

**THE OBSTACLES AND SOLUTIONS OF SHARIA MUNICIPAL BOND  
ISSUANCE FROM AN INDONESIAN LEGAL PERSPECTIVE.**

**A BACHELOR DEGREE THESIS**



By:

**RAFISYACHDI RAHMANDILLAH**

Student Number: 13410628

INTERNATIONAL PROGRAM

FACULTY OF LAW

UNIVERSITAS ISLAM INDONESIA

2018.

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**A BACHELOR DEGREE THESIS**

Presented as the Partial Fulfillment of the Requirements  
To Obtain the Bachelor Degree at the Faculty of Law  
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Yogyakarta



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PAGE OF APPROVAL I.

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

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Board of Examiners

1. Chief Examiner: Nandang Sutrisno, S.H., M.H., LL.M., Ph.D.
2. Examiner I : Ratna Hartanto, S.H., LL.M.
3. Examiner II : Drs. Agus Triyanta, M.A., M.H., Ph.D.

International Program  
Faculty of Law

Universitas Islam Indonesia  
Dean,



Dr. Abdul Jamil, S.H., M.H.

NIK: 904100102

**LETTER OF STATEMENT.**

**ORISINALITAS KARYA ILMIAH BERUPA TUGAS AKHIR MAHASISWA  
FAKULTAS HUKUM UNIVERSITAS ISLAM INDONESIA**

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

Yang bertandatangan di bawah ini, saya:

Nama : **RAFISYACHDI RAHMANDILLAH**

No. Mahasiswa : **13410628**

Adalah benar-benar mahasiswa Program Internasional Fakultas Hukum Universitas Islam Indonesia Yogyakarta yang telah melakukan penulisan karya tulis ilmiah (tugas akhir) berupa skripsi atau legal memorandum atau studi kasus hukum dengan judul:

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Selanjutnya, berkaitan dengan hal di atas terutama pernyataan pada butir no. 1 dan 2, saya sanggup menerima sanksi baik sanksi administrasi, akademik, bahkan sanksi pidana jika saya terbukti secara kuat dan menyakinkan telah melakukan perbuatan yang menyimpang dari pernyataan tersebut. Saya juga akan bersifat kooperatif untuk hadir menjawab, membuktikan, melakukan pembelaan terhadap hak-hak saya. Tim Fakultas Hukum Universitas Islam Indonesia yang ditunjuk oleh pimpinan Fakultas apabila ada tanda-tanda plagiat yang disinyalir terjadi pada karya tulis ilmiah saya ini oleh pihak Fakultas Hukum Universitas Islam Indonesia.

Demikian, Surat Pernyataan ini saya buat dengan sebenar-benarnya dalam kondisi sehat jasmani dan rohani, dengan sadar serta tidak ada tekanan dalam bentuk apapun oleh siapapun.

Dibuat di : Yogyakarta

Pada tanggal : 5 Februari, 2018

Yang membuat pernyataan,



RAFISYACHDI RAHMANDILLAH

**SURAT PERNYATAAN TELAH MELAKUKAN REVISI TUGAS AKHIR**

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

Yang bertanda tangan dibawah ini, Saya:

Nama : Rafisyachdi Rahmandillah.

No. Mahasiswa: 13410628.

Tanggal Ujian : 20 Agustus 2018.

Telah melakukan dan menyelesaikan revisi/perbaikan Tugas Akhir saya sebagaimana yang disyaratkan oleh Tim Penguji Tugas Akhir.

Perbaikan Tugas Akhir tersebut telah selesai dan disetujui oleh Tim Penguji Tugas Akhir dan Dosen Pembimbing Tugas Akhir.

Yogyakarta, 22 Agustus 2018



Rafisyachdi Rahmandillah.

Menyetujui:

1. Ketua Tim Penguji: Nandang Sutrisno, S.H., M.H., LL.M., Ph.D.
2. Penguji I : Ratna Hartanto, S.H., LL.M.
3. Penguji II : Drs. Agus Triyanta, M.A., M.H., Ph.D.



Mengetahui

Dosen Pembimbing Tugas Akhir



**Drs. Agus Triyanta, M.A., M.H., Ph.D.**



## **CURRICULUM VITAE.**

### **BASIC INFORMATION**

Name : Rafisyachdi Rahmandillah  
Date of Birth : July 22, 1995  
Place of Birth : Bekasi  
Gender : Male  
Religion : Islam  
Marital Status : Single  
Phone Number : 081321516171  
E-mail Address : ifarrahamd@gmail.com  
Address : Galaxy Residen Blok B 8 No.9, Jakasetia, Bekasi Selatan,  
Bekasi, Jawa Barat

### **Parents Identity**

- a) Father : Mustaniul  
Occupation : Private Employee  
b) Mother : Elly Sumiati  
Occupation : Housewife

### **BACKGROUND OF EDUCATION**

1. TK Aisyiah Bustanul Athfal 1 Sidoarjo
2. SD Muhammadiyah 1 Sidoarjo
3. SMP Ar-Rohmah Boarding School Malang
4. SMA Muhammadiyah 2 Sidoarjo
5. Fakultas Hukum International Program Universitas Islam Indonesia

### **ORGANIZATIONAL EXPERIENCES**

1. Members of Takmir Masjid Al-Millah
2. Members of Student Association of International Law (SAIL) FH UII
3. Members of Juridical Council of International Program (JCI) FH UII
4. Head of Social Department JCI FH UII
5. Members of Business Law Community (BLC) FH UII
6. Head of Capital Market Department BLC FH UII

## INTERNSHIP EXPERIENCE

1. Internship at Departemen Hukum Otoritas Jasa Keuangan (OJK) Jakarta

## SKILLS AND INTERESTS:

Negotiation, Legal Drafting, Debate

Law and Business, Sports

## LANGUAGES:

1. Bahasa Indonesia
2. English
3. Arabic

**MOTTO.**

*“The greatest Jihad is to battle your own soul and to fight the evil within yourself.”*

(Prophet Muhammad SAW)

*“Honesty is a very expensive gift. Don’t expect it from cheap people”*

(Warren Buffett)

*“If you are afraid to fail, then you are probably going to afraid”*

(Kobe Bryant)

*“Talent without working hard is nothing”*

(Cristiano Ronaldo)

## **DEDICATION.**

I dedicate this Bachelor Degree Thesis for:

1. Allah SWT and Prophet Muhammad SAW who continues to provide extraordinary favors and ease me in writing this bachelor degree thesis;
2. My little family (Mustaniul, Elly Sumiati, Rifqi Rahmandillah, and Raihan Rahmandillah who always support me in every situation to finish my bachelor degree thesis; and
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*Wassalamualaikum Wr. Wb.*

Yogyakarta, February 5, 2018

Rafisyachdi Rahmandillah.

## TABLE OF CONTENT.

PAGE OF APPROVAL I. ....	ERROR! BOOKMARK NOT DEFINED.
PAGE OF APPROVAL II.....	ERROR! BOOKMARK NOT DEFINED.
PAGE OF APPROVAL III.....	ERROR! BOOKMARK NOT DEFINED.
LETTER OF STATEMENT.....	ERROR! BOOKMARK NOT DEFINED.
CURRICULUM VITAE.....	VIII
MOTTO. ....	X
DEDICATION.....	XI
ACKNOWLEDGEMENTS.....	XII
TABLE OF CONTENT.....	XVII
ABSTRACT.....	XV
CHAPTER I: INTRODUCTION. ....	1
A. CONTEXT OF STUDY.....	1
B. PROBLEM STATEMENT.....	9
C. THEORETICAL REVIEW.....	9
D. THEORETICAL FRAMEWORK.....	10
E. DEFINITION OF TERMS.....	18
F. RESEARCH PROCEDURE.....	19
G. SYSTEMATIC OF WRITING.....	21
CHAPTER II: GENERAL OVERVIEW OF SHARIA MUNICIPAL BOND ISSUANCE, THE OBSTACLES AND SOLUTIONS FROM AN INDONESIAN LEGAL PERSPECTIVE.....	23
A. GENERAL OVERVIEW OF LOCAL GOVERNMENT, FISCAL DECENTRALIZATION, AND LOCAL BUDGET OF INCOME AND EXPENDITURE (APBD).....	23



1. Local Government and Local Governance.....	23
2. Decentralization and Fiscal Decentralization.....	31
3. Local Budget of Income and Expenditure (APBD). ....	37
4. Local Governance and Fiscal Decentralization in Islamic Perspective. ...	49
<b>B. GENERAL OVERVIEW OF SHARIA CAPITAL MARKET, SHARIA BOND, SHARIA BOND ISSUANCE, AND SHARIA CAPITAL MARKET REGULATORY AND SUPERVISORY.....</b>	<b>55</b>
1. Sharia Capital Market. ....	55
2. Sharia Bond.....	59
3. Sharia Bond Issuance. ....	71
4. Regulator and Supervisor in Sharia Capital Market.....	80
5. Sharia Capital Market and Sharia Bond in Islamic Perspective. ....	809
<b>CHAPTER III: THE OBSTACLES AND SOLUTIONS OF SHARIA MUNICIPAL BOND ISSUANCE IN INDONESIAN LEGAL PERSPECTIVE.</b>	<b>94</b>
.....	94
<b>A. THE OBSTACLES OF LOCAL GOVERNMENT IN TERMS OF SHARIA MUNICIPAL BOND ISSUANCE. ....</b>	<b>94</b>
1. The Obstacles of the Local Government against Pre-Registration Statement of Sharia Municipal Bond Issuance. ....	97
2. The O of the Local Government against Registration Statement of Sharia Municipal Bond Issuance. ....	109
<b>B. THE SOLUTIONS FOR THE RELATED PARTIES IN TERMS OF SHARIA MUNICIPAL BOND ISSUANCE. ....</b>	<b>123</b>
1. The Solutions for the Related Parties in terms of Pre-Registration Statement of Sharia Municipal Bond Issuance. ....	126
2. The Solution for the Related Parties in terms of Registration Statement of Sharia Municipal Bond Issuance.....	136
<b>CHAPTER IV CLOSURE. ....</b>	<b>144</b>
<b>A. CONCLUSION. ....</b>	<b>144</b>
<b>B. RECOMMENDATION.....</b>	<b>148</b>
<b>BIBLIOGRAPHY. ....</b>	<b>149</b>

## **ABSTRACT.**

According to the Law No. 23 year 2014 on the Local Governance, The Local Government has opportunities to obtain the loan from the public through Municipal Bond Issuance in order to enhance their Local Development. However, Municipal Bond Issuance contradict with Sharia Principles due to Municipal Bond not containing Sharia Compliance. In addition, there are many obstacles faced by the Local Government with the issuance of Sharia Municipal Bond, either during the preparation of Pre-Registration Statement of the Sharia Municipal Bond Issuance or the preparation of Public Offering of Sharia Municipal Bond in the Capital Market. The problems that discussed in this research are: (1) What are the obstacles of Local Government in terms of Sharia Municipal Bond? and (2) What are the solutions from the Related Parties in order to Synchronize and Harmonize the regulation related to Sharia Municipal Bond Issuance? This thesis use secondary data taken from the documents or archives that related to the problem discussed. The approach of thesis is juridical normative-empirical research. The best solutions for this obstacles may be provided by the Related Parties such as Ministry of Finance, Ministry of Local Affairs, Otoritas Jasa Keuangan (OJK), Majelis Ulama Indonesia (MUI), Komisi Pemberantasan Korupsi (KPK), and Badan Pemersika Keuangan (BPK) to revise the technical regulation regarding Sharia Municipal Bond Issuance, both in the outlook of preparation and in the scope of the registration statement by synchronizing and harmonizing the current technical regulation with Law of Sharia Sovereignty Bond and Law of the Financial Examiner Body. The recommendation in this thesis are Revise the Capital Market Law, add the provision of Sharia Municipal Bond Issuance in the legislation that related, and create the law regarding Government Procurement of goods and services.

***Keywords: Obstacles and Solutions, Sharia Municipal Bond Issuance, Indonesian Legal Perspective.***

## CHAPTER I

### INTRODUCTION.

#### A. Context of Study.

Local Government is the implementation of government affairs by the local government and the legislature according to the principles of autonomy and assistance with the principle of broad autonomy within the system and the principles of the Republic of Indonesia as defined in the 1945 Indonesian Constitution.<sup>1</sup> The Local Government is run by the Head of Local Government, Head Deputy of Local Government, Local Parliament, and other local officials as organizers of Local Governance. The Regulation on Local Government is governed by Law No. 23 year 2014 on the Local Government (Law of Local Governance) with the general principle of Local Governance to implement Local Autonomy as widely as possible.<sup>2</sup>

One of the purposes of the establishment of the Law of Local Governance is financial independence.<sup>3</sup> It is because of the spread of a less equitable execution of development giving rise to a gap of economic growth between the Local Governments.<sup>4</sup> The result of economic independence is Fiscal Decentralization. Fiscal Decentralization is intended to improve the efficiency of the economy where

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<sup>1</sup> Article 1 No. 2 Law No.23 year 2014 on the Local Governance.

<sup>2</sup> Article 1 No. 23 Law No.23 year 2014 on the Local Governance.

<sup>3</sup> Udin Rinaldi, *Kemandirian Keuangan Dalam Pelaksanaan Otonomi Daerah*, Vol.8 No.2, Pontianak, 2012, p.109, [http://rise43t.polnep.ac.id/bo/upload/penelitian/penerbitan\\_jurnal/06-eksos%204%20-%20udin%20rinaldi.pdf](http://rise43t.polnep.ac.id/bo/upload/penelitian/penerbitan_jurnal/06-eksos%204%20-%20udin%20rinaldi.pdf), accessed on August 5, 2017.

<sup>4</sup> Tarmidi Lepi, *Krisis Moneter Indonesia Sebab, Dampak, Peran IMF dan Saran*. Jurnal Akuntansi Pemerintah, Jakarta, 2000, p.5, <http://journalbankindonesia.org/index.php/BEMP/article/view/183/158>, accessed on August 5, 2017.

the provision of public goods and services can be tailored to suit different tastes and conditions of each region so as to provide greater social welfare rather than the provision of public goods and services are determined in implementation with the same amount of cross-jurisdiction.<sup>5</sup>

Therefore, the Government establishes the Law of Local Governance, one of which is to give the authority of provincial governments to manage the Local Budget of Income and Expenditure (APBD) independently. According to Article 1 number 32 Law of Local Governance, APBD is an annual financial plan in a defined area with the establishment of Local Government Regulation.<sup>6</sup> In the management of APBD, it contains the implementation of fiscal decentralization. In fact, it also contains the hopes of creating development from downwards.<sup>7</sup>

One part of the APBD structure besides local income and local outcome is Local Financing.<sup>8</sup> Local Financing is the entire of the Local Government financial transactions, either acceptance or spending, which needs to be paid or received back, which is in the Local Government budgeting is primarily intended for covering the deficit and surplus or to make use of the budget. Income of financing may come from loans and divestitures. While, among others, the Outcome of financing used for repayment of loan principal, the granting of loans to other

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<sup>5</sup> Wallace Oates, *Fiscal Decentralization and Economic Development*, National Tax Journal, XLVI, 1993, p.237-243, <https://www.ntanet.org/NTJ/46/2/ntj-v46n02p237-43-fiscal-decentralization-economic-development.pdf>, accessed on August 5, 2017.

<sup>6</sup> Article 1 No.32 Law No.23/2014 on the Local Government.

<sup>7</sup> Roy Bahl, *Implementation Rules For Fiscal Decentralization*, Working Paper, Andrew Young School of Policy Studies Georgia State University, USA, 1999, p.99, <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.200.7474&rep=rep1&type=pdf>, accessed on August 5, 2017.

<sup>8</sup> Article 66 Section (4) Law No.33 year 2004 on the Financial Equalization between Central Government and Local Government.

entities, and capital investment by local governments.<sup>9</sup> The fundamental difference between Local Financing and the structure of the other APBD is from the movement of the flow of funds. The flow of funds of local incomes is its income, while the flow of funds of local expenditures are its spending, and the flow of funds of Local Financing are income/outcome which should be paid/received by Local Governments.<sup>10</sup>

One way of Local Financing in Sharia principles is through the issuance of Sharia Municipal Bond.<sup>11</sup> Sharia Municipal Bond is of the product of Sharia Bond in Indonesia beside Sharia Sovereignty Bond (SBSN) and Sharia Corporate Bond. Sharia Bond is in principle similar to conventional bonds, with the main differences among others in the form of the use of the concept of reward and for results in lieu of interests, the existence of an underlying transaction in the form of a certain number of assets which becomes the basis of issuance of Shariah Bond, and the existence of a contract or agreement between the parties that are arranged based on Sharia principles. In addition, it should also be formed in Sharia-compliant financial

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<sup>9</sup> Angela Andromeda Setiadarma, *Pengaruh Pertumbuhan Ekonomi, Pendapatan Asli Daerah, dan Dana Alokasi Umum terhadap Pengalokasian Anggaran Belanja Modal Pada Pemerintah Kabupaten/Kota di Provinsi Daerah Istimewa Yogyakarta*, Thesis of Atmajaya University of Yogyakarta, Yogyakarta, 2011, p.13, <http://e-journal.uajy.ac.id/2657/3/2EA16605.pdf>, accessed on August 5, 2017.

<sup>10</sup> Moh Amri Ashidiq, *Pengaruh Pendapatan Asli Daerah, Transfer Pemerintah Pusat: Investasi Pemerintah daerah dan Pertumbuhan Ekonomi Terhadap Kemandirian Daerah (Studi Empiris Pada Kota/Kabupaten Bandung Di Wilayah Provinsi Jawa Barat)*, Thesis of Widyatama University, Bandung, 2015, p.13, <https://repository.widyatama.ac.id/xmlui/bitstream/handle/123456789/5628/Bab%201.pdf?sequence=9>, accessed on August 5, 2017.

<sup>11</sup> <https://m.tempo.co/read/news/2017/04/04/090862374/sukuk-bisa-jadi-alternatif-pembiayaan-daerah>, accessed on August 5, 2017.

instruments so that it is safe and free from interests, *gharar*, and *maysir*.<sup>12</sup> Then, in the process of issuance, there are several types of Sharia Bond issuance based on several kinds of agreements, namely *Ijarah*, *Mudarabah*, *Musyarakah*, and *Isthisna*.<sup>13</sup>

Sharia Bond is one of the instruments which provides investment opportunities for investors, both Muslims and Non-Muslims to invest in Indonesia. Hence, Sharia Bond can be utilized to build the economy of the nation and create welfare for the society. The fact shows that market is very responsive to the issuance of Sharia Bond. Almost all of the Sharia Bond issued by the market are exhausted, absorbed, and even in some cases give rise to excess demand/oversubscribe.<sup>14</sup> The existence of Shariah Bond can strengthen Indonesia's economic conditions and withstand the economic bubble because it will expand the portfolio of foreign currencies other than dollars. Sharia Bond is the suitable instrument for Middle Eastern investors by providing appropriate financing alternative in Islamic jurisprudence.<sup>15</sup>

Shariah Bond is one of the product of bonds that were a part of the effect and can be traded in the stock exchange under article 1 paragraph (4) Law No. 8 year 1995 on the Capital Market (Law of Capital Market).<sup>16</sup> In order to create construction, arrangement, and the supervision of day-to-day activities related to

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<sup>12</sup> Handityo Nugroho, *Perkembangan Sukuk Di Dunia*, Thesis of University of Indonesia, Jakarta, 2013, p.6, <http://lib.ui.ac.id/file?file=digital/20369039-MK-Handityo%20Nugroho.pdf>, accessed on August 5, 2017.

<sup>13</sup> Adrian Sutedi, *Aspek Hukum Obligasi dan Sukuk*, Sinar Grafika, Jakarta, 2009, p.153.

<sup>14</sup> Dede Abdul Fatah, *Perkembangan Obligasi Syariah (Sukuk) di Indonesia: Analisis Peluang dan Tantangan*, Jurnal Al-`Adalah Vol.X, Universitas Azzahra, Jakarta, 2011, p.41, <https://media.neliti.com/media/publications/57655-ID-perkembangan-obligasi-syariah-sukuk-di-i.pdf>, accessed on August 5, 2017.

<sup>15</sup> *Ibid*, p.42.

<sup>16</sup> Ridwan Khairandy, *Hukum Pasar Modal I*, UII Press, Yogyakarta, 2010, p.5

Sharia Bond, according to article 3 Law of Capital Market, the establishments that are authorized to perform such activity is the Capital Market Supervisory Agency and Financial Institution (BAPEPAM-LK), where these agencies hold responsibilities to the Ministry of Finance.<sup>17</sup> However, since the publication of Law No. 9 year 2011 on the Financial Services Authority (Law of OJK), the authority of BAPEPAM-LK in the field of the capital market is automatically taken over by OJK under article 51 section (1) of the Law of OJK.<sup>18</sup>

OJK's presence in order to realize the national economy was able to grow in a sustainable and stable, necessary activities in the financial services sector that was on a regular basis, fair, transparent, and accountable. As well as being able to realize the financial system growth in a stable and sustainable manner, enabling to protect the interests of the consumers and the society. To that end, OJK is bound with the functions, duties, and powers of the supervisory arrangements and towards activities in the financial services sector, particularly the capital markets which are integrated, independent, and accountable.

Issuance of Sharia Bond is basically similar with the issuance of the Conventional Bonds where both must register its activities, prospectus documents and other documents created by capital market professionals. Such as Legal Consultants for the legal auditing, Notary to audit for notarial deeds, Public Accounting for the financial auditing, Appraiser to assess the assets of the Issuer, the Trustee to represent the interests of Issuers, Ratings Companies to assess and

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<sup>17</sup> Hamud M Balfas, *Hukum Pasar Modal di Indonesia*, Tata Nusa, Jakarta, 2012, p.5.

<sup>18</sup> Article 51 Section (1) Law No.9 year 2011 of Financial Services Authority.

rank Bonds/Sharia Bonds to the OJK.<sup>19</sup> Distinguishing between Sharia Bonds with Conventional Bonds is the existence of additional documents for the issuance of Sharia Bonds, which is the underlying asset of the Issuer as security of the contract documents. Furthermore, there is the existence of Sharia Expert on the Capital Market to determine types of Sharia Bonds which will be published by the issuer as well as to give an advice the issuer in connection with the issuance of Sharia Bond.<sup>20</sup>

The attention of OJK on Sharia Bond, especially Sharia Municipal Bond, is significant. It is evident from the existence of the initiative undertaken by OJK for reviewing the publishing rules of Sharia Municipal Bond.<sup>21</sup> The purpose of the review was held in order to assist Local Governments to seek additional funds/capital for lucrative infrastructure development such as the construction of airport, seaport, hospital, and other infrastructure profitable in the Sharia. However, until now OJK have not issued any regulations regarding Sharia Municipal Bond.

