITRAL Legislative Guide, the insolvency test can be divided into two indicators, namely the cash flow/liquidity test and the balance sheet test. The cash flow test is used to initiate the insolvency process. According to this test, a debtor is considered insolvent when it stops paying debts to creditors because it does not have enough cash flow to meet its obligations when they fall due.

The cash flow test is used as the initial basis for filing a bankruptcy petition because cash flow is used to avoid the loss of debtor assets and the potential for preemption between creditors, which will result in losses for the creditors.

This cash flow test is also considered a forward-looking test because the assessment of whether or not the debtor can pay its debts is related to current and future obligations. Cash flow is less able to provide certainty and accuracy in terms of submission because this cash flow test can make debtors with little cash flow at a particular time because of the strategy they carry out to survive in the market by targeting low profits or even losses to gain market share.

The balance sheet test states that a debtor can be considered insolvent if its liabilities exceed its assets or the debtor's debt is more significant than its assets based on a reasonable assessment. The use of a balance sheet can also result in an inaccurate assessment in some conditions. For example, a new and rapidly growing company may have liabilities that exceed its assets due to large debts to buy buildings or production equipment, even though the company can generate high profits and stable cash flow. Therefore, the company can still meet its debt payment obligations through cash flow (Shubhan, 2006)<sup>[8]</sup>.

From the side of bankruptcy procedural law, if the basis of the bankruptcy petition is an insolvency test or balance sheet test, then the debtor's obligation to be insolvent or not must be presented through financial statements, which creditors generally do not have, while if viewed from the principle of contrary evidence (according to the American Accounting Association) going concern is used as an assumption in financial reporting as long as there is no contrary evidence, an entity is considered to continue operating indefinitely.

In the practice of bankruptcy law in Indonesia, even though the creditor says the debtor has debt as long as the debtor does not notify anything, the court is not under any obligation to actively ask the debtor to prove his debt, so when the creditor cannot prove his argument, the Court will reject it. However, if the creditor can prove that the debtor's assets are smaller than his debt, in accounting theory if the debtor's assets are smaller than his debt, it does not state that the debtor is insolvent because of the theory of current liabilities (the potential income that will come in is the basis for considering whether the debtor can be categorized as insolvent or not in accounting), (Teuku Syahrul Ansari, 2020).

So, from the insolvency test side of accounting theory, while from bankruptcy law in Indonesia, the basis for determining bankruptcy is only simple proof. Suppose the insolvency test is applied in a bankruptcy petition. In that case, it will shift the debtor's obligation to pay debts that have matured and can be collected into an accounting debate that makes the essence of bankruptcy a way to settle debts through a

collective shift to one point of justice and legal certainty. (J.B. Heaton, 2007) <sup>[10]</sup>.

The application of the insolvency test in Indonesia will result in a debate in the Court regarding the proof of whether or not the debtor is obliged to pay his debt to the creditor and the shift in legal certainty that the creditor has the right to receive payment for his receivables which are no longer debtors who are obliged to pay their debts. Still, the shift in the new debtor can only be punished if he does not pay his debt if he is insolvent, so in Indonesia, bankruptcy and insolvency are 2 (two) different things.

If the debtor has gone bankrupt, he is not insolvent. The bankrupt debtor is still given the opportunity to submit a peace proposal. So, if the debtor submits a peace proposal that is rejected by the Court, the debtor will be free from the position of insolvency. Next, what if the insolvency test is forced to be applied in bankruptcy law in Indonesia? In this case, law enforcement in Indonesia is very strict with the regulation of Article 2 Paragraph 1 of the Bankruptcy Law in the bankruptcy application requirements where the debtor is proven to have a minimum of 1 (one) debt that is due and collectible, and the debtor does not pay. There is no other consideration other than the debtor being declared bankrupt referring to the simple basis of evidence in Article 8 Paragraph 4 of the Bankruptcy Law, namely:

1. There are 2 (two) or more creditors. A creditor is a person who has receivables due to an agreement or law that can be collected in court. Creditors here include concurrent creditors, separatist creditors, and preferred creditors.
2. There is a debt that has matured and can be collected that has not been paid in full by the debtor. This means that there is an obligation to pay a debt that has matured, either because it has been agreed upon because the collection time has been accelerated as agreed, because the authorized agency has imposed sanctions or fines, or because of a court decision, arbitrator, or arbitration panel (Ron Mattocks, 2008) <sup>[12]</sup>.

#### 4. Conclusion

From the discussion in the previous chapters, it can be concluded whether an insolvency test is necessary for bankruptcy law in Indonesia and how the law will be implemented if the insolvency test is applied. The application of the insolvency test is considered to be able to cause clashes in accounting theory with Bankruptcy Law in Indonesia, so in this case, there will be a shift in the principle of legal certainty in bankruptcy procedural law in Indonesia, which is basically in Indonesia bankruptcy law is very strict, where the Commercial Court that tries bankruptcy cases still relies on the simple proof pattern in the Bankruptcy Law which is not in line with the insolvency test, namely the bankruptcy application requirement by requiring a minimum debt of 1 (one), where the debt is due and collectible and 2 (two) or more creditors. The insolvency test can cause debate in the Court regarding the openness of access to the debtor company, which is considered to only be opened by the debtor himself. Creditors and the Court cannot open access to the debtor's financial statements, especially closed companies. The insolvency test should not be able to conclude whether the debtor can be considered insolvent or not based on the income received by the debtor's company.

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