According to the observations of the author, up until now there is no Local Government that has succeeded in issuing Sharia Municipal Bond due to its issuance requirement. The Local Government until now have not been able to launch the investment products even though it is set up in a set of regulations regarding the Municipal Bond Issuance.<sup>22</sup> This is because there are some obstacles

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<sup>19</sup> See OJK Regulation No.7 year 2017 on the Document of Registration Statement in order to Public Offering Equity Effect, Debt Effect, and/or Sharia Effect.

<sup>20</sup> See OJK Regulation No.18 year 2016 of Requirement and Issuance of Sharia Bond.

<sup>21</sup> <http://financial.id/newsreader/613>, accessed on August 8, 2017.

<sup>22</sup> See Law No.33 year 2004 on the Financial Equalization between Central Government and Local Government, Law No.23 year 2014 on the Local Government, Government Regulation No.58 year 2005 on the Local Finance Management, Government Regulation No.30 year 2011 on the Local Loan, Ministry of Local Affairs Regulation No.13 year 2006 on the Guidance of Local Finance Management, Ministry of Finance Regulation No.111 year 2012 on the Procedure of Issuance and Responsibility against Municipal Bond, and the set of Head of BAPEPAM-LK



in the process of Municipal Bond Issuance, such as the necessity of the approval of the Local Parliament, the Ministry of Local Affairs and the Ministry of Finance to issue the Municipal Bond which certainly requires a long time and not necessarily be agreed to approve.<sup>23</sup> Second, the Local Government has no opportunity to make the Local Assets as the guarantee of the Municipal Bond when the Local Government fail to fulfill the repayment of the Municipal Bond against the Investors due to article 49 section (5) Law No.1 year 2004 on the State Treasury (Law of State Treasury) which states that The Local Government is prohibited to loan or guarantee the local assets to obtain the loans.<sup>24</sup> Third, the appointment of Supporting Institution and Supporting Profession of the Capital Market for Public Offering of Municipal Bond should be through goods and/or services procurement based on Ministry of Finance Regulation No.111 year 2012 on the Procedure of Issuance and Responsibility against Municipal Bond (MFR 111/2012).<sup>25</sup> Whereas, the obstacles on the goods and/or services procurement is corruption<sup>26</sup> and the absorption of the Local Budget of Income and Expenditure (APBD) is due to the lack of professionalism and commitment of the officer and Procurement Unit in conducting the procurement process.<sup>27</sup> Lastly, the Local Government is faced with

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Decision No.IX.C.12, IX.C.13, IX.C.14, VIII.G.14, VIII.G.15, and VIII.G.16 related with the Procedures of Registration Statement of Municipal Bond.

<sup>23</sup> <http://www.hukumonline.com/berita/baca/lt5651d28c6ad45/mengupas-kesulitan-penerbitan-obligasi-daerah>, accessed on August 8, 2017.

<sup>24</sup> Article 49 Section (5) Law No.1 year 2004 on the State Treasury.

<sup>25</sup> Article 14 Ministry of Finance Regulation No.111 year 2012 on the Procedure of Issuance and Responsibility against Municipal Bond.

<sup>26</sup> <http://nasional.kompas.com/read/2017/09/28/19204361/ini-celah-kecurangan-pengadaan-barang-dan-jasa-yang-berpotensi-korupsi>, accessed on August 8, 2017.

<sup>27</sup> Nafsi Hartoyo, *Percepatan Penyerapan Dana Belanja Modal Melalui Pengadaan Barang/Jasa Pemerintah*, Badan Pendidikan dan Pelatihan Keuangan Kementerian Keuangan, Malang, 2015, p.2, <http://www.bppk.kemenkeu.go.id/publikasi/artikel/149-artikel-kekayaan->

the problem of making Local Financial Statements<sup>28</sup> due to article 31 section (1) Law No.17 year 2003 of the State Financial that states only the Financial Examiner Body (BPK), one of which could conduct auditing of the Local Finance.<sup>29</sup> Moreover, it is strengthened by Law No.15 year 2006 of the Financial Examiner Body (Law of BPK)<sup>30</sup> and Law No.15 year 2004 of the Examination of Management and Responsibility of State Financial (Law of State Financial Examination)<sup>31</sup> that clearly explains BPK has the authority to examine the financial of Local Government. Whereas in article 64-69 Law of Capital Market *jo.* article 55 section (1) Law of OJK, clearly state that the audit can only conduct bookkeeping for the creation of a prospectus in connection with the primary issuance of Bonds/Sharia Bonds is the public accountant which is only registered by OJK.<sup>32</sup>

Even the Government strongly supports efforts in the issuance of Sharia Municipal Bond. This is evidenced by the statement of the Head of the Directorate General of Sharia-Compliant Financing and Risk Management Ministry of Finance, stating that the Sharia Municipal Bond can be considered as one alternative to Local

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[negara-dan-perimbangan-keuangan/20501-percepatan-penyerapan-dana-belanja-modal-melalui-pengadaan-barang-jasa-pemerintah](http://negara-dan-perimbangan-keuangan/20501-percepatan-penyerapan-dana-belanja-modal-melalui-pengadaan-barang-jasa-pemerintah), accessed on August 8, 2017.

<sup>28</sup>

<http://bisniskeuangan.kompas.com/read/2015/03/13/155000226/Soal.Obligasi.Daerah.OJK.Temui.Sejumlah.Hambatan>, accessed on August 8, 2017.

<sup>29</sup> Article 31 Section (1) Law No.17 year 2003 on the State Financial.

<sup>30</sup> Article 6 Law No.15 year 2006 on the Financial Examiner Body.

<sup>31</sup> Article 17 Law No.15 year 2004 on the Examination of Management and Responsibility of the State Financial.

<sup>32</sup> Article 64-69 Law No.8 year 1995 of the Capital Market *jo.* Article 55 Section (1) Law No.21 year 2011 on the Financial Services Authority.

Financing, because Sharia Bond is basically an instrument that uses the approach of investment rather than debt-approach.<sup>33</sup>

Based on the explanation above, The Local Government has the opportunity to issue Sharia Municipal Bond because the Authority aims to improve the well-being and self-reliance of the regional economy. But the Related Parties (BPK, Ministry of Finance, Ministry of Local Affair, MUI, OJK, BPK, and KPK) until now has not been realized because the lack of synchronized coordination of institutions related issuance of Sharia Municipal Bond. Thus, it is of the highlighted aforementioned issues, this thesis was made in order to analyze and figure out the obstacles and solutions of Sharia Municipal Bond Issuance from an Indonesian legal perspective.

## **B. Problem Statement.**

1. What are the obstacles of Local Government in terms of Sharia Municipal Bond Issuance?
2. What are the solutions from the Related Parties in order to Synchronize and Harmonize the regulation related to Sharia Municipal Bond Issuance?

## **C. Theoretical Review.**

1. To analyze the kind of obstacles of Sharia Municipal Bond issuance conducted by the Local Government in order to fulfill its obligation of economic independence in line with the issuance purpose of maintaining local development.

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<sup>33</sup> <http://www.antaranews.com/berita/622011/kemenkeu-sukuk-bisa-sebagai-alternatif-pembiayaan-daerah>, accessed on August 8, 2017.

2. To figure out the solutions that can be done by the related parties with the interest in Sharia Municipal Bond Issuance in order to Synchronize and Harmonize the regulations for the possibilities of Local Government in issuing Sharia Municipal Bond.

#### **D. Theoretical Framework.**

The purpose of a framework is to provide a systematic, comprehensive, and consistent description and analysis of the facts in order to understand the kind of those theories and concepts which correlates with Sharia Municipal Bond issued by Local Government.

Local Autonomy is the quality or state of independence, free, and self-directing or the degree of self-determination or political control possessed by a minority group, territorial division or political unit in its relations with the state or political community of which it forms a part and extending from local to full independence.<sup>34</sup> The principle of Local Autonomy uses the principle of existence autonomy where the region is given authority to administer and regulate all the Affairs of Government beyond into the Affairs of the Central Government. The Local Government has the authority to create policy in the area to provide services, increase participation, and community empowerment initiative aimed at improving the welfare of the people. In line with the principle of autonomy, is the principle of enforceable, real and responsible. Along with these two principles, the Organization of the Local Autonomy should be oriented for the improvement of the welfare of

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<sup>34</sup> Ahmad Yani, *Hubungan Antara Pemerintah Pusat dan Daerah di Indonesia*, Gramedia Pustaka Utama, Jakarta, 2002, p.5.

the community by always paying attention to the interests and aspirations that are grown in the community. Other than to organize, the Local Autonomy should also ensure the harmony of relations between regions, both fellow provinces, fellow district/city, or between the provinces with the district/city.<sup>35</sup>

In its application, Local Governments have the broad authoritative autonomy except in the fields of National Politics, Foreign Affairs, Defense-Security, Judiciary, Fiscal-Monetary, Religion, as well as other areas of authority specified by the Government Regulation. In addition, the discretion of Local Government includes authority intact and round in-ranging from planning, implementation, supervision, control, and evaluation.<sup>36</sup>

Related with Local Government, decentralization is the transfer of authority and responsibility for a public function from the central government to subordinate or quasi-independent government organization and/or the private sector. In decentralization, systemic efforts are being made to delegate to the lowest levels all authority except that which can only be exercised at the Central Government. Decentralization is delegation not from one individual to another but delegation to all units in an organization.<sup>37</sup> One of the kinds of Decentralization is Fiscal Decentralization, beside Political Decentralization and Administrative

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<sup>35</sup> H.A.W. Widjaja, *Penyelenggaraan Otonomi di Indonesia Dalam Rangka Sosialisasi UU No.32/2004 tentang Pemerintahan Daerah*, Raja Grafindo Persada, Jakarta, 2007, p.133.

<sup>36</sup> Bagir Manan, *Menyongsong Fajar Otonomi Daerah*, Penerbit Pusat Studi Hukum, Yogyakarta, 2005, p. 37-38.

<sup>37</sup> Boasiako and Peter Csanyi, *the Theories of Decentralization and Local Government: Implementation, Implication and Realities*, Austin State University Press, USA, 2012, p.7.

Decentralization. Fiscal Decentralization means that the central government gives the authority of local financial/treasury management to the Local Government.<sup>38</sup>

One of the authorities of Local Governments to implement of Fiscal Decentralization authority is the management of APBD. APBD is a form of long-term plan for the annual region as well as the medium-term plan of the vision and mission of the Head of Local Government. APBD are prepared by the Local Government, discussed and approved by Local Parliament so that ultimately a legal product in the form of the Local Government Regulation (Perda) should be followed by all the institutions in the area of.<sup>39</sup> Polling all the acceptance region aims to seize the targets set out in the APBD. Likewise, all spending areas and ties that strained the region in order of implementation of Fiscal Decentralization done pursuant with the number and the target which established in the APBD.<sup>40</sup>

One of the structures of APBD is Local Financing. Local financing is all receipts of money needs to be paid back and/or expense will be accepted back, either on the fiscal year in question or in the next fiscal year. The example of Local Financing is the establishment of Local Owned Enterprises and the issuance of Municipal Bond/Sharia Municipal Bond.<sup>41</sup>

Basically, Sharia Municipal Bond is the derivative product of Sharia Bond. According to Accounting and Auditing Organization for Islamic Financial

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<sup>38</sup> <http://pengertiandefinisi.com/pengertian-desentralisasi-dan-bagian-bagian-sistem-desentralisasi/>, accessed on September 4, 2017.

<sup>39</sup> Dadang Suwanda, *Optimalisasi Fungsi Penganggaran DPRD Dalam Penyusunan Perda APBD*, Remaja Rosdakarya, Bandung, 2016, p.77.

<sup>40</sup> *Ibid*, p.79-80.

<sup>41</sup> *Ibid*, p.85-86.

Institution (AAOIFI), Sharia Bond is defined as financial securities of equal denominations representing an undivided ownership interest in a portfolio of eligible existing and/or future assets, usufruct, services, and business activities.<sup>42</sup>

There are various types of Shariah Bond in the market such as:<sup>43</sup>

1. *Sharia Bond based on Ijarah*  
*Ijarah Sharia Bond is a Sharia Bond based Issuers asset guarantee upon Investors in the contract of issuance.*
2. *Sharia Bond Based on Mudarabah*  
*Mudharabah Sharia Bond is a Sharia Bond based on a joint venture between Investor as a provider of capital and Issuers as a manager of funds in its contract of issuance.*
3. *Sharia Bond based on Musyarakah*  
*Musyarakah Sharia Bond is a Sharia Bond based on cooperation to combine capital between Issuers and Investors in its contract of issuance.*
4. *Sharia Bond based on Isthisna'*  
*Isthisna' Sharia Bond is a Sharia Bond based on sale and purchase of commodities between Issuers and Investors with certain specifications approved by the parties in its contract of issuance.*

There are several new varieties such as convertible Shariah Bond and asset substitution Shariah Bond that have also come into the market. The underlying concept in much of this Shariah Bond is securitization of existing or to be constructed/developed assets or usufruct. However, Sharia Bond differs from conventional securitization in an important way that Sharia Bond is not the sale of receivables alone but carry ownership, albeit beneficial ownership, in the underlying asset or usufruct. Moreover, their secondary market tradability is subject to Sharia principles governing the trade in the underlying asset.<sup>44</sup>

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<sup>42</sup> <http://www.nortonrosefulbright.com/knowledge/publications/16852/aaofii-statement-on-sukuk-and-its-implications>, accessed on September 4, 2017.

<sup>43</sup> Adrian Sutedi, *Aspek Hukum.....*, p.153.

<sup>44</sup> Salman Syed Ali, *Introduction Islamic Capital Market: Current State and Developmental Challenges*, Journal: Islamic Research & Training Institute, KSA, 2008, p.7, <http://www.isdb.org/irj/go/km/docs/documents/IDBDevelopments/Internet/English/IDB/CM/Publi>

As part of an Islamic Economy, Sharia Bond has the nature of the economy as *Rabbani* and *Insani*. It is said *Rabbani's* economy is due to the Sharia Bond to fulfill the purpose and values of *Illahiyah*. While the *Insani's* economy is said to be due to the Sharia Bond which was implemented and demonstrated for the benefit of mankind.<sup>45</sup> This can be understood through the basic values that inspire the Islamic economy, including the concept of *tauhid*, the concept of *rububiyah*, the concept of *Khilafah*, and the concept of *tazkiyah*.<sup>46</sup>

In the matters of issuance, the process issuance of Sharia Bond is regulated by local Sharia Committee through framework provided under the Guidelines on the Offering of Islamic Securities. AAOIFI gives advice for the issuer who wishes to issue Sharia Bond, namely:<sup>47</sup>

1. *All tradable Sharia Bond should represent holdings of the Shariah Bondholders, with all their relevant rights and obligations in physical assets that may be legally and lawfully acquired to sold, whether in kind, usufruct, or services. Meanwhile, the Shariah Bond managers have to record such ownership transfer in his own registers and should not keep those assets among his own;*
2. *Tradable Shariah Bond should not represent either receivables or revenues unless a firm, whether commercial or financial, is selling all its assets or a financial standalone portfolio that the firm hold and that it happens that such receivables were attached to the sold assets or usufruct and were not meant to be sold per se;*
3. *The Shariah Bond manager whether in his capacity as mudarib, musyarik or investment agent, is not allowed to commit to lending to Shariah Bondholders in order to cover any deficit that may arise between expected and realized a profit. A provision may be formed from prior revenues to make up such deficit as possible, provided that such provision is stipulated in the prospectus.*

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[cations/Occasional%20Papers/Islamic%20Banking%20and%20Finance/Islamic\\_Capital\\_Marke%20Development\\_Products.pdf](#), accessed on September 4, 2017.

<sup>45</sup> Hulwati, *Ekonomi Islam: Teori dan Praktiknya dalam Perdagangan Obligasi Syariah di Pasar Modal Indonesia dan Malaysia*, Ciputat Press, Jakarta, 2009, p.1.

<sup>46</sup> Surtahman Kastin, *Ekonomi Islam*, Universiti Kebangsaan Malaysia Press, Malaysia, 1990, p.12-13.

<sup>47</sup> Abdulkader Thomas, *Sukuk: Islamic Capital Market Series*, Sweet & Maxwell Asia, Malaysia, 2009, p.35-37.



4. *The mudarib, musyarik, or investment agent should not undertake to buy the asset from the Shariah Bondholders or their representatives at face value at the time of Shariah Bond extinguishing/maturity date. However, this undertaking may be based on the net asset value, market value, cash equivalent value or any price agreed upon the time of purchase, knowing that Shariah Bond manager guarantees the capital at face value in cases of negligence or violation;*
5. *A lessee may purchase the lead assets at the time of Shariah Bond extinguishing at face value, provided that such a lease is not a musharik, mudharib or investment agent; and*
6. *The Sharia Supervisory Board in each several State should not just engage itself in issuing a fatwa on Shariah Bond structuring. It required, as well, to verify all contracts and relevant document, monitor their applications and assure that process is in compliance with stipulations, and assure that the process is in compliance with the stipulation and requirements defined by Sharia standards.*

Sharia Bond is one of the parts of transactions in Sharia Capital Market. Sharia Capital Market is an important component of the Islamic financial system for raising funds for long-term investment. They provide opportunities for diversification of risk through cross-sectional risk sharing. The long-term investment is facilitated through a series of short-term contracts in the form of tradable securities enabling the investor an opportunity to exit or enter through trade. Thus they provide an element of liquidity to the otherwise liquidity assets. The secondary market also provides pricing and valuation of assets on a continued basis thus eliminating arbitrage and inefficiencies.<sup>48</sup>

Sharia Capital Market contains Islamic financial system for efficient mobilization of resources and their optimal allocation. This market complements the investment role of Islamic banking sector. It is more relevant in Islamic economy because the prohibition of interest entails a greater reliance on equity and

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<sup>48</sup> Salman Syed Ali, *Introduction Islamic Capital Market*..., p.1.

asset-based finance. For the investor to know the fair value of their investments, smooth out the risks through diversification and be able to liquidate their positions in real assets, such markets are indispensable. However, the institutional arrangements of the Islamic financial system may be different with respect to these markets as compared to their conventional counterpart. This realization is found to a lesser extent among some stakeholders than the realization of the same in case of the Islamic and conventional banking sector.<sup>49</sup>

Every Capital Market activity around the world, including Sharia Capital Market, has a regulation and supervision. Both of them must be available in order to ensure that the overall activities within the capital market sector are implemented in an organized, fair, transparent and accountable manner. Then to promote a capital market system that grows in a sustainable and stable manner. Last but not least, is to protect the interest of Investor in the Capital Market.<sup>50</sup>

For the concept of regulation, it refers broadly to the creation of formal standards and codes of conduct which private individuals and firms must follow. These standards are rules that mandate certain behavior and they are normally created and enforced by the Government. Individuals and firms must follow those rules. The government will ensure that the rules are followed through persuasion and formal enforcement by means of administrative and criminal penalties.<sup>51</sup>

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<sup>49</sup> *Ibid*, p.1.

<sup>50</sup> Gonthor R. Aziz, *Financial Services Authority*, Indonesia Capital Market and Financial Institution Supervisory Agency, Ministry of Finance, Jakarta, Unknown Year, <http://www.oecd.org/finance/financial-markets/49703438.pdf>, accessed on August 22, 2017.

<sup>51</sup> Centre for Financial and Management Studies, *Regulation of International Capital Market: Introduction to Financial Regulation*, University of London, London, 2013, p.4-5.

Certainly, the government has always exercised some sort of control over the capital market activity of individuals. They have always set standards of behavior and penalized those who failed to abide by those standards imposed by government and backed by the enforcement authority of the state deliberately purport to set boundaries and essentially limit individual and commercial freedom, to change standards of behavior and to enforce a new economic order which accords with the overriding aim of the regulating government.<sup>52</sup>

Generally, the concept of regulation refers to a wide range of socioeconomic interest and policies which aim to shield the market against anti-competitive practices, to guarantee the provision of certain public goods, and to protect the interest of investors and the stability of the capital market system. To classify the many types of regulation more systematically, one may assign them to the categories of economic perspective and social perspective. Economic perspective normally refers to restriction on prices, interest rates, the quantity of production, and the entry in or exit from the industry. Social perspective seeks to correct some form of market imperfection or failure.<sup>53</sup>

The concept of supervision refers to the separate process of ensuring that those standards are observed and complied. Supervision is the act of supervising the completion of a task or the carrying out of an instruction. Regulatory authorities not only establish rules that mandate, restrict, and prohibit certain patterns of behavior. But they also supervise those to whom the rules are addressed and seek to ensure

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<sup>52</sup> *Ibid*, p.5.

<sup>53</sup> *Ibid*, p.6.

that the rules are complied with through persuasion or formal law enforcement.<sup>54</sup> In terms of establishment of financial services authority. The state must be arranged several strategy or agenda which has the maximal benefit and minimum risk. The State must follow some possible methods such as the requirement for prior approval or authorization for specific activities, the establishment of mandatory standards of behavior, the disclosure of information regarding certain risk, and taxation.<sup>55</sup>

#### **E. Definition of Terms.**

1. As one of the Sharia Effect product, Sharia Municipal Bond is a Sharia Bond where the issuer is the Local Government in order to finance its capital expenditure such as the development of the local hospital, stadium, school, or any project that profitable.<sup>56</sup> The elements that differentiates between Municipal Bonds is not interest application in the profit sharing system over the Sharia Municipal Bond, the implementation of asset securitization in the issuance of Sharia Municipal Bond, intents and purposes the issuance of Sharia Municipal Bond that does not conflict with Sharia, and the role of Indonesian Islamic Scholar Assembly (MUI) in supervisory activities regarding issuance and sale of Sharia Municipal Bond beside to the Ministry of Finance, Ministry of Local Affairs, and OJK.<sup>57</sup> As one of the instruments of regional finance, Sharia Municipal Bond can be used to address budget constraints in encouraging regional development acceleration.

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<sup>54</sup> *Ibid*, p.6.

<sup>55</sup> *Ibid*, p.7.

<sup>56</sup> <http://www.investopedia.com/terms/m/municipalbond.asp>, accessed on September 10, 2017.

<sup>57</sup> Mohd Ma'sum Billah, *Penerapan Pasar Modal Islam*, Al-Azhar University Press, Jakarta, 2010, p.59-65.

2. In the event of the issuance of Sharia Municipal Bond, The Local Governments is faced with obstacles and solutions. Obstacles and solutions in this regard are the obstacles faced by Local Government in conducting the registration statement in order to perform of Sharia Municipal Bond issuance as well as the solutions for local Government to steady over their plans of registration statement in connection with the issuance of Sharia Municipal Bond.

#### **F. Research Procedure.**

1. The object of Study.
  - a. The obstacles of Local Government in terms of Sharia Municipal Bond Issuance; and
  - b. The role of the Related Parties who have interest in order to harmonize the regulation of Sharia Municipal Bond Issuance.
2. Classification of Data.

This research used secondary data taken from the documents or archives that related to the problem discussed. The purpose of this data is to identify the data systematically in order to answer the problems. Secondary data are divided into:

- a. Primary Legal Materials
  - 1) Law No. 23 year 2014 on the Local Government;
  - 2) Law No. 33 year 2004 on the Balancing of Finance Between Central Government and Local Government;
  - 3) Law No. 19 year 2008 on the Sharia Sovereignty Bond;
  - 4) Law No. 8 year 1995 on the Capital Market;
  - 5) Law No. 21 year 2011 on the Financial Services Authority (OJK);

- 6) Law No. 15 year 2006 of Financial Examiner Body (BPK);
- 7) Law No.15 year 2004 of the Examination of Management and Responsibility of the State Financial;
- 8) Law No.1 year 2016 on the Guarantee;
- 9) Others Government Regulation related to Local Income and Outcome Budget (APBD);
- 10) Others Presidential Regulation related to Procurement of Goods and Services;
- 11) Others Ministry Regulation (Ministry of Local Affairs and Ministry of Finance) related with Local Loan;
- 12) Others BAPEPAM-LK and OJK Regulation related with Sharia Municipal Bond Issuance and Municipal Bond Issuance; and
- 13) Others Fatwa DSN-MUI related with Sharia Bond.

b. Secondary Legal Materials

- 1) Text Book;
- 2) Legal Journals; and
- 3) Internet Sources.

c. Tertiary Legal Material

- 1) Legal Dictionary; and
- 2) Business Dictionary.

3. Data Collection.

The method of gathering legal materials will be using library studies and documentation from an interview with OJK employees. The data collected from books and interviews that are related to the issuance of Sharia Municipal Bond.

#### 4. The approach of Study.

This thesis is a juridical normative-empirical research that identifies legal norms, legal perspectives, and legal implementations. The objective is to understand and answer the object of study by using juridical normative-empirical approach.

#### 5. Data Analysis.

The data collection is organized by selecting the data related to the discussed problems in this research. It is structured descriptively in order to answer the problem in a descriptive analysis. The data are collected, managed, and used to answer the problem formulation. The method of analyzing the data was a qualitative method. It means that the data achieved are not in the form of numbers and statistics. Collected data are analyzed qualitatively and descriptively. Moreover, it also portrays facts, legal enforcement, and bears with the applicable legal aspects. The steps are defined as follows:

- a. Classification of the data collection based on the problems of the research;
- b. Systematic of data collection; and
- c. Systematic data are analyzed to achieve a conclusion.

### **G. Systematic of Writing.**

#### 1. Chapter I.

Chapter I contains an introduction that encompasses these following parts: the context of the study, statement of problems, research objectives, theoretical frameworks, research procedure, and system of writing.

2. Chapter II.

Chapter II contains theoretical review on Issuance of Sharia Municipal Bond, definition and elements which are related to Sharia Municipal Bond, and obstacle and solutions on Issuance of Sharia Municipal Bond in legal perspective.

3. Chapter III.

Chapter III contains the analysis of the possibilities of Local Government in terms of Sharia Municipal Bond Issuance in legal perspective and the role of the Related Parties who have interest in terms of harmonizing the regulation of Sharia Municipal Bond Issuance.

4. Chapter IV.

Chapter IV provides the conclusion and recommendation that are made based on the previous analysis that has been done.



## CHAPTER II

### GENERAL OVERVIEW OF SHARIA MUNICIPAL BOND ISSUANCE, THE OBSTACLE AND SOLUTIONS FROM AN INDONESIAN LEGAL PERSPECTIVE.

#### A. General overview of Local Government, Fiscal Decentralization, and Local Budget of Income and Expenditure (APBD).

##### 1. Local Government and Local Governance.

According to Article 1(2) Law No. 23 year 2014 on the Local Governance (Law of Local Governance), Local Governance is the conduct of the Governments Affairs by Local Governments and the Local Parliament according to the principle of autonomy and the assistance with the principle of broader autonomy in the system and the principle of the Unitary State of the Republic of Indonesia as intended in the Constitution 1945.<sup>58</sup> According to Liang Gie, Local Governance is a government organization units authorized to organize all the local interests of the bunch who inhabit a region led by the head of the Local Government.<sup>59</sup> Meanwhile according to Gomme, Local Government is that part of the whole government of a nation or state which is administrated by authorities subordinate to the state authority, but elected independently of control by the state authority, by qualified persons resident or

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<sup>58</sup> Article 1 Number 2 Law No.23 year 2014 on the Local Governance

<sup>59</sup> The Liang Gie, *Pertumbuhan Pemerintahan Daerah di Negara Kesatuan Republik Indonesia*, Liberty, Yogyakarta, 1988, p.44.

having property in certain localities, which localities have been formed by communities having common interests and common history.<sup>60</sup>

The existences of Local Government could not be regardless of the existence of the Local Autonomy. According to Article 1 number 6 Law of Local Governance, Local Autonomy is a right, authority, and obligation of Local Autonomy to set up and take care of her own Affairs of Government and the interests of the local community in the system of Unitary State of the Republic of Indonesia.<sup>61</sup> Meanwhile, according to Lawrence, Local Autonomy is a perennial issue in the study of sub-central government. He added that it is almost impossible to discuss the relationship between central government and local government or the political concept of local government without substantial reference to notions of Local Autonomy.<sup>62</sup> Local Autonomy is a process of an embodiment of the implementation of the decentralized system in which decentralized system was implemented as a follow-up to democratization in Indonesia. Thus, the decentralized system is set to divide power between the Central Government and Local Government. Local Governments have the authority to set up his own administration.<sup>63</sup>

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<sup>60</sup> G.L. Gomme, *Lectures on the Principles of the Local Government*, London School of Economic, UK, 1987, p.1-2, <https://id.scribd.com/document/97173885/Local-Government>, accessed on October 1, 2017.

<sup>61</sup> Article 1 Number 6 Law No.23 year 2014 on the Local Governance.

<sup>62</sup> Lawrence Pratchett, *A Separation of Local Autonomy and Local Democracy*, ECPR Joint Sessions of Workshops, De Montfort University, UK, 2001, p.1, <https://pdfs.semanticscholar.org/65d5/1f2f7cc2f1b8e3a4d2922dfed11690b99597.pdf>, accessed on October 1, 2017.

<sup>63</sup> Natal Kristiono, *Buku Ajar Otonomi Daerah*, Universitas Negeri Semarang, 2015, p.1, [https://www.researchgate.net/profile/Natal\\_Kristiono2/publication/301781293\\_Diktat\\_Otonomi\\_Daerah/links/57280a0c08aee491cb415048/Diktat-Otonomi-Daerah.pdf](https://www.researchgate.net/profile/Natal_Kristiono2/publication/301781293_Diktat_Otonomi_Daerah/links/57280a0c08aee491cb415048/Diktat-Otonomi-Daerah.pdf), accessed on October 1, 2017.

The Organization of the Local Autonomy will essentially be manifested properly if implemented by using the principles of Good Governance.<sup>64</sup> Good Governance is the process management of the various areas of life, such as social, political, legal, and economic, in a country by involving the various stakeholders, as well as the use of human and natural resources in a manner that complies with the principles of participation society, the rule of law, transparency, responsiveness, consensus-oriented, equity and inclusiveness, effectiveness and efficiency, as well as accountability of public.<sup>65</sup>

The Local Government is the Head of Local Government (Governor, Regent, or Mayor) along with the device element area organizers of Local Governance. While the Local Parliament is the institution of the regional House of Representatives in the region as an organizer of Local Governance. Local governments should be able to manage their own local area with good and full responsibility as well as much of the corruption practices.<sup>66</sup> The rights and obligations of Local Government in governance functions, especially in implementing regional autonomy provided with certain rights and obligations under Article 65-75 on the Law of Local Governance.<sup>67</sup>

Arthur Mass states there are two types of power-sharing in the principles of organization of Local Governance, namely the Central Division of Power in which the Division of power is done in vertical like the division between the

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p. 2. <sup>64</sup> Syamsuddin Haris et.al, *Desentralisasi dan Otonomi Daerah*, LIPI Press, Jakarta, 2004,

<sup>65</sup> *Ibid*, p. 5-6.

<sup>66</sup> Natal Kristiono, *Op.Cit*, p.88.

<sup>67</sup> Article 65-75 Law No.23 year 2014 on the Local Governance.

Executive, legislative, and judicial; and the Division of Powers in which the Division of power is carried out horizontally like the Division of power between the Central Government with local government.<sup>68</sup> He added that there are three basic values that must be met to realize the Area Division of Powers, namely:<sup>69</sup>

1. Liberty

Liberty means power-sharing to retain individuals and groups against arbitrary government action.

2. Equality

Equality means power-sharing provides ample opportunity for the participation of citizens in policy.

3. Welfare

Division of power ensures that Government action will be effective in meeting the needs of the community.

Therefore, for the sake of passage of an organization, the State applying the governance principles, namely:

1. Decentralization

Decentralization is a transfer of authority/affairs of government from Central Government to Local governments in order to set up and take care of its own territory.<sup>70</sup>

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<sup>68</sup> Arthur Mass, *Area and Power: A Theory of Local Government*, Glencoe, USA, 1959, p.10.

<sup>69</sup> *Ibid*, p.10.

<sup>70</sup> Phillipus M.Hadjon et.al, *Pengantar Hukum Tata Usaha Indonesia*, Gajah Mada University Press, Yogyakarta, 2011, p.112.

## 2. De-Concentration

De-Concentration is the assignment to the Local governments from Central Government to handle certain things which carry the right to govern and make decisions on certain matters.<sup>71</sup>

## 3. Co-Administration Task

Co-Administration Task is the obligation of Local Government to enforce the law over the assignment from the Central Government by means of making local regulations to adapt from Act to local conditions.<sup>72</sup>

With regard to the setting of regional affairs, Article 9 section (1) Law of Local Governance explains there are three types of Government Affairs, namely Absolut Government Affairs, Concurrent Government Affairs, and Public Government Affairs. Absolute Government Affairs is a vital, strategic and are absolutely owned by the Central Government such as Foreign Affairs, Defense, Security, Judicial, National Monetary and Fiscal, and Religion.<sup>73</sup> While the Concurrent Government Affairs is an authority outside the Central Government such as basic services (education, health, social), non-basic services (labor, the environment, investment) and option (tourism, trade, industry).<sup>74</sup> Then General Government Affairs is a Government Affairs became

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<sup>71</sup> *Ibid*, p.113.

<sup>72</sup> S.L.S. Danuredjo, *Struktur Administrasi dan Sistem Pemerintah di Indonesia*, Penerbit Laras, Jakarta, 1967, p.75.

<sup>73</sup> Article 9 Section (1) Law No. 23 year 2014 on the Local Governance.

<sup>74</sup> SLS Danuredjo, *Op.Cit*, p.75.

the authority of the President as head of State and is exercised by the Local Government (Governors, Regents, and Mayors) which includes:<sup>75</sup>

1. Coaching insight nationality and national resilience in order to establish the practice of Pancasila, the 1945 Constitution, the implementation of preservation "Bhinneka Tunggal Ika", as well as the maintenance of the integrity of the Unitary State of the Republic of Indonesia;
2. The construction of the unity and oneness of the nation;
3. The construction of the tribes, religious, racial and other divisions in order to realize national stability;
4. Social conflict Handling;
5. Coordination of the implementation of tasks between governmental agencies; and
6. Development of life-based on Pancasila.

In the Implementation of Local Autonomy, Head of Local Government together with the Local Parliament has the authority to create Local Regulation in order to run the government principles such as Decentralization, De-Concentration, and Co-Administration Task. Local Regulation is the legislation which created by the Local Parliament with the approval by the Head of Local Government. As a product of the law, the position of the local regulations is very clear in the hierarchy of legislation in Indonesia. According to article 7 grains (f and g) Law No. 12 year 2011 on the Formulation of

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<sup>75</sup> *Ibid*, p.75.

Legislation (Law of the Formulation of Legislation), the position of local regulations, whether in the provincial or district/city level are under the 1945 Constitution, the MPR TAP, Laws, Government Regulations, and the President Regulation.<sup>76</sup> Material charge Local Regulation contains material in order to charge the Organization of decentralized, De-Concentration and Co-Administration Task as well as accommodate special conditions of the area and/or further explanations against the higher legislation.<sup>77</sup>

Mechanism of Local Regulation creation is divided into 6 sections, namely; the stage of planning, drafting, discussion, confirmation, designation, and enactment.<sup>78</sup> In the planning stages, the Head of the Local Government along with the Local Parliament draft the program of local legislation. The preparation of local legislation program is based on:<sup>79</sup>

1. *The higher legislation orders;*
2. *The plan of Local Development;*
3. *The Performance of Local Autonomy and Co-Administration Task; and*
4. *The Aspiration of Local Society.*

Besides that, the draft of Local Regulation can be proposed if:<sup>80</sup>

1. *The impact of Supreme Court verdict;*
2. *The forming of APBD;*
3. *There is a force majeure, conflict, or natural disaster;*
4. *There is cooperation with other parties; and*
5. *The others condition.*

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<sup>76</sup> Article 7 Grains f and g Law No.12/2011 on the Formulation of Legislation.

<sup>77</sup> Article 14 Law No.12 year 2011 on the Formulation of Legislation.

<sup>78</sup> <http://www.hukumpedia.com/twthaha/penyusunan-peraturan-daerah>, accessed on December 9, 2017.

<sup>79</sup> Article 35 Law No.12 year 2011 on the Formulation of Legislation.

<sup>80</sup> Article 38 Law No.12 year 2011 on the Formulation of Legislation.

The materials which arranged in the draft of Local Regulation are:<sup>81</sup>

1. *The background and purpose of drafting;*
2. *The goals who want to be realized;*
3. *The thoughts, scope, or objects that will be arranged; and*
4. *The range and direction settings.*

The material that has been through assessment and alignment are noted in the academic manuscript. The academic manuscript is a manuscript or research studies on legal and other research results to a specific problem which can be scientifically justified about those problems arrangement in a draft regulation legislation as a solution to the problems and needs of the legal community.<sup>82</sup>

As for drafting Local Regulations, the head of Local Government or Local Parliament may submit draft local regulations are accompanied by an explanation or description and/or academic manuscript. The draft of Local Regulations regarding:<sup>83</sup>

1. *The Local Budgets of Income and Expenditure (APBD);*
2. *The revocation of Local Regulation; or*
3. *The changes in local regulations that only limited change some charge is accompanied by a caption that contains the principal thought and material charge which is set.*

In the step of Local Regulation discussion, the mechanism of discussion is:<sup>84</sup>

1. *The discussion of the draft of Local Regulation conducted by the head of Local Government and the Local Parliament;*
2. *The discussion of the draft of Local Regulation conducted through levels of conversation; and*
3. *The levels of conversation consist of meeting of commission/committee/body/fittings of the Local Parliament in the legislation sector and plenary meeting.*

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<sup>81</sup> Article 33 Law No.12 year 2011 on the Formulation of Legislation.

<sup>82</sup> Article 1 Number 11 Law No.12 year 2011 on the Formulation of Legislation.

<sup>83</sup> Article 56 Law No.12 year 2011 on the Formulation of Legislation.

<sup>84</sup> Article 75 Law No.12 year 2011 on the Formulation of Legislation.



At the stage of determination of the draft of Local Regulations, it can be done when the heads of the Local Government and the Local Parliament together to approve the draft of Local Regulations in question. The Local Parliaments are given 7 days from the date of approval of the joint draft determination to convey the draft of Local Regulation become the Local Regulation to the Head of Local Government. Then the Head of Local Government given 30 days to sign the assignment against the draft of Local Regulations become the Local Government.<sup>85</sup>

## **2. Decentralization and Fiscal Decentralization.**

Decentralization comes from the Latin word “*Decentrum*” meaning to take off from the Center.<sup>86</sup> According to Rodnelli and Cheema, Decentralization is the transfer of planning, decision making, or administrative authority from the central government to its field organization, local administrative units, semi-autonomous and parasternal organization.<sup>87</sup> Meanwhile, according to Joeniarto, Decentralization is a basic principle to give the authority of the Central Government to Local Governments to arrange and take care of certain matters as his own household affairs.<sup>88</sup> Then according to Montoux, Decentralization is a process by which central state power is transferred in varying degree into sub-national governance units to broaden access to political

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<sup>85</sup> Article 79 Law No.12 year 2011 on the Formulation of Legislation.

<sup>86</sup> Arthur Mass, *Op.Cit* p.3.

<sup>87</sup> Rondinelli and Cheema, *Decentralization and Development: Policy Implementation in Developing Countries*, Sage Publication, USA, 1983, p.5.

<sup>88</sup> Joeniarto, *Perkembangan Pemerintahan Lokal*, Bumi Aksara, Jakarta, 1992, p.15.

and administrative decision-making and localize provision of delivering public goods and services and strengthen local development initiatives.<sup>89</sup>

The essence of decentralization is the process of autonomy, namely the process of submission to the lower unit of Government to regulate and manage certain Affairs of the Government as his household affairs.<sup>90</sup> Through decentralization, more people (directly or indirectly) involved in the process of formulation, implementation, and evaluation of public policies for the benefit of the community so that it will support the decentralization process of democratization.<sup>91</sup>

According to Rondinelli and Cheema, the forms of decentralization are divided into four parties, namely:<sup>92</sup>

1. De-Concentration

De-Concentration is the shift from central agencies functioning from the center cities to ground offices of these agencies.

2. Delegation

Delegation is the convey of service duty from central government agencies to expert institutions or bodies with a few or little level of functioning independently.

3. Devolution

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<sup>89</sup> Camille A. Monteux, *Decentralization: The New Delusion of Ethnic Conflict Regulation*, International Journal Multicultural Society Vol.8, USA, 2006, p.162, <http://unesdoc.unesco.org/images/0014/001499/149924e.pdf>, accessed on October 2, 2017.

<sup>90</sup> Sirajuddin et.al., *Op.Cit*, p.3.

<sup>91</sup> Rondinelli and Cheema, *Op.Cit*, p.15.

<sup>92</sup> *Ibid*, p.20.

Devolution is the shift from central government to independent division of local government with group prominence

#### 4. Privatization

Privatization is the transfer of duty for manufacturing goods or services to private unpaid organizations or private enterprises.

Decentralization may take many different dimensions and there is a close relationship between the objectives of decentralization and the dimension which it takes. According to Rondinelli and Cheema, there are three fundamental types of decentralization which have different objectives, degree, and means of decentralization of power, namely: <sup>93</sup>

##### 1. Political Decentralization

Political Decentralization as a mechanism to increase the participation of citizens and civil society in their selection of governmental representatives and in political decision-making, thereby, the lower levels of government administration become accountable to the public. Further, political decentralization changes the way policy responsibilities are shared between the levels of government.

##### 2. Administrative Decentralization

Administrative Decentralization as transfer of authority from a higher level of government to a lower, delegation of decision-making process, placement of authority, allowing greatest number of actions to be taken

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<sup>93</sup> *Ibid*, p.25-28.

where most of the people reside, removal of functions from center to the periphery, and a mode of operations involving wider participation of people in the whole range of decision-making process. This type of decentralization involves in sharing the responsibilities and authorities between the headquarters and the field offices.

### 3. Fiscal Decentralization

Fiscal Decentralization is the most traceable type of decentralization which directly linked to budgetary practices. It necessitates the transfer of powers to raise and retain financial resources to fulfill assigned responsibilities to local level political and administrative organizations. It comprises the assignment of functions and responsibilities regarding revenue collections and spending to a sub-national government institution. Further, it allows allocating resources, including the delegation of funds within sector ministries to the sub-national level of government.

Political Decentralization is to take care of the household area itself which will only be effective if accompanied by the Fiscal Decentralization namely fiscal equalization funds and granting the right area to attract Original Revenue (PAD) as well as in accordance with the potential it owns. Next Fiscal Decentralization will only be able to put to good use when planned, implemented, supervision and examination and accounted for by the third pillar of the autonomous region namely Local Government, Local Parliament, and

the community in accordance with the mechanisms and rules of the applicable legislation.<sup>94</sup>

Related with the function of Fiscal Decentralization, it has to be done to support the Organization of the autonomous areas through the provision of funding sources based on the authority of the Central Government, Decentralization, De-concentration and Co-Administration Task, need to be regulated financial equalization between the Central Government and Local Governments in the form of a financial system which is set based on the separation of the powers, duties and responsibilities that clear between the arrangement of Government.<sup>95</sup>

According to Law No.33 year 2004 on the Financial Equalization between Central Government and Local Government (Law of Financial Equalization), financial equalization between central government and local government is a separation of the financial system which is fair, proportional, democratic, transparent and efficient organization of funding within the framework of decentralization, taking into account the potential, conditions, and the needs of the region, as well as the magnitude of funding the Organization of De-concentration and Co-Administration Task.<sup>96</sup> Financial equalization between

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<sup>94</sup> Lestrianingsih, *Pengelolaan Penerimaan Daerah Melalui Desentralisasi Fiskal Dalam Penyelenggaraan Otonomi Daerah*, Spirit Publik Vol.9 No.1, UNS Journal, Surakarta, 2004, p.16, <https://digilib.uns.ac.id/dokumen/download/43258/MTQ5MjUw/PENGELOLAAN-PENERIMAAN-DAERAH-MELALUI-DESENTRALISASI-FISKAL-DALAM-PENYELENGGARAAN-OTONOMI-DAERAH.pdf>, accessed on October 2, 2017.

<sup>95</sup> *Ibid*, p.18-19.

<sup>96</sup> Article 1 Number 3 Law No.33 year 2004 on the Financial Equalization between Central Government and Local Government.

central government and local government is the subsystem of financial of State as a consequence of the Division of tasks between the Central Government and Local Governments, the financial equalization is also part of the settings is not an integral part of the financial system of the country as well as the intended to set the system funding over government authority that submitted, delegated, and assigned to the region.<sup>97</sup>

The granting of financial resources of the State to local governments is carried out in order to implement the Organization of the Government that is based on the submission of assignments by the Central Government to Local Governments to pay attention to the stability of conditions the national economy and the fiscal balances between the Central Government and local governments. Financial Equalization between the Central Government and Local Governments is a comprehensive system in the framework of funding the Organization of the principle of Decentralization, De-concentration, and Co-Administration Task. The finance equalization is carried out in line with the Division of authority between the Central Government and local governments. Thus the financial equalization arrangement not only covers aspects of revenue areas but also regulates aspects of the management and responsibility.<sup>98</sup>

In funding the Organization of the Government so that it can be implemented efficiently and effectively, as well as to prevent the presence of

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<sup>97</sup> Lestrianingsih, *Op.Cit*, p.19.

<sup>98</sup> *Ibid*, p.19.

overlap or unavailability of funding on a governance, the Government is needed to fund the Organization of the Government, while the Organization of the regional authority of the Government is financed from the APBD. Furthermore, the Organization of t Government authority which is the responsibility of the Central Government is financed from the State Budget of Income and Expenditures (APBN), both the central authorities of the de-concentrate to the Governor or assigned to the Government regional and/village in order to implement of Co-Administration Task.<sup>99</sup>

### **3. Local Budget of Income and Expenditure (APBD).**

According to Nordiawan, APBD is the local Government annual financial plan approved by the Local Parliament and are set by local regulations (PERDA).<sup>100</sup> While according to Law of Financial Equalization, APBD is an annual local government financial plans are discussed and approved jointly by Local Governments and Local Parliament and is set with Local Regulations.<sup>101</sup> APBD means the form of annual plan from the long-term plans of the region as well as the medium-term plan of region based on the vision and mission of the Local Government, discussed and approved by Local Parliament so that ultimately a legal product in the form of a local regulation should be followed by all the institutions of the community.<sup>102</sup> APBD is an embodiment of

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<sup>99</sup> *Ibid*, p.20.

<sup>100</sup> Nordiawan et.al, *Akuntansi Pemerintahan*, Salemba Empat, Jakarta, 2007, p.25.

<sup>101</sup> Article 1 Number 14 Law No.33 year 2004 on the Financial Equalization between Central Government and Local Government.

<sup>102</sup> Dadang Suwanda, *Op.Cit*, p.77.

financial equalization between the Central Government and Local Government in the framework of the implementation of fiscal decentralization.<sup>103</sup>

In the principles, the management of the APBD must meet the following conditions:<sup>104</sup>

1. Unity

This principle requires all income, expenditure, and financing presented in a single document.

2. Universal

This principle requires that any financial transactions be shown completely in the budget documents.

3. Enforceability

This principle of limiting the validity period of the budget for one particular year.

4. Specialty

This principle requires that a detailed budget that provided credit is clearly the purpose of its use.

5. Actual

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<sup>103</sup> Machfud Sidik, *Perimbangan Keuangan Pusat dan Daerah Sebagai Pelaksanaan Desentralisasi Fiskal (Antara Teori dan Aplikasinya di Indonesia)*, The Exhibition of “Setahun Implementasi Kebijakan Otonomi Daerah di Indonesia”, Yogyakarta, 2004, p.6, [https://www.academia.edu/3102066/Perimbangan\\_Keuangan\\_Pusat\\_dan\\_Daerah\\_Sebagai\\_Pelaksanaan\\_Desentralisasi\\_Fiskal](https://www.academia.edu/3102066/Perimbangan_Keuangan_Pusat_dan_Daerah_Sebagai_Pelaksanaan_Desentralisasi_Fiskal), accessed on October 2, 2017

<sup>104</sup> Dadang Suwanda, *Op.Cit*, p.80.



This principle requires a one-year budget burdened for expenses that should have paid, or favorable budget for acceptance should be received.

6. Treasury

This principle requires a one-year budget burdened at the time of the expenditure/receipt of money from/to local treasury.

Meanwhile, the function of APBD based on Article 3 section (4) Law No.17 year 2003 on the State Financial (Law of State Financial) are:<sup>105</sup>

1. Authorization

The local budget is the basis for implementing the income, expenditure, and financing in the year in question.

2. Planning

The regional budget is a guideline for management in planning activities in the year in question.

3. Supervision

The local budget is a guideline to assess whether the activities of the Organization of the Government in accordance with the provisions of.

4. Allocation

The local budget is directed to reduce the unemployment, retrenchment of resources, as well as the increased efficiency and effectiveness of the economy.

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<sup>105</sup> Article 3 Section (4) Law No.17 year 2003 on the State Financial.

5. Distribution

The local budget must contain the sense of justice and propriety.

6. Stabilization

The local budget must contain the meaning of becoming a tool for nurturing and seeking the fundamental balance of the economy.

According to Halim, the elements of APBD are:<sup>106</sup>

1. The plan of activities of a region, along with his detailed;
2. The existence of a source of acceptance which is the target of at least to cover costs in connection with the activity and the presence of the costs which is the maximum limit of expenditure which will be implemented;
3. The types of activities and projects that are described in the form of numbers; and
4. The budget period is usually 1 (one) year.

The arrangement of APBD needs to concern several principles such as:<sup>107</sup>

1. Society Participation

Decision making in the process of drafting and defining of APBD should involve the society so the society knows the rights and obligations in the implementation of APBD.

2. Transparency and Accountability

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<sup>106</sup> Abdul Halim, *Akuntansi dan Pengendalian Keuangan Daerah*, UPP AMP YKPN, Yogyakarta, 2004, p.15-16.

<sup>107</sup> Irwan Taufiq Ritonga, *Perencanaan dan Penganggaran Daerah*, Andi Offset, Yogyakarta, 2006, p.36-38.

The APBD should be present information in an open and accessible to the society include goals, objectives, sources of funding at each type/object of expenditure as well as the relationship between the magnitude of the budget with benefits and results to be achieved from budgeted activities.

3. Budget Discipline

All regional revenue and expenditure of the budget in one-year concerned should be budgeted in the APBD and conducted through public cash account of Local Government.

4. Budget Justice

APBD should be considered the fairness and equitable in order not to burden the society, as well as the society, can enjoy the results.

5. Efficiency and Effectivity

The available budget should be put to the best possible to be able to generate an increase in the maximum welfare services and to the interests of the society.

6. Obey the Rules

Preparation of APBD should not be contrary to the legislation, the interests of the public, and other regulations.

Then, the process of APBD's arrangement are:<sup>108</sup>

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<sup>108</sup> Sanna Gleiska N., *Pertanggungjawaban Kepala Daerah Dalam Pelaksanaan Anggaran Pendapatan dan Belanja Daerah Kota Bandar Lampung*, Thesis, Lampung University, Bandar Lampung, 2016, p.25-27, <http://digilib.unila.ac.id/21298/20/SKRIPSI%20TANPA%20BAB%20PEMBAHASAN.pdf>, accessed on October 2, 2017.

1. The preparation of the draft of Local Medium-Term Development (RPJMD) containing the vision, mission, and Local Government job desk that includes the regional development strategy, public policy, local government priorities, programs and policy directions of the local financial;
2. The preparation of the Strategic Work Plan of Local Unit (SKPD) based on payload of RPJMD;
3. Data sophisticated and the economic and fiscal projections based on the indicative annual RPJMD/regional planning documents that have been agreed between the heads of the regions and the Local Parliament of the regional job training center (PPKD);
4. Preparation of an initial draft of the regional economic framework drawn up by Local Secretary as a reference in the creation of circulars on priority programs and indicators;
5. SKPD drafting the working plan of SKPD plans based on strategic plan of SKPD circulars priority programs and indicators;
6. the Secretary formulate a work plan of local government (RKPD) with reference to the deliberation of planning development, annual indicative of RPJMD and work plans of SKPD;
7. The head of the Local Government arrange the Public Policy drafting of budget-Budget Ceiling Priority Temporary (KUA-PPAS) based on RKPD;

8. Submission of KUA-PPAS draft to the Local Parliament to do the discussion along and the results will be described in the MoU of KUA-PPAS;
9. The head of the Local Government establish the head of Local Government circulars about drafting guidelines of RKA-SKPD and KUA-PPAS;
10. RKA-SKPD that arranged by SKPD submitted to the Secretary as coordinator of the regional financial management to do the discussion draft of APBD;
11. The Secretary delivered the draft of APBD along with their attachments to the head of Local Government;
12. The head of the Local Government delivered a draft of APBD to the Local Parliament to be discussed and requested approval;
13. If approved, the Local Parliament set up the draft of APBD regulation, while the head of the Local Government prepared the draft regulation to the head area of the explanation of the APBD;
14. The evaluation of the Minister of the Local Affairs against draft APBD regulation and draft of Local Regulation on the explanation of APBD;
15. The preparation of the draft Document the implementation of the budget (DPA)-SKPD regarding the APBD explanation;
16. SKPD explain the draft of DPA-SKPD to the Local Parliament; and
17. The Plenary meeting of the Local Parliament on the draft of Local Regulation on the APBD as well as the endorsement on it.

Then after the APBD are implemented, the Head of Local Government obligated to make report for Accountability Information (LKPI) to the Local Parliament about the implementation of the APBD for a fiscal year not later than 6 months after the fiscal year ends.<sup>109</sup> It aims to satisfy the principle of transparency and accountability in governance, particularly in the local financial. The shape of the report for the Accountability Information of the Head of Local Government is the local financial reports based on Government accounting standards that are audited by the Financial Examiners Agency (BPK). These financial statements report of the realization of the budget, accounting balance sheet, cash flow statement, and notes to financial statements.<sup>110</sup>

The steps of execution of the report for the Accountability Information of the Head of Local Government based on article 101-103 Government Regulation No.58/2005 on the Management of Local Financial (GR 58 year 2005) are:<sup>111</sup>

1. *The Head of Local Government deliver the draft of Local regulation on the responsibility of APBD implementations to the Local Parliament in the form of financial statements that has been audited by the Financial Examiner Agency at least 6 months after the end of fiscal years;*
2. *The financial statement of APBD implementation deliver to the Financial Examiner Agency at least 3 months after the end of fiscal year;*
3. *The examination of financial statements by the Financial Examiner Agency finished at least 2 months after receive the financial statements from the Local Government; and*

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<sup>109</sup> Article 31 Law No.17 year 2003 on the State Financial.

<sup>110</sup> Article 5 Government Regulation No.8 year 2006 of the Report of Financial and Performance of Government Institution.

<sup>111</sup> Article 101-103 Government Regulation No.58 year 2005 of the Management of Local Financial.

4. *The Head of Local Government give the response and make an adjustment against the financial assessments based on Financial Examiner Agency examination against financial statements of Local Government.*

The purposes of Head of Local Government responsibility against the implementations of the local financial are:<sup>112</sup>

1. Give the information that used for economic, social, and political decision as well as the evidence of responsibility and management; and
2. Give the information that used in order to evaluating the performance of manager and organization.

Related to the structure of APBD, Article 20 GR 58 year 2005 states that the structures of APBD are:<sup>113</sup>

1. *Local Income*  
*Local Income is all the income of money through the Public Treasury Account of Local Government, which increase to the equity funds smoothly, which is a Local Government right in one fiscal year that does not need to be paid back by the Local Government.*
2. *Local Expenditure*  
*Local Expenditure is all the outcome of money from Public Treasury Account of Local Government, which decrease equity funds smoothly, which is Local Government rights in one fiscal year that does not need to be received back by the Local Government.*
3. *Local Financing*  
*Local Financing is all income of money needs to be paid back and/or all outcome of money will be accepted back, either on the financial year in question or in the next fiscal year.*

According to Halim, the Local Income is divided into three categories, namely the Local Original Income (PAD), Transfer Income, and Other

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<sup>112</sup> Soekarwo, *Hukum Pengelolaan Keuangan Daerah Berdasarkan Prinsip-Prinsip Good Financial Governance*, Airlangga University Press, Surabaya, 2005, p.43.

<sup>113</sup> Article 20 Government Regulation No.58 year 2005 on the Management of Local Financial.

Legitimate Income. Then Local Expenditure is divided into four categories, namely Local Apparatus Expenditure, Expenditure on Public Services, the Profit-Sharing Expenditure and the Financial Assistance, as well as Unforeseen Expenditure. Then the financing area divided into two Revenue Financing and Expenditure Financing.<sup>114</sup>

The Local Original Income is all the region acceptance which is derived from the source of local original economy. The Local Original Income consists of tax, levy, dividends from the local owned enterprise (BUMD), the income of the management of the local property, and other original legitimate income. The Local Original Income aims to give authority to Local Governments to fund the implementation of Local Autonomy in accordance with the area's potential as a manifestation of Decentralization.<sup>115</sup>

Transfer Income is the funds allocated by the Central Government to Local Governments to reduce the imbalance the funding source between central and region, reducing the funding gap of Local Government Affairs, reducing the gap public services between regions, funded the implementation of special autonomy and the specialty area.<sup>116</sup> In the transfer policy to the region, there are 4 kinds of allocation of funds namely:<sup>117</sup>

1. *Equalization Fund*

*Equalization Fund is a fund sourced from income in the State Budget of Income and Expenditure allocated to fund the needs of the region in the framework of the implementation of decentralization. There are*

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<sup>114</sup> Abdul Halim, *Op.Cit*, p.18.

<sup>115</sup> *Ibid*, p.67.

<sup>116</sup> <https://www.kemenkeu.go.id/transfers-ke-daerah>, accessed on October 1, 2017.

<sup>117</sup> *Ibid*.



*three forming components of Equalization Fund, namely General Allocation Fund, Special Allocation Fund, and Profit Sharing Fund.*

2. *Special Autonomy Fund*

*Special Autonomy Fund is fund given to areas that run special autonomy such as the Province of Jakarta, Papua, West Papua, and Nanggroe Aceh Darussalam.*

3. *Speciality Area Fund*

*Speciality Area Fund is the funds allocated for conducting the Affairs of the specialness of D.I. Yogyakarta.*

4. *Others Transfer Fund*

*Other Transfer Fund is the funds allocated to implement policies based on specific laws.*

Other Legitimate Income is income which is not included in the types of local tax, local levy, and income from agencies. Other Legitimate Income could be said to be a component of the local original income because when the Other Legitimate Income is a lot of automatically Local original income also increased and can be allocated to Local Expenditure.<sup>118</sup>

Local apparatus Expenditure is part of expenditure in the form of spending on the administration, operation and maintenance Expenditure, and expenditure for capital/development allocated to finance activities which results, benefits, and its effects are indirectly enjoyed by Community.<sup>119</sup>

Expenditure on Public Services is part of expenditure in the form of spending on the Administration, operation and maintenance Expenditure, and

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<sup>118</sup> Edy Sarwono, *Pengaruh Pajak Daerah, Retribusi Daerah, Pendapatan Lainnya yang Sah, dan Dana Alokasi Umum (DAU) Terhadap Belanja Daerah Pada Kabupaten/Kota Se-Indonesia Tahun Anggaran 2010-2011*, Journal of Faculty of Economy and Business Dian Nuswantoro University, Semarang, 2014, p.7, [http://eprints.dinus.ac.id/8766/1/jurnal\\_13442.pdf](http://eprints.dinus.ac.id/8766/1/jurnal_13442.pdf), accessed on October 2, 2017.

<sup>119</sup> <http://www.dprdkutaiartanegara.go.id/bacacatatan.php?id=10>, accessed on October 1, 2017.

expenditure for capital/development allocated to finance activities which results, benefits, and the impact directly enjoyed by Community.<sup>120</sup>

The Profit-Sharing Expenditure and the Financial Assistance is the expenditure fund with some criteria, namely:<sup>121</sup>

1. *Do not accept directly in Exchange for goods and services as it did in the transaction of purchase and sale;*
2. *Do not expect repayment in the future, as expected on a loan; and*
3. *Don't expect the forthcoming earnings results, as expected in the investment activities.*

Unexpected Expenditure is an expenditure that provided to:<sup>122</sup>

1. *Natural disasters that endanger region;*
2. *Loan periods previously completed and/or available budget in the year in question; and*
3. *Acceptance of returns is not right or the receipt of the canceled and/or over acceptance.*

Revenue Financing is all the revenue of the Public Treasury Account of Local Government which must be taken out again for the purpose of the well-being of the region. Revenue Financing came from among others sales of municipal bonds, the results of the privatization of the Local Owned Enterprise, receiving back a loan granted to third parties, other sales of permanent investments, and liquidation of Reserve fund. Meanwhile, Expenditure Financing is all of the expenditure of the Public treasury Account of Local Government which must be accepted again for the purpose of the well-being of the region. The Expenditure Financing came from among others the granting

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<sup>120</sup> *Ibid.*

<sup>121</sup> Yolanda Wulandari, *Pengaruh Dana Bagi Hasil Terhadap Belanja Daerah Pada Kabupaten dan Kota di Indonesia*, Thesis, Universitas Negeri Padang, Padang, 2014, p.5, <http://ejournal.unp.ac.id/students/index.php/akt/article/download/862/612>, accessed on October 2, 2017.

<sup>122</sup> *Ibid*, p.5-6.

of loans to third parties, the inclusion of government capital, repayment of principal of the loan (include the interest of municipal bond) in a particular fiscal year, and the establishment of a reserve fund.<sup>123</sup>

#### **4. Local Governance and Fiscal Decentralization in Islamic Perspective.**

The development of the Local Governance in Islamic perspective was started in The Prophet Muhammad SAW era, especially when the Prophet and his companion was established Medina Charter in Medina City after migration from Mecca City.<sup>124</sup> The establishment of the Medina Charter has formulated the principles and basis of social life order. The initiative and the efforts of the Prophet Muhammad SAW in organizing and unifying his followers and the other society being a regular society, independent, and sovereign that eventually became a State under the leadership of the Prophet Muhammad SAW is the practice of *siyasa*, namely process and efforts to achieve the goal of State.<sup>125</sup> In the Medina Charter, there are fourteen principles that stated in the Medina Charter namely *ummah*, unity and brotherhood, equality, freedom, the relation among religious people, mutual assistance, neighborhood life,

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<sup>123</sup> <http://keuda.kemendagri.go.id/pages/view/20-modul-penerapan-akuntansi-berbasis-akrual>, accessed on October 9, 2017.

<sup>124</sup> Yuli Andriansyah, *Constructing an Islamic Economic Model for Local Autonomy and Fiscal Decentralization: A Preliminary Study*, Journal of Islamic Studies Faculty of Universitas Islam Indonesia, Yogyakarta, 2014, p.11-12, [https://www.researchgate.net/publication/268509313\\_Constructing\\_an\\_Islamic\\_Economic\\_Model\\_for\\_Local\\_Autonomy\\_and\\_Fiscal\\_Decentralization\\_A\\_Preliminary\\_Study](https://www.researchgate.net/publication/268509313_Constructing_an_Islamic_Economic_Model_for_Local_Autonomy_and_Fiscal_Decentralization_A_Preliminary_Study), accessed on October 9, 2017.

<sup>125</sup> Suyuthi Pulungan, *Prinsip-Prinsip Pemerintahan dalam Piagam Madinah Ditinjau dari Pandangan Al-Qur'an*, Rajawali Press, Jakarta, 1996, p.5.

peace, farming, deliberation, justice, law enforcement, leadership, and devotion.<sup>126</sup>

After the establishment, the Prophet later became the leader of the community of Medina City through a collective agreement. The position of the Prophet in the Medina Charter is a political leader, spiritual leader, justice leader, and military leader whose main task to maintain public safety in Medina City.<sup>127</sup> The government system in the Prophet era tends to be Centralistic due to the area of the power of Islam have not been too extensive and also the center of Islamic civilization was centralized in Medinah City.<sup>128</sup> It can be proved by Division of ten *Al-Wilayah Al-Khasah* in which each region is led by the *Al-Amil*.<sup>129</sup> *Al-Wilayah Al-Khasah* is the administrative area is led by an *Al-Amil* in which the region does not have autonomous rights.<sup>130</sup>

The implementation of *Al-Wilayah Al-Khasah* started to change by the implementation of *Al-Wilayah Al-Ammah* in the era of *Khulafaur Rasyidin*, precisely in the time of Umar Ibn Al-Khattab. *Al-Wilayah Al-Ammah* the administrative area is led by an *Al-Wali*, *Al-Amir*, or *Al-Sultan* which the region has the rights of autonomy granted by the Central Government. He embodies the principles of deliberation and *ulil amri* taught Islam in the Government of the Local Autonomy to have full rights to set its territory. In addition, regional

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<sup>126</sup> *Ibid*, p.121.

<sup>127</sup> Yuli Andriansyah, *Op.Cit*, p.12.

<sup>128</sup> Von Grunebaum, *Islam: Essays in the Nature and Growth of a Cultural Tradition*, Routledge Press, New York, 1955, p.278.

<sup>129</sup> Zainal Abidin Ahmad, *Membangun Negara Islam*, Pustaka Iqra, Yogyakarta, 2001, p.180.

<sup>130</sup> *Ibid*, p.178.

autonomy was also given the rights to administer the regulations and instructions of the Central Government.<sup>131</sup>

Based on the urgency of the existence of an organization of Local Governance, then the Government in Islam known term *Al-Siyasa Al-Syar'iyat* (religious politics) and formal leadership called *Al-Wali*, *Al-Amir* or *Al-Sultan*. Local Governance in order to improve the efficiency and effectiveness of the Organization of the Local Autonomy needs to pay attention to the relationship between the order of local governance, regional diversity, potential, and justice by way of doing local development should refer and oriented to the public benefit.<sup>132</sup>

Postulates of the Al-Qur'an which support the existence of this concept are:<sup>133</sup>

1. *QS. Saba' (34:15)*

لَقَدْ كَانَ لِسَبَإٍ فِي مَسْكِنِهِمْ آيَةٌ جَنَّتَانِ عَنْ يَمِينٍ وَشِمَالٍ كُلُوا مِنْ  
رِزْقِ رَبِّكُمْ وَاشْكُرُوا لَهُ، بَلَدَةٌ طَيِّبَةٌ وَرَبٌّ غَفُورٌ ﴿١٥﴾

*Translation:*

*There was certainly a sign for Sheba in their habitation: two gardens, to the right and to the left. 'Eat of the provision of your Lord and give Him thanks: a good land and an all-forgiving Lord!'*

2. *QS. An-Nisa (4:59)*

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<sup>131</sup> *Ibid*, p.181.

<sup>132</sup> Abd. Gani Jumat, *Konsep Pemerintahan Dalam Al-Qur'an: Analisis Makna Khalifah Dalam Perspektif Fiqh Politik*, Hunafa: Jurnal Studia Islamika Vol.11 No.1, IAIN Palu, Palu, Unknown Year, p.173-174, <https://www.jurnalhunafa.org/index.php/hunafa/article/view/346/395>, accessed on October 9, 2017.

<sup>133</sup> *Ibid*, p.174.

يَأْتِيهَا الَّذِينَ ءَامَنُوا أَطِيعُوا اللَّهَ وَأَطِيعُوا الرَّسُولَ وَأُولِيَ الْأَمْرِ مِنْكُمْ فَإِن  
 نُنزَعْنَمُ فِي شَيْءٍ فَرُدُّوهُ إِلَى اللَّهِ وَالرَّسُولِ إِن كُنتُمْ تُؤْمِنُونَ بِاللَّهِ وَالْيَوْمِ  
 الْآخِرِ ذَلِكَ خَيْرٌ وَأَحْسَنُ تَأْوِيلًا ﴿٥٩﴾

Translation:

O you who have faith! Obey Allah and obey the Apostle and those vested with authority among you. And if you dispute concerning anything, refer it to Allah and the Apostle, if you have faith in Allah and the Last Day. That is better and more favorable to the outcome.

3. QS. Hud (11:61)

﴿وَإِلَى ثَمُودَ أَخَاهُمْ صَالِحًا قَالَ يَا قَوْمِ اعْبُدُوا اللَّهَ مَا لَكُم مِّنْ إِلَٰهٍ  
 غَيْرُهُ هُوَ أَنشَأَكُمْ مِنَ الْأَرْضِ وَاسْتَعْمَرَكُمْ فِيهَا فَاسْتَغْفِرُوهُ ثُمَّ تَوْبُوا إِلَيْهِ  
 إِنَّ رَبِّي قَرِيبٌ مُّجِيبٌ ﴿٦١﴾﴾

Translation:

And to Thamūd (We sent) Ṣāliḥ, their brother. He said, 'O my people! Worship Allah. You have no other god besides Him. He brought you forth from the earth and made it your habitation. So plead with Him for forgiveness, then turn to Him penitently. My Lord is indeed nearest (and) responsive.'

4. QS. Al-Baqarah (2:30)

وَإِذْ قَالَ رَبُّكَ لِلْمَلٰٓئِكَةِ إِنِّي جَاعِلٌ فِي الْأَرْضِ خَلِيفَةً قَالُوا أَتَجْعَلُ  
 فِيهَا مَنْ يُفْسِدُ فِيهَا وَيَسْفِكُ الدِّمَآءَ وَنَحْنُ نُسَبِّحُ بِحَمْدِكَ وَنُقَدِّسُ لَكَ  
 قَالَ إِنِّي أَعْلَمُ مَا لَا تَعْلَمُونَ ﴿٢٠﴾

Translation:

When your Lord said to the angels, 'Indeed I am going to set a viceroy on the earth,' they said, 'Will You set in it someone who will cause corruption in it, and shed blood, while we celebrate your praise and proclaim your sanctity?' He said, 'Indeed I know what you do not know.'

5. QS. Shad (38:26)

يٰۤاٰدَمُ اٰنَا جَعَلْنَاكَ خَلِيفَةً فِى الْاَرْضِ فَاحْكُم بَيْنَ النَّاسِ بِالْحَقِّ وَلَا تَتَّبِعِ  
 الْهَوٰى فَيُضِلَّكَ عَن سَبِيْلِ اللّٰهِ اِنَّ الَّذِيْنَ يَضِلُّوْنَ عَن سَبِيْلِ اللّٰهِ لَهُمْ  
 عَذَابٌ شَدِيْدٌۢ يَّمَا نَسُوْا يَوْمَ الْحِسَابِ ﴿٢٦﴾

Translation:

'O David! Indeed we have made you a vicegerent on the earth. So judge between people with justice, and do not follow desire, or it will lead you astray from the way of Allah. Indeed those who stray from the way of Allah —there is a severe punishment for them because of their forgetting the Day of Reckoning.'

6. QS. Ali Imran (3:26)

قُلِ اللَّهُمَّ مَلِكُ الْمَلِكِ تُؤْتِي الْمَلِكَ مِنْ تَشَاءُ وَتَنْزِعُ الْمَلِكَ مِنْ تَشَاءُ وَتُعِزُّ مَنْ تَشَاءُ وَتُذِلُّ مَنْ تَشَاءُ بِإِذْنِكَ الْخَيْرُ إِنَّكَ عَلَى كُلِّ شَيْءٍ قَدِيرٌ

Translation:

Say, 'O Allah, Master of all sovereignty! You give sovereignty to whomever You wish, and a strip of sovereignty whomever you wish; You make mighty whomever You wish, and You abase whoever You wish; all good is in Your hand. Indeed You have power over all things.

7. QS. Asy-Syura (42:38)

وَالَّذِينَ اسْتَجَابُوا لِرَبِّهِمْ وَأَقَامُوا الصَّلَاةَ وَأَمْرُهُمْ شُورَى بَيْنِهِمْ وَمِمَّا رَزَقْنَاهُمْ يُنْفِقُونَ

Translation:

And those who answer their Lord, maintain the prayer, and their affairs are by counsel among themselves, and they spend out of what we have provided them with;

Fiscal Decentralization in Islam started by Prophet Muhammad once declared the Medina Charter although only limited applicability of *zakat* and the treasure spoils of war. Then in the time of Umar Ibn Khattab, the implementation of Fiscal Decentralization began to progress. It can be proved by the application of the tax, the levy for the Affairs of the war, and the levy for the good of the people.<sup>134</sup>

<sup>134</sup> Any Setianingrum, *Desentralisasi Fiskal Kontemporer Dalam Perspektif Kebijakan Publik Islam*, Journal of Ekonomika-Bisnis Vol.4 No.1 Az-Zahra University, Jakarta, 2013, p.7-8, [https://www.academia.edu/30656444/DESENTRALISASI\\_FISKAL\\_KONTEMPORER\\_DALAM\\_PERSPEKTIF\\_KEBIJAKAN\\_PUBLIK\\_ISLAM](https://www.academia.edu/30656444/DESENTRALISASI_FISKAL_KONTEMPORER_DALAM_PERSPEKTIF_KEBIJAKAN_PUBLIK_ISLAM), accessed on October 9, 2017.

The general elements of the Islamic fiscal theory are:<sup>135</sup>

1. *Islamic Economics consists of three sectors, namely, the public sector, the private sector, and social sectors should work together to provide the institutional framework for Islamic economy.*
2. *Zakat as the basis of the fiscal system.*
3. *The allocation, distribution, and function of the Islamic economic stabilization are processed and implemented through all the sectors together.*
4. *The role of the public sector than in other sectors is minimal but essential as far as operating continuously to ensure optimal allocation of resources in the community, distribution of income, and building stability.*

Verses of the Al-Qur'an which support the existence of Fiscal

Decentralization are:<sup>136</sup>

1. *QS. An-Nisa (4:9)*

وَلْيَخْشَ الَّذِينَ لَوْ تَرَكَوْا مِنْ خَلْفِهِمْ ذُرِّيَّةً ضِعَافًا خَافُوا عَلَيْهِمْ  
فَلْيَتَّقُوا اللَّهَ وَلْيَقُولُوا قَوْلًا سَدِيدًا ﴿٩﴾

*Translation:*

*And let those (executors and guardians) fear (injustice) as if they (themselves) had left weak offspring behind and feared for them. So let them fear Allah and speak words of appropriate justice.*

2. *QS. Al-Isra (17:26)*

وَأَاتِ ذَا الْقُرْبَىٰ حَقَّهُ وَالْمِسْكِينَ وَابْنَ السَّبِيلِ وَلَا تَبْذُرْ  
تَبْذِيرًا ﴿٢٦﴾

*Translation:*

*Give the relatives their (due) right, and the needy and the traveler (as well), but do not squander wastefully.*

Local Autonomy and Fiscal Decentralization should follow the ideals of Islamic Doctrines. Local Autonomy and Fiscal Decentralization according to Islam are necessary conditions for better of local development, especially to

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<sup>135</sup> *Ibid*, p.8-9.

<sup>136</sup> *Ibid*, p.9.



improve the quality of social-economic life, distribution of welfare in society, increasing economic growth, and fostering a culture in society.<sup>137</sup>

## **B. General Overview of Sharia Capital Market, Sharia Bond, Sharia Bond Issuance, and Sharia Capital Market Regulatory and Supervisory.**

### **1. Sharia Capital Market.**

Sharia finance has the potential for the further contributions in at least three dimension. First, it promises to foster greater financial inclusion, especially of large underserved Moslem populations. Second, its emphasis on asset-backed financing and risk-sharing feature mean that it could provide support for small and medium-sized enterprises (UKM), as well as investment in public infrastructure. Finally, its risk-sharing features and prohibition of speculation suggest that Sharia finance may, in principle, pose less systemic risk than conventional finance.<sup>138</sup> One of Sharia finance product is Sharia capital market beside Sharia banking, Sharia insurance, Sharia pawn, Sharia pension fund, and Sharia financial technology.

The development of Sharia capital market is not separate from the development of capital market in general. The Capital Market plays a vital role in attracting savings and channeling them for productive purpose. Both primary and secondary markets are important in this regard. While the primary market

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<sup>137</sup> Faridi, *Theory of Fiscal Policy in an Islamic State*, Journal of Research in Islamic Economics, Vol.1 No.1, 1983, p.15, <http://www.iefpedia.com/english/wp-content/uploads/2009/10/Theory-of-Fiscal-Policy-in-an-Islamic-State-by-F.R.-Faridi.pdf>, accessed on October 9, 2017.

<sup>138</sup> Alfred Kammer et.al, *Islamic Finance: Opportunities, Challenges, and Policy Options*, IMF Staff Discussion Note SDN/15/05, USA, 2015, p.6, <https://www.imf.org/external/pubs/ft/sdn/2015/sdn1505.pdf>, accessed on October 15, 2017.

directly affects the supply of funds for investment, the secondary market does the same indirectly. The function of the secondary market provides liquidity to the assets by providing early exit opportunity, prices the assets and their associated risks on continuous basis incorporating relevant new information as it arrives.<sup>139</sup>

According to Article 1 no.13 Law No.8 year 1995 on the Capital Market (Law of Capital Market), Capital Market is an activity concerned with the public offering and trading securities, the public company relating to the issuance of securities, as well as the institution and profession related to securities.<sup>140</sup> Based on this definition, the meaning of Sharia Capital Market is the activity in capital markets as provided in Law of Capital Market that does not against Islamic principles.<sup>141</sup> Meanwhile, according to Sutedi, Sharia Capital Market is the capital market that is run by Sharia principles, each transaction of securities in the capital markets is carried out in accordance with the provisions of the guidelines of Islam.<sup>142</sup> Then according to International Centre for Education in Islamic Finance (INCEIF), Sharia Capital Market is a market where the activities are carried out in ways that do not conflict with the conscience of Moslem and the Islamic Principles. In other words, Sharia

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<sup>139</sup> Salman Syed Ali, *Islamic Capital Market Products: Developments and Challenges*, Islamic Research and Training Group of IDB, KSA, 2005, p.1, <http://www.kantakji.com/markets/islamic-capital-markets-products.-regulation-development.aspx?download=true>, accessed on October 15, 2017.

<sup>140</sup> Article 1 Number 13 Law No.8/1995 on the Capital Market.

<sup>141</sup> <http://www.ojk.go.id/en/kanal/syariah/tentang-syariah/pages/pasar-modal-syariah.aspx>, accessed on October 15, 2017.

<sup>142</sup> Adrian Sutedi, *Pasar Modal Syariah: Sarana Investasi Keuangan Berdasarkan Prinsip Syariah*, Sinar Grafika, Jakarta, 2011, p.29.

Capital Market represents an assertion of religious law within a capital market transaction and where the market is free from involvement in activities prohibited in Islam.<sup>143</sup>

The concept of Sharia Capital Market is supposed to perform all the useful function of conventional capital markets with justice and equitable distribution of benefits. However, the guidance provided in *Al-Qur'an*, *Hadist*, and *Ijtihad* from the Ulama related with *Fiqh Muammalah* on the moral rules and behavior along with the well-defined boundaries of prohibitions and compulsory obligations narrow down this debate and these are fundamental to the concept of justice and welfare in Islam.<sup>144</sup>

Every transaction in Sharia Capital Market should be guided by the norms of Islamic ethics as prescribed by the Islamic legal system or the Sharia. In other words, every transaction should be in tandem with the Islamic Principles.<sup>145</sup> The provision of the Sharia are derivable from the *Al-Qur'an*, *Hadist*, and *Ijtihad* from Moslem Scholars. While Sharia transaction is generally free and fair, this freedom is however not an unlimited one but constrained by the provision of Sharia which includes the prohibition of interest

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<sup>143</sup> S. Shahida and S. Sapiyi, *Why Do Firms Issue Sukuk Over Bonds? Malaysia Evidence*, Journal of Prosiding Perkem VIII, Vol.2, Universiti Kebangsaan Malaysia, Malaysia, 2013, p. 559, [http://www.ukm.my/fep/perkem/pdf/perkemVIII/PKEM2013\\_3A1.pdf](http://www.ukm.my/fep/perkem/pdf/perkemVIII/PKEM2013_3A1.pdf), accessed on October 15, 2017.

<sup>144</sup> Salman Syed Ali, *Islamic Capital Market Products*...., p.4.

<sup>145</sup> Syed Othman Al-Habshi, *Development of Capital Market under Islamic Principles*, Paper Presented at the Managing and Implementing Interest-Free Banking/Islamic Financial System, Malaysia, 1994, p.2, <http://www.kantakji.com/media/8184/y102.pdf>, accessed on October 15, 2017.

(*riba*), speculation (*gharar*), alcohol (*khamr*), and gambling (*maysir*) among others.<sup>146</sup>

According to DSN-MUI Fatwa No.40/DSN-MUI/X/2003 of Capital Market and the General Guidelines for the Application of the Sharia Principles in the Capital Market (Fatwa of Sharia Principles in Capital Market), the Sharia principles in the capital market are:<sup>147</sup>

1. *The capital market mechanism and all its activities especially regarding issuers, the types of securities that are traded, and the mechanism of its trade is seen to have been in accordance with the Sharia in compliance of Sharia principles; and*
2. *The securities is seen has complied with Sharia principles in Sharia compliance statement has gained issued by DSN-MUI to a Sharia Securities that the Securities is in compliance with Sharia principles.*

Sharia Capital Market play important roles in Sharia Financial System. The key function of Sharia Capital Market as follows:<sup>148</sup>

1. *To transfer fund from surplus to deficit unit in order to ensure the equitable allocation of capital to sector which would yield the best returns, and hence contribute towards the overall growth and expansion of the economy;*
2. *To ensure that there exists a means of attracting surplus funds for worthwhile investment in accordance with the owner's preference in terms of the extent of risks involvement, rates of return as well as the period of investment preferred;*
3. *To provide fund owners with sufficient opportunities to invest for short or medium term; and*
4. *To promotes investment of saving among surplus unit, ass it un-Islamic to hoard wealth.*

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<sup>146</sup> Dusuki and Abozaid, *Fiqh Issues in Short Selling as Implemented in the Sharia Capital Market in Malaysia*, JKAU: Islamic Economic, Malaysia, 2008, p.65, <http://citeseerx.ist.psu.edu/viewdoc/download;jsessionid=856776D067EEF304608104C38B694664?doi=10.1.1.600.7819&rep=rep1&type=pdf>, accessed on October 21, 2017.

<sup>147</sup> See DSN-MUI No.40/DSN-MUI/X/2003 on the Capital Market and General Guidelines for the Application of the Sharia Principle in the Capital Market.

<sup>148</sup> S. Shahida and S. Sapiyi, *Op.Cit*, p. 559-560.

According to BAPEPAM-LK Regulation No.II.K.1 of Criteria and Issuance of List of Sharia Securities, Sharia Securities is a collection of Securities that are not contrary to the Sharia Principles in the Capital Market.<sup>149</sup>

The kinds of Sharia Securities are:<sup>150</sup>

1. *Sharia Shares;*
2. *Sharia Bond;*
3. *Sharia Right Issue and Sharia Warrant;*
4. *Sharia Mutual Fund; and*
5. *Sharia Asset Back Securities.*

## **2. Sharia Bond.**

A number of different Islamic financing products have been developed in accordance with the Sharia principles and one of these is the Sharia Bond or *Sukuk*.<sup>151</sup> *Sukuk* (Arabic: صكوك *ṣukūk*, plural of صك *ṣakk*, "legal instrument, deed, cheque") is the Arabic name for financial certificates, also commonly referred to as "sharia-compliant" bonds.<sup>152</sup>

According to Sutedi, Sharia Bond is a Bond that is offered with provisions that require the issuer to pay a number of Sharia Bond's income for yield and pay an amount of income for results and repay funds of Islamic bonds on the

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<sup>149</sup> See the Head of BAPEPAM-LK Decision No.II.K.1 on the Criteria and Issuance of List of Sharia Securities.

<sup>150</sup> See the Head of BAPEPAM-LK Decision No.II.K.1 on the Criteria and Issuance of List of Sharia Securities.

<sup>151</sup> Clifford Chance Paper, *Introduction to Sukuk*, Clifford Chance, Dubai, 2006, p.1, <https://onlineservices.cliffordchance.com/online/freeDownload.action?key=OBWlBfgNhLNomwBI%2B33QzdFhRQAhp8D%2BxrIGReI2crGqLnALtyZe5xfVa8%2F7HPmSZKKu27Wnu3p%0D%0A5mt12P8Wnx03DzsaBGwsIB3EVF8XihbSpJa3xHNE7tFeHpEbaeIf&attachmentsize=461715>, accessed on October 21, 2017.

<sup>152</sup> Hans Visser, *Islamic Finance: Principle and Practice*, Edward Elgar, UK, 2009, p.63, <https://www.download-geek.com/download/book/Islamic+Finance%3A+Principles+And+Practice.html?aff.id=9325&aff.subid=7550>, accessed on October 21, 2017.

date of repayment and the Sharia Bond to the holder/investor.<sup>153</sup> Meanwhile according to AAOIFI, Sharia Bond defined as financial securities of equal denominations representing an undivided ownership interest in a portfolio of eligible existing and/or future assets, usufruct, services, and business activities.<sup>154</sup> Then according to Fatwa DSN-MUI No.32/DSN-MUI/IX/2002 of Sharia Bond (Fatwa of Sharia Bond), Sharia Bond is a long-term security based on Sharia Principles that issued by Issuers to pay revenue to the holder of the Islamic bonds be for results/margin/fee and repay funds bonds at maturity.<sup>155</sup>

Sharia Bond has a number of features that have made it attractive to issuers and investors. These include its ability to:<sup>156</sup>

1. *Meet the changing and differentiated demands of the modern economy;*
2. *Develop innovative and cutting-edge structures and products; and*
3. *Achieve such issuance at competitive pricing.*

As the result, Sharia Bond market has drawn an increase of interest from sovereigns, multilateral institutions, and multinational and national corporations from advanced, emerging, and development projects. Sharia Bonds can help close the funding gap for infrastructure, and an increasing share of issuance has been in this area. Many countries are struggling to meet their infrastructure needs, while bank regulation has made banks more selective in their allocation of capital to lending infrastructure. However, a growing dedicated and globally diversifying investor base is raising demand for Sharia

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<sup>153</sup> Adrian Sutedi, *Aspek Hukum.....*, p.126.

<sup>154</sup> <http://aaoifi.com/standard/shariah-standards/?lang=en>, accessed on October 21, 2017.

<sup>155</sup> DSN-MUI No.32/DSN-MUI/IX/2002 of Sharia Bond.

<sup>156</sup> Alfred Kammer et.al, *Op.Cit*, p.26.

Bond, thus providing an opportunity to help close the infrastructure gap. Appropriately structured of Sharia Bond have a demonstrated track record in financing infrastructure upgrades such as for the financing infrastructure of airports, marine ports, toll road, etc.<sup>157</sup>

The risk-sharing aspect of Sharia Bond gives the issuers and the investors' clear advantage as a funding instrument for infrastructure. Nearly all conventional infrastructure projects contain separate equity and debt components, especially during the Greenfield phase. Sharia Bond is designed from the outset to spread the risk more broadly because all investors share in the same manner. Sharia Bond can also be used more flexible over time because payments are tied to underlying returns rather than to fixed schedules.<sup>158</sup>

The basic concept of Sharia Bond is different with Conventional Bond. Thus Sharia Bond are compared to Conventional Bond by following characteristics, namely:<sup>159</sup>

1. *Sharia Bonds represents a claim on ownership of asset and cash flow as opposite to Conventional Bonds whose claim is on debt instrument;*
2. *Their return is expected from underlying asset as opposed to the Conventional Bond whose return as interest is pre-determined;*
3. *There is a possibility of capital appreciation, that is, investors can get more return on their invested capital as opposite to Conventional Bonds that return is fixed and cannot vary with the performance of Bond Issuer;*
4. *Their return on invested capital is not guaranteed as opposite to the Conventional Bond that the issuer is obligated to pay at maturity;*

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<sup>157</sup> *Ibid*, p.26.

<sup>158</sup> *Ibid*, p.27.

<sup>159</sup> Tahmoures A. Afshar, *Compare and Contrast Sharia Bonds with Conventional Bonds: Are they Compatible*, The Journal of Global Business Management Vol.9 No.1, Woodbury University, USA, 2013, p. 47-48, <http://www.jgbm.org/page/5%20Tahmoures%20A%20%20Afshar.pdf>, accessed on October 23, 2017.

5. *The contract of Sharia Bonds are based on seller-buyer as opposite to the Conventional Bonds are based on borrower-lender;*
6. *Sharia Bonds may have fixed or variable rates of return as opposite to a fixed rate in Conventional Bonds;*
7. *The Sharia Bond Issuers should have types of business activities and the result of income that spared from non-halal items as opposite to Conventional Bond which is not spared from non-halal items; and*
8. *There is Sharia Supervisory Body in the supervisory activities related with Sharia Bond management as opposite with Conventional Bond management which has no Sharia Supervisory Body.*

In the World, mostly, Sharia Bond agreement use five types of Sharia Bond agreement, namely *Ijarah, Mudharabah, Istisna', Salam, and Murabahah*. However, *Ijarah* and *Mudharabah* are applied in around the World because the application of them is easy than others such as *Istisna', Salam, and Murabahah*.<sup>160</sup>

*Ijarah* Sharia Bond is a Sharia Bond that using *Ijarah* agreement. *Ijarah* agreement is a type of contract for the benefit by way of reimbursement. It means *Mu'jir* (Issuer and Property Owner) gives the right to make use of objects that are transacted through temporary control or loaning objects with certain benefits by paying rewards to the owner of the object to *Musta'jir* (Investors). In the *Ijarah* agreement, it is accompanied by the existence of the displacement benefits but not the case the transfer of ownership.<sup>161</sup>

The provisions of *Ijarah* agreement are:<sup>162</sup>

1. *The object must be in the form of goods (movable things, immovable things, treasury of the merchant) or in the form of services;*

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<sup>160</sup> Nurul Huda and Edwin Nasution, *Investasi pada Pasar Modal Syariah*, Kencana Prenada Media Grup, Jakarta, 2007, p.86.

<sup>161</sup> Abdul Manan, *Hukum Ekonomi Syariah: Dalam Perspektif Kewenangan Pengadilan Agama*, Kencana Pranada Media Grup, Jakarta, 2012, p.337.

<sup>162</sup> *Ibid*, p.337-338.



2. *The benefits of the object and the value of these benefits is known and agreed upon by both parties;*
3. *The scope and period of use must be stated specifically;*
4. *A tenant must divide the results the benefits acquired in the form of rewards or rental/wage; and*
5. *The tenant must keep the object so that the benefits provided by object stay awake.*

*Ijarah* Sharia Bond uses securitization as an asset for the issuance process.

Securitization is funding technique whereby investor ultimately invests their capital in credit or performance pool of assets instead of the credit of corporate or other entities. The investor takes a risk on the performance of the asset themselves instead risk on the performance of the entity that previously owned the asset.<sup>163</sup> Meanwhile, according to Gastineau, Securitization is the process of raising fund through the sale of securities. It usually creates a new financial instrument representing an undivided interest in a segregated pool of assets such as a commercial mortgage. The ownership of assets is usually transferred to a legal trust or special purpose entity to protect the interest of the investor.<sup>164</sup>

There are several significant advantages of securitization, namely:<sup>165</sup>

1. *Securitization enables conventional institution to efficiently remove asset from their balance sheet, to monetize previously illiquid assets, recycle cash to be reinvested and, hence, expand the volume of their business without a corresponding increase in their equity capital;*
2. *Securitization helps financial institution to raise cheaper capital for their business at the asset level instead of the enterprise level;*

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<sup>163</sup> Debashis D. and Greg Man, *Should the Islamic Finance Community be Embracing Securitization*, Islamic Finance News Guide, 2009, p.33, <https://www.islamicfinancenews.com/should-the-islamic-finance-community-be-embracing-securitization.html>, accessed on October 23, 2017.

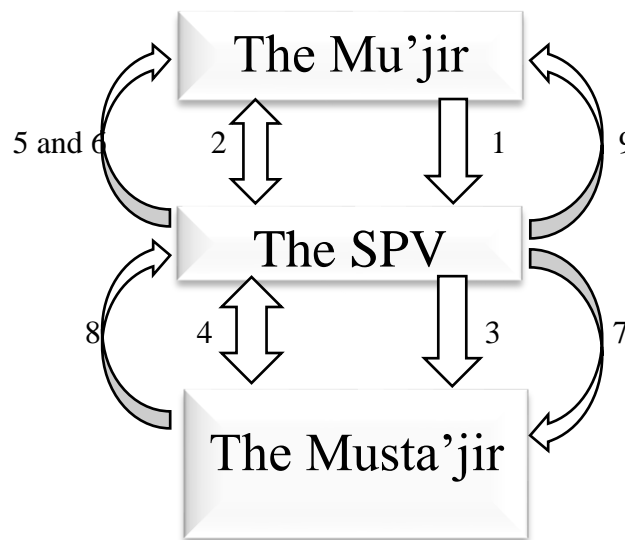
<sup>164</sup> Gary L. Gastineau, *Dictionary of Financial Risk Management*, Golden Books Center, Malaysia, 1992, p.223.

<sup>165</sup> Chris P. Sioufi and Samer Y. Amro, *Securitization in Islamic Finance: The Beginning of a Golden Era*, Islamic Finance News Guide, 2006, p.10, <https://www.islamicfinancenews.com/securitization-in-islamic-finance-the-beginning-of-a-golden-era.html>, accessed on October 23, 2017.

3. *Securitization, in some jurisdiction, allows the originator to benefit from tax savings such as a tax on capital.*

Although the concept of securitization is derived from the conventional bond application, Sharia securitization has distinctive features that distinguishes it from asset securitization. Following the Sharia principles, Sharia securitization must be free from three prohibited practices such as *riba*, *gharar*, and *maysir*. Thus, anything leading to these practices is not tolerated such as debt and financial asset trading, *haram* activities, interest-bearing collateral and so forth. Furthermore, Sharia securitization must involve the funding or the production of real assets instead of financial securities, which causes irresponsible leverage as well as speculation, through derivatives lending.<sup>166</sup>

The Diagram of *Ijarah* Sharia Bond



<sup>166</sup> M. Ridwan Abd. Aziz et.al., *The Structure of Sukuk Ijarah: An Initial Analysis From the Perspective of Maqasid Al-Shari'ah*, Paper Proceeding of the 5th Islamic Economics System Conference (iECONS 2013), "Sustainable Development Through The Islamic Economics System", Organized by Faculty Economics and Muamalat, Universiti Sains Islam Malaysia, Berjaya Times Square Hotel, Kuala Lumpur, Malaysia, 2013, p.6, <http://nurmoh1.100webspaces.net/iecons2013/6B-1.pdf>, accessed on October 23, 2017.

Explanation of *Ijarah* agreement:<sup>167</sup>

1. The Mu'jir establish an SPV (Special Purpose Vehicle) in order to facilitate the *Ijarah* Sharia Bond issuance, securitization of asset, and transaction;
2. The Mu'jir and the SPV make an agreement in order to facilitate the *Ijarah* Sharia Bond issuance, securitization of the asset, and transaction. In this agreement, the Mu'jir sell the asset (legal owner or beneficial owner) to the Sharia-compliant *Ijarah* enterprise for optimizing the contribution of the SPV and also the Mu'jir can buy back the asset in maturity date. Meanwhile, the SPV buy the legal ownership or beneficial ownership of Mu'jir's asset, conduct asset securitization, and contributes the principal amount to the Sharia-compliant *Ijarah* enterprise;
3. After securitization of the asset. The SPV issue the *Ijarah* certificate to the Musta'jir in the stock market. In this phase, the SPV explain the Prospectus of Mu'jir such as the asset, the projects, the rating of certificate, the financial disclosure, the legal disclosure, the profit from the asset, and the maturity date;
4. The Musta'jir and the SPV make an agreement in term of *Ijarah* certificate transaction. In this agreement, the Musta'jir buy the asset to

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<sup>167</sup> *Ibid*, p.7.

the SPV. Meanwhile, the SPV is acting as trustee on behalf of the Musta'jir such as asset management and buy back the asset;

5. The SPV give the funds from the Musta'jir to the Mu'jir in order to finance the Mu'jir's projects;
6. The SPV rents the asset to the Mu'jir in order to gain the profit from asset management;
7. The SPV gives the profit to the Musta'jir in order to share the profit from asset management;
8. In the maturity date, the Musta'jir sell the asset and return the certificate to the SPV;
9. The SPV sells the asset to the Mu'jir and the Mujir give the money to the SPV;

There is two type of Sharia Bonds based on the Asset principle, namely:<sup>168</sup>

1. Asset-Based Sharia Bond

Asset-Based Sharia Bond is raising finance where the principal is covered by the capital value of the asset but the returns and repayments to Sharia Bondholders are not directly financed by these assets.

2. Asset-Backed Sharia Bond

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<sup>168</sup> Pegah Zolfaghari, *An Introduction to Islamic Securities (Sukuk)*, Working Paper of Uppsala University Faculty of Law, Sweden, 2017, p.7-8, [http://www.jur.uu.se/digitalAssets/563/c\\_563862-1\\_3-k\\_wps2017-2.pdf](http://www.jur.uu.se/digitalAssets/563/c_563862-1_3-k_wps2017-2.pdf), accessed on October 26, 2017.

Asset-Backed Sharia Bond is raising finance where the principal is covered by the capital value of the asset but returns and repayments to Sharia Bondholders are directly financed by these assets.

There are fundamental differences between Asset-Based Sharia Bond and Asset-Backed Sharia Bond, namely:<sup>169</sup>

1. *In the source of payment, Asset-Based Sharia Bond comes from obligor cash flows. Meanwhile Asset-Backed Sharia Bond comes from the revenue generated by underlying asset;*
2. *In the disclosure of the asset, the asset in Asset-Based Sharia Bond stays on the balance sheet of the obligor. Meanwhile, the asset in Asset-Backed Sharia Bond is separated from the obligatory balance sheet;*
3. *In asset ownership, Asset-Based Sharia Bond use beneficial ownership to dispose of the asset. Meanwhile Asset-Backed Sharia Bond use legal ownership;*
4. *In recourse, Asset-Based Sharia Bond purchase undertaking at performing with obligor is the ultimate resource and the resource is only to the obligor. Meanwhile Asset-Backed Sharia Bond only have recourse to asset thus asset plays a genuine role in defaults.*

Meanwhile, *Mudharabah* Sharia Bond is a Sharia Bond that uses *Mudharanah* agreement. *Mudharabah* agreement is a cooperation agreement between *Shahibul Mal* (investors) which *Shahibul Mal* only provides funds fully in a business activity and the role of *Shahibul mal* should be passive in the management of the business. As for the *Mudharib* (issuer) provided services, namely managing *Shahibul mal* treasure fully and independently in the form of the asset at the business activities.<sup>170</sup>

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<sup>169</sup> Sutan Emir Hidayat, *A Comparative Analysis between Asset Based and Asset Backed Sharia Bond: Which One is More Sharia Compliant?*, International SAMANM Journal of Finance and Accounting Vol.1 No.2, Bahrain, 2013, p.26, [https://www.researchgate.net/publication/270284769\\_A\\_Comparative\\_Analysis\\_between\\_Asset\\_Based\\_and\\_Asset\\_Backed\\_Sukuk\\_Which\\_One\\_is\\_More\\_Shariah\\_Compliant](https://www.researchgate.net/publication/270284769_A_Comparative_Analysis_between_Asset_Based_and_Asset_Backed_Sukuk_Which_One_is_More_Shariah_Compliant), accessed on October 26, 2017.

<sup>170</sup> Abdul Manan, *Op.Cit*, p.334.

The provisions of *Mudharabah* agreement are:<sup>171</sup>

1. *Mudharabah* agreement included in the Trustee agreement;
2. A ratio or a percentage of revenue to be set based on the results of revenue sharing or profit sharing;
3. The ratio can be set up for the results in constant, increasing, or declining income projections taking into account the *Mudharib* and should be set at the beginning of the contract;
4. The Profit Sharing Income is the amount of revenue that is shared which is become the rights and hence are to be paid by *Mudharib* to *Shahibul Mal*;
5. The Profit Sharing derived from the multiplication between the ratio of profit sharing results of *Shahibul Mal* and income/profits are distributed and the amount stated in the financial statements are consolidated by *Mudharib* and paid monthly, quarter (3 months), semester (6 months), or the annual; and
6. Because of the magnitude of the profit sharing revenue to be determined by the actual performance of the *Mudharib*, so *Ijarah Sharia Bond* gives a certain indicative return.

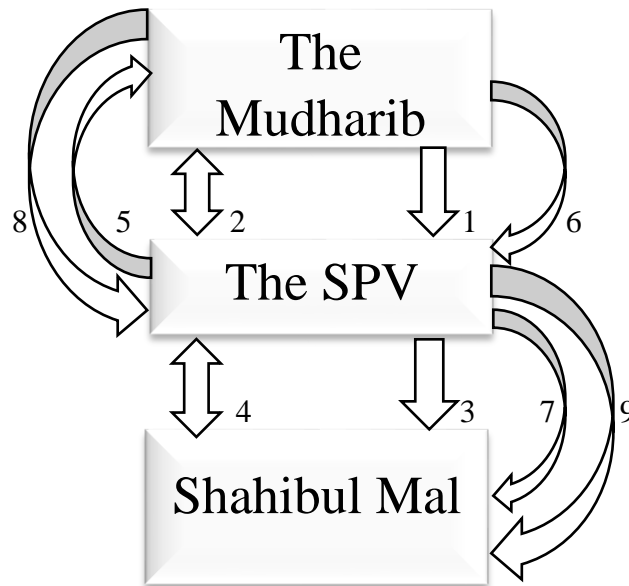
*Mudharabah* Sharia Bond provides its owner the right to receive his capital at the time the Sharia Bond is surrendered and an annual proportion of the realized profits as agreed. They play a vital role in the process of development financing it is related to the profitability of the projects. *Mudharabah* neither yield interest nor entitle owners to make claims for any definite annual interest. This show that *Mudharabah* are like shares with regard varying returns, which is accrued according to the profit made by the project. *Mudharabah* must represent a common ownership and entities their holder to shares in a specific project for which the Sharia Bond has been issued to fund.<sup>172</sup>

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<sup>171</sup> *Ibid*, p.336.

<sup>172</sup> Remali Yusoff et.al, *The Contract of Sukuk Al-Musharakah and Sukuk Al-Mudharabah in Islamic Commercial Law: A Comparative and Application Analysis for Waqf*, Universiti Sains Islam Malaysia, Malaysia, 2016, p.10, [https://www.researchgate.net/publication/309191475\\_The\\_Contract\\_of\\_Sukuk-al-Musharakah\\_and\\_Sukuk-al-Mudharabah\\_in\\_Islamic\\_Commercial\\_Law\\_A\\_Comparative\\_and\\_Application\\_Analysis\\_for\\_WAQF](https://www.researchgate.net/publication/309191475_The_Contract_of_Sukuk-al-Musharakah_and_Sukuk-al-Mudharabah_in_Islamic_Commercial_Law_A_Comparative_and_Application_Analysis_for_WAQF), accessed on October 26, 2017.

The Diagram of the *Mudharabah* Sharia Bond



Explanation of *Mudharabah* agreement:<sup>173</sup>

1. The Mudharib establish an SPV in order to facilitate the Mudharabah Sharia Bond issuance and transaction;
2. The Mudharib and The SPV make an agreement in order to facilitate the Mudharabah Sharia Bond issuance and transaction. In this agreement, the Mudharib contributes its expertise and managerial skill to the Sharia-compliant Mudharabah enterprise for optimizing the contribution of the SPV. Meanwhile, the SPV contributes the principal amount to the Sharia-compliant Mudharabah enterprise.
3. The SPV issue the Mudharabah certificate to the Shahibul Mal in the Stock Markets. In this phase, the SPV explain the Prospectus of

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<sup>173</sup> *Ibid*, p.11.

Mudharib such as the projects, the rating of the certificate, the financial disclosure, the legal disclosure, the profit, the scheme of profit sharing, and the period of the certificate.

4. The Shahibul Mal and the SPV make an agreement in term of Mudharabah certificate transaction. In this agreement, the Shahibul Mal pay the proceeds (the principal amount) to the SPV. Meanwhile, the SPV is acting as trustee on behalf of the Shahibul Mal such as the distribution of profit and return on financing.
5. The SPV give the funds from the Shahibul Mal to the Mudharib in order to finance the Mudharib's projects.
6. The Mudharib give the profit of the projects to the SPV in order to share the profit to the Shahibul Mal.
7. The SPV give the profit to the Shahibul Mal in order to share the profit from the Mudharib's profit of the projects.
8. In the maturity date. The Mudharib return the Shahibul Mal funds to the SPV.
9. The SPV return the Shahibul Mal funds to the Shahibul Mal and the Shahibul Mal return the certificate to the SPV.

Then, there are several types of Sharia Bond based on the issuer, namely:<sup>174</sup>

1. *Sharia Sovereignty Bond;*
2. *Sharia Municipal Bond;*
3. *Sharia State or Local Owned Enterprise Bond; and*

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<sup>174</sup> Heru Sudarsono, *Bank dan Lembaga Keuangan Syariah*, Ekonosia-FH UII, Yogyakarta, 2007, p.223.



#### 4. *Sharia Corporation Bond.*

### 3. **Sharia Bond Issuance.**

The primary market is that part of the capital markets that deals with the issuance of new securities (shares, bond, or any derivative product who sell in a stock exchange). The issuers (Companies, Governments or public sector institutions) can obtain funding through the sale of a new stock or bond issue.<sup>175</sup> The process of selling new issues to investors is called underwriting. In the case of a new stock issue, this sale is an initial public offering (IPO). Dealers earn a commission that is built into the price of the security offering, though it can be found in the Prospectus.<sup>176</sup>

Primary Market is the market for new long-term equity capital. The primary market is the market where the securities are sold for the first time. In a primary issue, the securities are issued by the issuers directly to investors.<sup>177</sup> The new issue market does not include certain other sources of new long-term external finance, such as loans from financial institutions. Borrowers in the new issue market may be raising capital for converting private capital into public capital.<sup>178</sup>

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<sup>175</sup> Inda Rahadiyan, *Hukum Pasar Modal di Indonesia: Pengawasan Pasar Modal Pasca Terbentuknya Otoritas Jasa Keuangan*, UII Press, Yogyakarta, 2014, p.18

<sup>176</sup> David S. Kidwell, *Financial Institution, Markets, and Money*, The Dryden Press, USA, 1990, p.513.

<sup>177</sup> Muhammad Ikbal, *Protection Towards Investor: Enforcement of The Authorities Of Indonesian Financial Services Authority (OJK) During Capital Market Integration*, Thesis, Universitas Islam Indonesia, Yogyakarta, 2015, p.39.

<sup>178</sup>

<http://www.stanlib.com/Individuals/knowledgecentre/Pages/Capitalmarketsandcapitalmarketinstruments.aspx>, accessed on October 26, 2017.

In the issuance process, issuers should do disclosure to investors in order to give legal protection to investors if fraud occurs intermittently conducted by issuers. The application of the principle of disclosure is also a way to increase your confidence to investors more broadly. With the protection and openness toward investors, it would affect an economic progress of the State.<sup>179</sup>

To do so, issuers must register the statement to the capital market supervisory agency of a State in a way to make a Prospectus. The Prospectus is a formal legal document that is required by and filed with the Securities and Exchange Commission that provides details about an investment offering for sale to the public.<sup>180</sup> Meanwhile, according to Black Law Dictionary, the Prospectus is a document published by a company or corporation setting forth the nature and objects of an issue of securities and inviting the public to subscribe to the issue.<sup>181</sup> According to Article 1 No.26 Law No.8 year 1995 on the Capital Market (Law of Capital Market), the Prospectus is every written information related to Public offering in order to the other parties buy the securities.<sup>182</sup> Then according to Hamud Balfas, the Prospectus is the documents offer an abstracted from effect and represents the documents that accompany a registration statement.<sup>183</sup> With the existence of the Prospectus, investors no longer need to examine all the documents that are submitted in order of registration statement to the capital market supervisory agency.

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<sup>179</sup> Hamud M. Balfas, *Op.Cit*, p.28-30.

<sup>180</sup> <http://www.investopedia.com/terms/p/prospectus.asp>, accessed on November 4, 2017.

<sup>181</sup> <http://thelawdictionary.org/prospectus/>, accessed on November 7, 2017.

<sup>182</sup> Article 1 Number 26 Law No. 8 year 1995 on the Capital Market.

<sup>183</sup> Hamud M. Balfas, *Op.Cit*, p.60.

The type of this prospectus itself is divided into three, namely Early Prospectus, Short Prospectus, and Final Prospectus. The difference between Early Prospectus and Short Prospectus with the Final Prospectus is located at the time in which this prospectus is issued. Early Prospectus and Short Prospectus are issued prior to a registration statement declared effective, whereas the Final Prospectus is issued after the registration statement is declared effective. Then the content of a document of the Early Prospectus and Short Prospectus is far from complete as of the effective date, planning offer period, planning date of refund of booking and delivery of securities, the date of listing of the effect on the stock exchange, and so on. While the contents of the Final Prospectus, the documents described above are listed on the final content of this Prospectus.<sup>184</sup>

In Sharia Capital Market, one of the instruments of Sharia Capital Market which can be issued by the issuers as Sharia Bond. According to AAOIFI Sharia Board, the regulation of Sharia Bond issuance are:<sup>185</sup>

1. All tradable Sharia Bond should represent holdings of the Shariah Bondholders, with all their relevant rights and obligations in physical assets that may be legally and lawfully acquired to sold, whether in kind, usufruct, or services. Meanwhile, the Shariah Bond managers have to record such ownership transfer in his own registers and should not keep those assets among his own;

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<sup>184</sup> *Ibid*, p.62-64.

<sup>185</sup> Thomas, Abdulkader, *Op,Cit*, p.35-37.

2. Tradable Shariah Bond should not represent either receivables or revenues unless a firm, whether commercial or financial, is selling all its assets or a financial standalone portfolio that the firm hold and that it happens that such receivables were attached to the sold assets or usufruct and were not meant to be sold per se;
3. The Shariah Bond manager whether in his capacity as *Mudharib*, or investment agent, is not allowed to commit to lending to Shariah Bondholders in order to cover any deficit that may arise between expected and realized a profit. A provision may be formed from prior revenues to make up such deficit as possible, provided that such provision is stipulated in the Prospectus.
4. The Mudarib or investment agent should not undertake to buy the asset from the Shariah Bondholders or their representatives at face value at the time of Shariah Bond extinguishing/maturity date. However, this undertaking may be based on the net asset value, market value, cash equivalent value or any price agreed upon the time of purchase, knowing that Shariah Bond manager guarantees the capital at face value in cases of negligence or violation;
5. A lessee may purchase the lead assets at the time of Shariah Bond extinguishing at face value, provided that such a lease is not a Mudharib or investment agent; and
6. The Sharia Supervisory Board in each several State should not just engage itself in issuing a fatwa on Shariah Bond structuring. It required,

as well, to verify all contracts and relevant document, monitor their applications and assure that process is in compliance with stipulations, and assure that the process is in compliance with the stipulation and requirements defined by Sharia standards.

In Indonesia, the process of Sharia Bond Issuance is regulated by OJK (Indonesia Financial Services Authority) and DSN-MUI (National Sharia Council of Assembly of Indonesian Islamic Scholar).<sup>186</sup> The role of OJK in term of Sharia Bond Issuance is established the requirement and procedures of the registration statement of Sharia Bond and also declare, postpone, and cancel the effective of the registration statement of Sharia Bond.<sup>187</sup> Meanwhile, the role of DSN-MUI in term of Sharia Bond Issuance is given the idea and advice to OJK related with the requirement and procedures of the registration statement of Sharia Bond and also declare, postpone, and cancel the effective of the registration statement of Sharia Bond.<sup>188</sup>

According to article 3-7 OJK Regulation No.7 year 2017 of the Document of Registration Statement in order to Public Offering of Equity, Debt, and or Sharia Bond (POJK 7/2017) *jo.* article 5-7 OJK Regulation No.18 year 2016 of Issuance and Requirement of Sharia Bond (POJK 18/2016), the documents that must be fulfilled by the issuer are related to financial report, report of legal audit, report of appraisal, report of expert of sharia capital market, statement

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<sup>186</sup> Mohd Ma'sum Billah, *Op, Cit*, p.59-65.

<sup>187</sup> Article 5 Letter c Law No.8 year 1995 on the Capital Market.

<sup>188</sup> <https://dsnemui.or.id/kami/sekilas/>, accessed on November 5, 2017.

from underwriter, report of rating agency, trustee agreement, and SPV (Special Purpose Vehicle) agreement.<sup>189</sup>

Therefore, the parties that has interest in the Sharia Bond issuance process are:

1. Public Accountant;

Public Accountants is a party that gives an opinion upon the naturalness, in all things material, business results, financial position and cash flows in accordance with accounting principles generally accepted.<sup>190</sup> In the Sharia Bond issuance, The Public Accountants duty is to give an opinion regarding the financial reporting issuers in accordance with standard accounting.<sup>191</sup>

2. Legal Consultant;

Legal Consultant is a party who has legal training and employment practices experience, are especially well suited to offer employee training and engage in an internal investigation. Legal Consultant does not practice law, instead, they market their knowledge and skills outside the framework of an attorney-client relationship.<sup>192</sup> In the Sharia Bond issuance, Legal Consultant duty is to ensure issuers has been established

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<sup>189</sup> Article 3-7 OJK Regulation No.7 year 2017 on the Document of Registration Statement in order to Public Offering of Equity, Debt, and or Sharia Bond *jo.* Article 5-7 OJK Regulation No.18 year 2016 on the Issuance and Requirement of Sharia Bond.

<sup>190</sup> Khaerul Umam, *Pasar Modal Syariah dan Praktek Pasar Modal Syariah*, Pustaka Setia, Bandung, 2013, p.40.

<sup>191</sup> Hamud M. Balfas, *Op.Cit*, p.252.

<sup>192</sup> Tanina Rostain, *The Emergence of Law Consultant*, Fordham Legal Review Vol.75, New York Law School, USA, 2006, p.1397, <http://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=4228&context=flr>, accessed on November 6, 2017.

in accordance with the applicable law, and all transactions that do meet the requirements that must be met, as well as the asset it has a legally valid.<sup>193</sup>

3. Appraiser;

The appraiser is a party that act or process of developing an opinion of value. The valuation process is a systemic procedure the Appraiser follows to answer a client's question about the value of client's assets.<sup>194</sup> In Sharia Bond issuance, the Appraiser duty to ensure the value of the assets of the issuer corresponding estimates so it won't cause swelling up in value.<sup>195</sup>

4. Public Notary;

Public Notary is a party authorized to make an authentic deed of all deeds, agreements, and determination, guaranteeing the certainty of making the deed, saving deed, validating the signature, and make a copy against the deed of.<sup>196</sup> In the Sharia Bond issuance, The Public Notary duty is to create an authentic deed against the issuer related to the Article of Association, and the making of the agreement between the issuer with the Public Accountant's Office, the Legal Consultant's Office, The Appraiser's Office, the Sharia Expert's Office, Trustee,

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<sup>193</sup> Hamud M. Balfas, *Op.Cit*, p.252-253.

<sup>194</sup> [http://www.appraisalinstitute.org/assets/1/7/understand\\_appraisal\\_1109](http://www.appraisalinstitute.org/assets/1/7/understand_appraisal_1109), accessed on November 6, 2017.

<sup>195</sup> Hamud M. Balfas, *Op.Cit*, p.252.

<sup>196</sup> Law No.2 year 2014 of Revise of Law No.30 year 2004 of Public Notary.

SPV, the company ratings effect, securities companies, as well as other agreements related to the issuance of Sharia Bond.<sup>197</sup>

5. Sharia Expert;

Sharia Expert is a party who has authority to give opinions and make sure that the client's activity is not contradicted by sharia principles.<sup>198</sup>

In the Sharia Bond issuance, the Sharia Expert duty is to give an opinion on the Sharia Bond issued by the issuer and ensure publication of Sharia Bond were not contrary to the Sharia principles.<sup>199</sup>

6. The Trustee;

The trustee is a party who appointed by the client to act in a fiduciary capacity to execute a trust. Trustee serves and assume legal ownership of the property, which could be cash, securities, real estate, or other property.<sup>200</sup> In the Sharia Bond issuance, the Trustee duty to represent the interests of the holders of Sharia Bond either outside or inside the court.<sup>201</sup>

7. Special Purpose Vehicle (SPV);

SPV is a party who created by the client by transferring assets to carry out some specific purpose or circumscribed activity or a series of such transaction.<sup>202</sup> In the Sharia Bond issuance, SPV duty on the basis of

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<sup>197</sup> M. Irsan Nasarudin et.al, *Aspek Hukum Pasar Modal Indonesia*, Kencana, Jakarta, 2007, p.94.

<sup>198</sup> Khaerul Umam, *Op.Cit*, p.302-303.

<sup>199</sup> *Ibid*, p.310.

<sup>200</sup> <https://www.leggmason.com/content/dam/legg-mason/documents/en/insights-and-education/worksheet/role-of-the-corporate-trustee>, accessed on November 6, 2017.

<sup>201</sup> Article 51 (2) Law No.8 year 1995 on the Capital Market.

<sup>202</sup> Gary B. Gorton and Nicholas S. Souleles, *Special Purpose Vehicles and Securitization*, University of Chicago Press, USA, 2007, p.550.



the designation of the issuer to issue Sharia Bond, becoming its issuer in the transaction transfer of assets, and act as trustee to represent the interests of investors.<sup>203</sup>

8. Securities Rating Agency;

Securities Rating Agency is a party who conduct by giving an opinion on the creditworthiness of debt securities. Securities Rating Agency aimed at reducing information asymmetries by providing information on the rated securities.<sup>204</sup> In the Sharia Bond issuance, Securities Rating Agency duty is to publish the ranks against Sharia Bond.<sup>205</sup>

9. Underwriter.

The underwriter is a party or parties who create agreements with the issuer in order to a public offering for issuer interest with or without obligation to buy the remains of securities who not sold.<sup>206</sup> In Sharia Bond issuance, Underwriter duty is to market, distributes and sells Sharia Bond that issued by the issuer.<sup>207</sup>

In Indonesia, the legal basis of Sharia Bond Issuance is stated in Set of OJK Regulation related to Sharia Bond issuance.<sup>208</sup>

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<sup>203</sup> Sunarsih, *Potensi Obligasi Syariah Sebagai Sumber Pendanaan Jangka Menengah dan Panjang bagi Perusahaan di Indonesia*, Jurnal Asy-Syri'ah Fakultas Syariah UIN Sunan Kalijaga, Yogyakarta, 2008, p.5, <http://asy-syirah.uin-suka.com/index.php/AS/article/view/250>, accessed on November 6, 2017.

<sup>204</sup> <http://siteresources.worldbank.org/EXTFINANCIALSECTOR/Resources/282884-1303327122200/Note8>, accessed on November 6, 2017.

<sup>205</sup> Khaerul Umam, *Op.Cit*, p.40.

<sup>206</sup> Article 72 Law No.8 year 1995 on the Capital Market.

<sup>207</sup> Hamud M. Balfas, *Op.Cit*, p.68.

<sup>208</sup> See the Head of BAPEPAM-LK Decision No.IX.A.13 of Issuance of Sharia Securities, OJK Regulation No.53 year 2014 of Application of Agreement in Sharia Securities Issuance, OJK Regulation No.7 year 2017 of the Document of Registration Statement in order to Public Offering of Equity, Debt, and or Sharia Bond, OJK Regulation No.15 year 2016 of Application of Sharia

#### 4. Regulator and Supervisor in Sharia Capital Market.

An effective legal, regulatory and supervisory framework provides the essential foundation for the functioning of a modern capital market. For a rapidly growing market like the Sharia Capital Market, it is important to ensure that an enabling and conducive regulatory environment exists to adequately regulate the Sharia Capital Market. Individual members may also wish to address any factors that may impede effective product development and innovation or discourage participation in Islamic Capital Market transactions.<sup>209</sup>

In Indonesia, the institution that has the authority to regulate and supervise of Sharia Capital Market are OJK, Indonesian Stock Exchange (IDX), and DSN-MUI. Financial Service Authority is the new supervisory body in Capital Market. According to Article 55 section (1) Law of Capital Market, the supervisory duty of Capital Market has been transferred to Financial Services Authority (OJK) from the Capital Market Supervisory Body and Financial Body (BAPEPAM-LK) since December 31, 2012. The transfer of authorities includes function, duty and authority on regulation and supervision of financial service activities in the sector of the capital market, and non-bank financial industries.<sup>210</sup>

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Principle in Capital Market, OJK Regulation No.16 year 2016 of Sharia Expert of Capital Market, and OJK Regulation No.18 year 2016 of Issuance and Requirement of Sharia Bond.

<sup>209</sup> IOSCO, *Islamic Capital Market Fact Finding Report*, Report of the Islamic Capital Market Task Force of the International Organization of Securities Commission, 2004, p.50, <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD170.pdf>, accessed on November 8, 2017.

<sup>210</sup> Article 55 Section (1) Law No.8 year 1995 of Capital Market.

The purpose of OJK's establishment is for the overall activity in the financial services sector to be on a regular basis, fair, transparent, accountable, and able to realize the financial system growth in a sustainable and stable manner, as well as being able to protect the interests of consumers as well as the community. With the establishment of OJK, it is expected to support the interests of the financial services sector as a whole so as to enhance the competitiveness of the economy. In addition, OJK must be able to maintain national interests, including human resources, management, control, and ownership in the financial services sector still consider the positive aspects of globalization. OJK formed and based on principles of good governance, which includes independence, accountability, responsibility, transparency, and fairness.<sup>211</sup>

As part of the Capital Market, the activity of Sharia Capital Market in Indonesia also refers to the Law of Capital Market, Law No.21 year 2011 on the Financial Services Authority (Law of OJK), Government Regulation related with Capital Market Activities, BAPEPAM-LK Regulation, OJK Regulation, and Indonesia Stock Exchange Regulation. The authorities of OJK in Sharia Capital Market based on Article 5 Law of Capital Market are:<sup>212</sup>

1. *Giving business permit to stock exchange, Clearing and Guarantee Institution, Depository and Settlement Body, mutual funds, Securities Company, investment advisor, and registrar as well as giving license for deputy underwriter, broker-dealer, deputy manager of investment; and approval for Custodian Bank;*

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<sup>211</sup> <http://www.ojk.go.id/id/Pages/FAQ-Otoritas-Jasa-Keuangan.aspx>, accessed on November 8, 2017.

<sup>212</sup> Article 5 Law No.8 year 1995 of Capital Market

2. *Obligates the registration of supporting profession of capital market and trustee;*
3. *Determine the requirements and procedure of candidacy as well as temporarily suspend the activity of commissary and/or director and temporarily appoint the management of Stock Exchange, Clearing and Guarantee institution, as well as Depository and Settlement institution until the election of new commissary and/or director;*
4. *Determine the requirements and procedures for registration statement also express, postpone or cancel the effectiveness of registration statement;*
5. *Conduct an audit and investigation of any party suspected of committing a violation of the Law No.8/1995 of Capital Market or any law related to capital market activities;*
6. *Requires all parties in capital market to stop or fix the advertisement or promotion related to capital market activity or take necessary measures to overcome the consequences arising from certain advertisement or promotion;*
7. *Authorize to conduct investigation toward each issuer or public company who have or is obliged to deliver registration statement or each party required to have a business license, licensed, approval, or registration under law on capital market;*
8. *Appoint another party to conduct certain investigation in the scope of enforcement of supervisory authority;*
9. *Announce the result of investigation;*
10. *Freeze or cancel the recording of certain securities in Stock Exchange or to stop exchange or certain securities transaction in certain period of time to protect the interest of the investor;*
11. *Stop the trading activity in Stock Exchange in certain period of time during emergency situation;*
12. *File objection proposed by parties being penalized by Stock Exchange, Clearing and Guarantee Institution, Depository and Settlement Institution as well as to dispose of decision to cancel or strengthen the sanction;*
13. *Determine the fee for permission, agreement, registration, investigation, and research as well as other fees in the scope of capital market activity;*
14. *Conduct necessary activities to prevent losses to the investor as the result of violation in the field of capital market;*
15. *Give further technical explanation of Law on Capital Market and other laws related to it;*
16. *Determine other instruments as securities; and*
17. *Conduct other activities allowed by Law on Capital Market.*

Indonesian Stock Exchange (IDX) is a Limited Liability Company with the core business namely as Stock Exchange, The purpose of IDX establishment

is in order to organize the trading of Securities that regular, reasonable, and efficient.<sup>213</sup> The trading of Securities by regular, reasonable, and efficient is a trading which organized based on the clear regulations that implemented consistently. Thus, the making price of the Securities reflected the market mechanism based on the power of demand and supply. The trading of Securities efficiently reflected in the settlement of transaction quickly and cheap.<sup>214</sup>

SRO is a non-governmental entity responsible for regulating its members through the adoption and enforcement of rules and regulations which are binding to every institution involved in its function.<sup>215</sup> As the Self-Regulatory Organization (SRO), the IDX has authority to establish regulations related its duties, namely:

1. *Issuing regulation which is related to Stock Exchange's activities;*
2. *Preventing the practices of prohibited transaction through its supervision function; and*
3. *The provision of IDX has legally binding towards the actors in the Capital Market.*

This rulemaking power is delegated by law and with respect to 4 types of organizations, namely Securities Exchange, Clearing, Settlement, and Depository Institution.<sup>216</sup> However, to establish the regulations, IDX should

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<sup>213</sup> Inda Rahadian, *Pokok-Pokok Hukum Pasar Modal di Indonesia*, UII Press, Yogyakarta, 2016, p.43.

<sup>214</sup> Article 7 Law No.8 year 1995 on the Capital Market.

<sup>215</sup> Christopher W. Cole, *Financial Industry Regulatory Authority (FINRA): Is the Consolidation of NASD and the Regulatory Arm of NYSE a Bull or a Bear for U.S. Capital Market*, UMKC Legal Review No.251, 2006, p.255-256, <http://heinonline.org/HOL/LandingPage?handle=hein.journals/umkc76&div=14&id=&page=>, accessed on November 8, 2017.

<sup>216</sup> I Putu Gede Ary Suta, *Foundations of Our Capital Market*, Yayasan Sad Satria Bhakti, Jakarta, 2000, p.169.

be asking the permission to the OJK as the General Regulator and Supervisor on the Capital Market activities.<sup>217</sup>

There are main elements of Indonesia Stock Exchange, namely:

1. Clearing and Guaranteeing Institution<sup>218</sup>

Clearing and Guaranteeing Institution is a party who organize clearing and guaranteeing services of securities transaction settlement. This institution provides services on clearing and finishing of Securities Exchange, Guaranteeing the finishing of Securities transaction, and borrowing the Securities. The organizer of the Clearing and Guaranteeing Institution in Indonesia is PT. Kliring dan Penjaminan Efek Indonesia (PT. KPEI).

2. Depository and Settlement Institution<sup>219</sup>

Depository and Settlement Institution is a party who organize custodian central activities for the custodian bank, Securities Company, and other parties. This institution provides services on Securities depository, incoming of dividend and interest, finishing the Securities transaction, and representing bill holders. The organizer of the Depository and Settlement Institution in Indonesia is PT. Kustodian Sentral Efek Indonesia (PT. KSEI).

3. Securities Company<sup>220</sup>

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<sup>217</sup> Tjiptono Darmadji and Hendy M. Fakhruddin, *Pasar Modal di Indonesia Third Edition*, Salemba Empat, Jakarta, 2011, p.34.

<sup>218</sup> *Ibid*, p.35.

<sup>219</sup> Article 1 Number 10 Law No.8 year 1995 on the Capital Market.

<sup>220</sup> Inda Rahadian, *Pokok-Pokok Hukum...*, p. 45-54.

Securities Company is a party who conduct business activity such as:

a. Underwriter

The underwriter is a party who makes an agreement with the issuers in order to Public offering for the Issuer's interest with/without obligation to buy the rest of Securities that not sold.

b. Broker-Dealer

Broker-Dealer is a party who conduct business activities of sell and buy the Securities for the self-interest or other interest.

c. Investment Management

Investment Management is a party who manage the Customer/Investor's Securities or manage the collective investment for a group of customer, except insurance company, pension fund, and the bank who self-conduct their business.

DSN-MUI is an independent institution established by MUI on duty to give a fatwa or legal opinion about the economy/financial issues. DSN-MUI was formed in order to realize the aspirations of Muslims on the issue of the economy and encourage the application of Islamic teachings in the field of economy/finance is performed according to the guidance of Islamic jurisprudence. The establishment of DSN-MUI is a step of efficiency and coordination in responding to the issues related to the economic/financial issues.<sup>221</sup> In the field of Sharia Capital Market, DSN-MUI formed by MUI that has a duty and the finances to ensure conformity between the products,

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<sup>221</sup> <https://dsnmui.or.id/kami/sekilas/>, accessed on November 9, 2017.

services, and business activities in the Sharia Capital Markets with the Sharia principles.<sup>222</sup>

In the Sharia Capital Market activity, the authorities of DSN-MUI are:<sup>223</sup>

1. Issuing fatwa that binds the Sharia Supervisory Board (DPS) in the Islamic capital market institutions and the basis of legal actions related parties;
2. Issuing fatwa that became the Foundation for the provisions/regulations promulgated by OJK regarding Sharia Capital Market;
3. Give recommendations and/or unplugging recommendation of the names that will sit as the Sharia Supervisory Board on an Islamic capital market institutions;
4. Invites the experts to explain a problem which is needed in the discussion of the Sharia Capital Market, including Sharia Capital Market institutions both from local and foreign;
5. Give a warning to the Islamic capital market institution to discontinue aberration from a fatwa has been issued by the DSN-MUI; and
6. Propose to the OJK to take action if the warnings are not responded to complaints.

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<sup>222</sup> Akhmad Faozan, *Optimalisasi Peran Dewan Pengawas Syariah Pada Lembaga Keuangan Syariah*, Journal El-Jizya Vol.II No.1, 2014, p.25, <http://download.portalgaruda.org/article.php?article=342432&val=7954&title=OPTIMALISAI%20OPERAN%20DEWAN%20PENGAWAS%20SYARIAH%20PADA%20LEMBAGA%20KEUANGAN%20SYARIAH>, accessed on November 9, 2017.

<sup>223</sup> <https://dsnemui.or.id/kami/sekilas/>, accessed on November 9, 2017.



In the exercise of the authority of the DSN-MUI, then the DSN-MUI form Sharia Supervisory Board as a representative of the DSN-MUI on Sharia Capital Market.<sup>224</sup> Sharia Supervisory Board is an agency which was authorized to conduct supervision and look closely at the activities of Sharia Capital Market institutions so that these institutions always follows the rules and principles of Sharia.<sup>225</sup> Sharia Supervisory Board acted as Supervisor of the Sharia Capital Market related the products, management, and administration so that the institution running in accordance with the Islamic guidance. On the other hand, the Sharia Supervisory Board is part of the Sharia Capital Market institutions that his job approval over DSN-MUI.<sup>226</sup> The functions of Sharia Supervisory Board are; First, as an advisor and mentor to the Board of Directors, the Chairman of the Sharia unit, and the Chief of Sharia branch offices on matters related to the Sharia aspects; Second, as a mediator between the institution of Sharia capital market with the DSN-MUI in giving advice and suggested the development of products and services of Sharia Capital Market that require study and the fatwa of DSN-MUI.<sup>227</sup>

Related to Sharia Bond Issuance, DSN-MUI is tasked with issuing a fatwa regarding Sharia Bond Issuance as a guideline for OJK to issue OJK regulation (POJK) regarding the Sharia Bond Issuance.<sup>228</sup> DSN-MUI when giving fatwa

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<sup>224</sup> See DSN-MUI Decision No.2 year 2000 on the Guidance of DSN-MUI.

<sup>225</sup> Akhmad Faozan, *Op.Cit*, p.26.

<sup>226</sup> DSN-MUI Decision No.3 year 2000 on the Instruction of Establishment Implementation of Board of Sharia Supervisory Member on Sharia Financial Institution.

<sup>227</sup> Akhmad Faozan, *Loc.Cit*, p.26.

<sup>228</sup> See Fatwa DSN-MUI No.32/DSN-MUI/IX/2002 on the Sharia Bond, Fatwa DSN-MUI No.33/DSN-MUI/IX/2002 on the *Mudharabah* Sharia Bond, Fatwa DSN-MUI No.40/DSN-MUI/X/2002 on the Capital Market and Guidance of Implementation of Sharia Principle in Capital

always refer to propositions that *syara* just like Al-Qur'an the *Hadith* of the Prophet Muhammad SAW, and the *Ijtihad* from the scholars that serve as the legal basis.<sup>229</sup> The Fatwa is associated with the Sharia Bond Issuance include that of a Sharia Bond is viewed has complied with Sharia principles in Sharia compliance statement has obtained the written from the DSN-MUI.<sup>230</sup> As a follow up to the issuance of a DSN-MUI fatwa, OJK then issued OJK regulations associated with the Sharia Bond Issuance.<sup>231</sup>

## 5. Sharia Capital Market and Sharia Bond in Islamic Perspective.

*Muammalah* is a branch of Islamic Jurisprudence that deals with commercial and business activities in an economy. *Fiqh* literally means understanding of rulings and precepts, whilst *Muammalah*, in this particular facet, refers to economic transactions and activities. This branch of *fiqh* covers the rulings that define and govern the relationship between humans, i.e., their financial rights and obligations towards each other.<sup>232</sup>

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Market, Fatwa DSN-MUI No.41/DSN-MUI/III/2004 on the *Ijarah* Sharia Bond, and Fatwa DSN-MUI No.59/DSN-MUI/V/2007 on the Conversion of *Mudharabah* Sharia Bond.

<sup>229</sup> S. Burhanuddin, *Aspek Hukum Lembaga Keuangan Syariah*, Graha Ilmu, Yogyakarta, 2010, p.132-133.

<sup>230</sup> Adrian Sutedi, *Pasar Modal Syariah*..... p.9-10.

<sup>231</sup> See the Head of BAPEPAM-LK Decision No.IX.A.13 on the Sharia Securities Issuance, OJK Regulation No.53 year 2014 on the Application of Agreement in Sharia Securities Issuance, OJK Regulation No.7 year 2017 on the Document of Registration Statement in order to Public Offering of Equity, Debt, and or Sharia Bond, OJK Regulation No.15 year 2016 on the Application of Sharia Principle in Capital Market, OJK Regulation No.16 year 2016 on the Sharia Expert of Capital Market, and OJK Regulation No.18 year 2016 on the Issuance and Requirement of Sharia Bond.

<sup>232</sup> <https://www.investment-and-finance.net/islamic-finance/f/fiqh-muamalat.html>, accessed on August 18, 2018.

According to Muhammad, there are five foundations of *Muammalah*, namely:<sup>233</sup>

1. *Ilaiah (God Values);*
2. *Al- 'Adl (Justice Values);*
3. *An-Nubuwah (Prophet Values);*
4. *Al-Khalifah (Government Values); and*
5. *Al-Ma 'ad (Profit Values).*

Meanwhile, the principles of *Muammalah* according to Djamil are:<sup>234</sup>

1. *Allowed by Islam;*
2. *Benefit for people;*
3. *Contain balancing values;*
4. *Contain justice values;*
5. *Object of transaction is Halal;*
6. *Willingness among parties; and*
7. *Trust in doing.*

In order to support *Muammalah* activities, Islam has legal sources to decide whether the *Muammalah* activities is allowed or prohibited, namely:<sup>235</sup>

1. *Al-Qur 'an;*
2. *Hadist of Prophet Muhammad;*
3. *Ijma (Consensus of Muslim Jurist);*
4. *Qiyas (The application of Rule by analogy);*
5. *Istihsan (Application of the Principle of Equity in Jurisprudence);*
6. *Maslahah Mursalah (Consideration of Public Interest);*
7. *Urf (Application of custom in Jurisprudence);*
8. *Istishab (Presumption of Continuity); and*
9. *Ijtihad (Exercise of independent reasoning).*

Capital Market according to the Islamic view is a *Muammalah* activity consist of listing and trading of securities (shares, bond, right issue, warrant,

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<sup>233</sup> Muhammad, *Ekonomi Mikro dalam Perspektif Islam*, FH UGM Press, Yogyakarta, 2004, p.95.

<sup>234</sup> Faturrahman Djamil, *Hukum Ekonomi Islam: Sejarah, Teori, dan Konsep*, Sinar Grafika, Jakarta, 2013, p.50.

<sup>235</sup> Javaid Rehman and Aibek Ahmedov, *Sources of Islamic Law*, UK Centre for Legal Education, UK, 2011, p.56-76, <http://pgil.pk/wp-content/uploads/2014/04/Sources-of-Islamic-Law.pdf>, accessed on August 18, 2018.

etc) that should follow the provisions of the Sharia, no coercion, no scams, no gambling, no speculation and no uncertainty over something being sold or others.<sup>236</sup>

Verses of the Al-Qur'an related to the implementation of Sharia Capital Market are:<sup>237</sup>

1. QS Al-Baqarah (2:219)

﴿ يَسْأَلُونَكَ عَنِ الْخَمْرِ وَالْمَيْسِرِ قُلْ فِيهِمَا إِثْمٌ كَبِيرٌ وَمَنْفَعَةٌ لِلنَّاسِ وَإِثْمُهُمَا أَكْبَرُ مِنْ نَفْعِهِمَا وَيَسْأَلُونَكَ مَاذَا يُنْفِقُونَ قُلْ الْعَفْوَ كَذَلِكَ يُبَيِّنُ اللَّهُ لَكُمْ آيَاتِهِ لَعَلَّكُمْ تَتَفَكَّرُونَ ﴾ (٢١٩)

Translate:

They ask you concerning wine and gambling. Say, 'There is a great sin in both of them and some profits for the people, but their sinfulness outweighs their profit.' And they ask you as to what they should spend. Say, 'All that is surplus.' Thus does Allah clarify His signs for you so that you may reflect?

2. QS Al-Baqarah (2:275)

﴿ الَّذِينَ يَأْكُلُونَ الرِّبَا لَا يَقُومُونَ إِلَّا كَمَا يَقُومُ الَّذِي يَتَخَبَّطُهُ الشَّيْطَانُ مِنَ الْمَسِّ ذَلِكَ بِأَنَّهُمْ قَالُوا إِنَّمَا الْبَيْعُ مِثْلُ الرِّبَا وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا فَمَنْ جَاءَهُ مَوْعِظَةٌ مِنْ رَبِّهِ فَانْتَهَى فَلَهُ مَا سَلَفَ وَأَمْرُهُ إِلَى اللَّهِ وَمَنْ عَادَ فَأُولَئِكَ أَصْحَابُ النَّارِ هُمْ فِيهَا خَالِدُونَ ﴾ (٢٧٥)

Translate:

Those who exact interest will not stand but like one deranged by the Devil's touch. That is because they say, 'Trade is just like interest.' While Allah has allowed trade and forbidden interest. Whoever, on receiving advice from his Lord, relinquishes (interest), shall keep (the

<sup>236</sup> H. Romansyah, *Pasar Modal Dalam Perspektif Islam*, Jurnal Pemikiran Hukum Islam Mazahib Vol.XIV No.1 IAIN Samarinda, Samarinda, 2015, p.7, <https://media.neliti.com/media/publications/58051-ID-pasar-modal-dalam-perspektif-islam.pdf>, accessed on November 12, 2017.

<sup>237</sup> Consideration of Fatwa DSN-MUI No.40/DSN-MUI/X/2002 on the Capital Market and Guidance of Implementation of Sharia Principle in Capital Market.

gains of) what is past, and his matter shall rest with Allah. As for those who resume, they shall be the inmates of the Hell and they shall remain in it (forever).

3. QS Al-Baqarah (2:278-279)

يٰۤاَيُّهَا الَّذِيْنَ ءَامَنُوْا اتَّقُوا اللّٰهَ وَذَرُوْا مَا بَقِيَ مِنَ الرِّبْوٰۤاِ اِنْ كُنْتُمْ مُّؤْمِنِيْنَ ﴿٢٧٨﴾  
 فَاِنْ لَّمْ تَفْعَلُوْا فَاذْنُوْا بِحَرْبٍ مِّنَ اللّٰهِ وَرَسُوْلِهِؕ وَاِنْ تَابْتُمْ فَلَكُمْ رِءُوْسُ اَمْوَالِكُمْ  
 لَا تَظْلِمُوْنَ وَلَا تُظْلَمُوْنَ ﴿٢٧٩﴾

Translate:

O you who have faith! Be wary of Allah, and abandon (all claims to) what remains of usury, should you be faithful. And if you do not, then be informed of a war from Allah and His apostle. And if you repent, then you will have your principal, neither harm others nor suffer harm.

4. QS. An-Nisa (4:29)

يٰۤاَيُّهَا الَّذِيْنَ ءَامَنُوْا لَا تَاْكُلُوْا اَمْوَالِكُمْ بَيْنَكُمْ  
 بِالْبَاطِلِ اِلَّا اَنْ تَكُوْنَ تِجَارَةً عَنْ تَرَاضٍ مِّنْكُمْ وَلَا تَقْتُلُوْا  
 اَنْفُسَكُمْ اِنَّ اللّٰهَ كَانَ بِكُمْ رَحِيْمًا ﴿٢٩﴾

Translate:

O you who have faith! Do not eat up your wealth among yourselves unrightfully, but it should be traded by mutual consent. And do not kill yourselves. Indeed Allah is most merciful to you.

In the development of Sharia Capital Market, there are a lot of products of Sharia Capital Market. One of the products of Sharia Capital Market is Sharia Bond. Sharia Bond in principle it is the securities that can be sold and management based on Islamic jurisprudence. The principles that exist in Sharia Bond is the use of the concept of reward and profit sharing, the presence of an underlying asset that is the basis supporting the issuance of Sharia Bond, and the existence of an agreement between the parties which was formed based on the principles of Islam. In addition, Sharia Bond should also be set up in Islam in order to secure and free from gambling, interest, uncertainty, and speculation.

Verses of the Al-Qur'an related to the Issuance and Trading of Sharia Bond

are:<sup>238</sup>

1. QS. Al-Maidah (5:1)

يَتَأْتِيهَا الَّذِينَ ءَامَنُوا أَوْفُوا بِالْعُقُودِ ؕ أُحِلَّتْ لَكُمْ بَهِيمَةُ ٱلْأَنْعَامِ  
إِلَّا مَا يَتَنَبَّأُ عَلَيْكُمْ ۚ غَيْرِ مُحِلِّي الصَّيْدِ وَأَنْتُمْ حُرْمٌ ۗ إِنَّ ٱللَّهَ يَحْكُمُ مَا  
يُرِيدُ ﴿١﴾

Translate:

O you who have faith! Keep your agreements. Lawful for you are the animals of grazing livestock except for that which is recited to you (in this Qur'an) hunting not being permitted while you are in the state of Ihram. Indeed, Allah ordains what He intends.

2. QS. Al-Baqarah (2:233)

﴿٢٣٣﴾ وَالْوَالِدَاتُ يُرْضِعْنَ أَوْلَادَهُنَّ حَوْلَيْنِ كَامِلَيْنِ ۖ لِمَنْ أَرَادَ أَنْ يُنِيمَ الرِّضَاعَةَ  
وَعَلَى ٱلْمَوْلُودِ لَهُ رِزْقُهُنَّ وَكِسْوَتُهُنَّ بِٱلْمَعْرُوفِ ۚ لَا تُكَلِّفُ نَفْسٌ إِلَّا وُسْعَهَا ۚ لَا  
تُضَارَّ وَٱلِدَةٌ ۖ يَوْلَدُهَا وَلَا مَوْلُودٌ لَهُ يَوْلَدُهَا ۚ وَعَلَى ٱلْوَارِثِ مِثْلُ ذَٰلِكَ ۚ فَإِنْ  
أَرَادَا فِصَالًا عَنْ تَرَاضٍ مِنْهُمَا وَتَشَاوُرٍ فَلَا جُنَاحَ عَلَيْهِمَا ۗ وَإِنْ أَرَدْتُمْ أَنْ  
تَسْتَرْضِعُوا أَوْلَادَكُمْ فَلَا جُنَاحَ عَلَيْكُمْ إِذَا سَلَّمْتُمْ مَآءَ ٱلْأَنفُسِ بِٱلْمَعْرُوفِ ۚ وَأَتَّقُوا  
ٱللَّهَ وَٱعْلَمُوا أَنَّ ٱللَّهَ يَمَآعْمَلُونَ بَصِيرٌ

Translate:

And if you want to have your children wet-nursed, there will be no sin upon you so long as you pay what you give in accordance with honorable norms, and be wary of Allah, and know that Allah sees best what you do.

3. QS. Al-Qashas (28:26)

قَالَتْ إِحْدَاهُمَا يَأْتِي ٱبْتِ ٱسْتَعْجَرَهُ ۗ إِنَّ خَيْرَ مَنِ ٱسْتَعْجَرْتَ ٱلْقَوِيُّ  
ٱلْأَمِينُ ﴿٢٦﴾

Translate:

One of the two women said, 'Father, hire him. Indeed the best you can hire is a powerful and trustworthy man.'

<sup>238</sup> Consideration of Fatwa DSN-MUI No.33/DSN-MUI/IX/2002 on the Mudharabah Sharia Bond and Fatwa DSN-MUI No.41/DSN-MUI/III/2004 on the Ijarah Sharia Bond.

From those several verses of Al-Qur'an related with Sharia Capital Market and Sharia Bond, it can be concluded that the implementation of Sharia Capital Market and the issuance and transaction of Sharia Bond should prevail the interest of justice. Justice requires that the items exchanged among parties must be of equal value. Gambling, interest, uncertain, and speculation makes a result of unequal exchanges of value in the securities transaction. That is why Al-Qur'an and *Hadith* are prohibited gambling, interest, uncertain, and speculation because all of them are violates a justice in trading/transaction.<sup>239</sup>

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<sup>239</sup> Muhammad Anwar, *An Islamic Perspective on Capital Markets and Islamic Securities in Malaysia*, The Pakistan Development Review Vol.34:4 Part II, Pakistan 1995, p.866-867, <http://www.pide.org.pk/pdf/PDR/1995/Volume4/865-878.pdf>, accessed on November 12, 2017.

## CHAPTER III

### OBSTACLES AND SOLUTIONS OF SHARIA MUNICIPAL BOND ISSUANCE IN INDONESIAN LEGAL PERSPECTIVE.

#### A. The Obstacles of Local Government in terms of Sharia Municipal Bond Issuance.

As has been elaborated previously, the Local Government has a chance to publish Sharia Municipal Bond in order to perform the economic independence and the development of the Local Governance in accordance with the Sharia principles. Furthermore, the Sharia Municipal Bond issuance has been considered earlier by the Ministry of Finance because essentially Sharia Municipal Bond is a securities issued by the Local Governments where the approach leads to more investment than the debt.<sup>240</sup>

However, there is a deficiency regarding the issuance of Sharia Municipal Bond because it does not own a legal basis that is clear so that the opportunity of Local Government to publish Sharia Municipal Bond simply discourses. In contrast to the issuance of Sharia Sovereignty Bond that has a clear legal basis.<sup>241</sup> Then, the

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<sup>240</sup> <https://bisnis.tempo.co/read/862374/sukuk-bisa-jadi-alternatif-pembiayaan-daerah>, accessed on November 24, 2017.

<sup>241</sup> See Law No.19 year 2008 on the Sharia Sovereignty Bond.



issuance of Municipal Bond is also governed by the regulations governing the issuance of the Municipal Bond.<sup>242</sup>

The Issuance of Municipal Bond could be conducted in the domestic market and in the currency of Rupiah (Rp). Municipal Bond is the securities which issued by Local Government and it is not guaranteed by the State.<sup>243</sup> This provision confirms that all the risks which arises due to the issuance of Municipal Bonds are not guaranteed and underwritten by the State because it is essentially the Municipal Bond is not included in the Sovereignty Bond (SUN).

The value of the Municipal Bond at maturity equal to the face value of the Municipal Bond at the time of publication. The issuance of Municipal Bond can only be made to finance the public sector investments that generate profits and provide benefits to the community. Then the income admission of public sector investment priority to pay principal, interest, and fines of Municipal Bond. The payment of principal, interest, and fines of Municipal Bond should be budgeted into the Local Budget of Income and Expenditure (APBD) until the Municipal Bond is declared settled.<sup>244</sup>

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<sup>242</sup> See Law No.33 year 2004 on the Financial Equalization between Central Government and Local Government, Law No.23 year 2014 on the Local Governance, Government Regulation No.58 year 2005 on the Local Finance Management, Government Regulation No.30 year 2011 on the Local Loan, the Ministry of Local Affairs Regulation No.13 year 2006 on the Guidance of Local Finance Management, the Ministry of Finance Regulation No.111 year 2012 on The Procedure of Issuance and Responsibility regarding Municipal Bond, and Head of the BAPEPAM-LK Decision No.IX.C.12, IX.C.13, IX.C.14, VIII.G.14, VIII.G.15, and VIII.G.16 related with the Procedures of Registration Statement of Municipal Bond.

<sup>243</sup> Article 40 Government Regulation No.30 year 2011 on the Local Loan.

<sup>244</sup> Article 46 Government Regulation No.30 year 2011 on the Local Loan.

Although the issuance of Municipal Bond has been set of rules on the issuance of the Municipal Bond, in fact, up to this point there has been no Local Government could publish the Municipal Bond. It is because of the difficulty of getting approval from Local Parliament and Ministry of Finance, and also getting the consideration from Ministry of Local Affairs in order to conduct registration statement for the Municipal Bond Issuance. Then the clash between the Financial Examiner Body (BPK) and Financial Services Authority (OJK) regarding the financial audit of Financial Statement of Local Government as a condition for doing the registration statement in Municipal Bond Issuance.<sup>245</sup> Then the appointment of supporting institutions and supporting profession on capital markets in order to the public offering of the Municipal Bonds must pass through a stage of goods and services procurement.<sup>246</sup> Also there is a prohibition of the Local Government to use the Local Assets as a guarantee of the Municipal Bond payment against the Investor.<sup>247</sup>

Whereas, there are several Local Government which has interest to issue Municipal Bond in the Capital Market in order to develop their region infrastructure

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<http://ekonomi.kompas.com/read/2015/03/13/155000226/Soal.Obligasi.Daerah.OJK.Temui.Sejumlah.Hambatan>, accessed on December 1, 2017.

<sup>246</sup> Article 14 Ministry of Finance Regulation No.111 year 2012 on the Procedure of Issuance and Responsibility against Municipal Bond.

<sup>247</sup> [http://www.djpk.depkeu.go.id/?page\\_id=328](http://www.djpk.depkeu.go.id/?page_id=328), accessed on December 1, 2017.

and business such as DKI Jakarta, Central Java, East Java<sup>248</sup>, West Java<sup>249</sup>, West Sumatera<sup>250</sup>, East Borneo<sup>251</sup>, and South Celebes.<sup>252</sup>

## **1. The Obstacles of the Local Government against Pre-Registration Statement of Sharia Municipal Bond Issuance.**

Essentially, the legal basis for the Local Government to issue a Sharia Municipal Bond has not been regulated by legislation related to the mechanism of the issuance of Sharia Municipal Bond. However, if the related parties refer to the rules concerning the terms and conditions of the issuance of the Municipal Bond, they could consider the possibility of Sharia Municipal Bond issuance.<sup>253</sup>

Generally, there are 2 kinds of Municipal Bond that can be issued by the Local Government, namely:<sup>254</sup>

### **1. General Obligation Municipal Bond**

General Obligation Municipal Bond is issued by the Local Government and is not backed by revenues from a specific project or sources.

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<sup>248</sup> <https://investasi.kontan.co.id/news/jabar-jateng-dki-jakarta-tertarik-terbitkan-obligasi-daerah>, accessed on August 16, 2018.

<sup>249</sup> <http://www.tribunnews.com/bisnis/2018/01/18/tiga-provinsi-ini-siap-rilis-obligasi-daerah-di-2018>, Accessed on August 16, 2018.

<sup>250</sup> <https://www.republika.co.id/berita/ekonomi/makro/17/09/19/owj1o0416-pemprov-sumbar-ingin-terbitkan-obligasi-daerah>, accessed on August 16, 2018.

<sup>251</sup> <https://republika.co.id/berita/ekonomi/keuangan/17/07/14/ot2h93382-kalimantan-timur-berencana-terbitkan-obligasi-daerah>, accessed on August 16, 2018.

<sup>252</sup> <https://sulselprov.go.id/post/obligasi-daerah-alternatif-percepatan-infrastruktur-sulsel>, accessed on August 16, 2018.

<sup>253</sup> See Law No.33 year 2004 on the Financial Equalization between Central Government and Local Government, Law No.23 year 2014 on the Local Government, Government Regulation No.58 year 2005 on the Local Finance Management, Government Regulation No.30 year 2011 on the Local Loan, Ministry of Local Affairs Regulation No.13 year 2006 on the Guidance of Local Finance Management, and Ministry of Finance Regulation No.111 year 2012 on The Procedure of Issuance and Responsibility against Municipal Bond.

<sup>254</sup> <https://www.sec.gov/oiea/investor-alerts-bulletins/investor-alerts-municipalbondshmt.html>, accessed on December 1, 2017.

General Obligation Municipal Bond is backed by dedicated taxes on real property and other taxes. This bond is also payable from general funds and is often referred to as being backed by the full faith and credit of the Local Government. The example of General Obligation Municipal Bond is issued in order to give subsidies, pay the civil servant salary, and the development project of the road, bridge, and public facilities.

## 2. Revenue Municipal Bond

Revenue Municipal Bond is backed by revenues from a specific project or sources. The Local Government issues this bond in order to fund the development of toll roads, stadiums, airports, ports, and other development of tourism areas. From these projects, the Local Government makes the project as the underlying asset to pay the interest and return to the investor.

According to article 142 Ministry of Local Affairs Regulation No.13 year 2006 on the Guidance of Local Finance Management (MLAR 13/2006), the principles of Municipal Bond issuance are:<sup>255</sup>

1. *The acceptance of Municipal Bond conducted through general treasury account of Local Government.*
2. *The Local Governments are unable to provide collateral for the loan to other parties.*
3. *Local income and/or Local assets should not be used as a loan guarantee.*
4. *The activities financed from the Municipal Bond along with Local assets of the activities inherent in any warranty of Municipal Bond.*

Then, the requirements of the Local Government to conduct Municipal Bond issuance are:<sup>256</sup>

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<sup>255</sup> Article 142 Ministry of Local Affairs Regulation No.13 year 2006 on the Guidance of Local Finance Management.

<sup>256</sup> Article 15 Government Regulation No.30 year 2011 on the Local Loan.

1. *The amount of the rest of Local Loan plus the loan amount will be withdrawn does not exceed 75% of the amount of APBD in the previous years.*
2. *Fulfill the Debt Services Coverage Ratio (DSCR) which established by the State.*
3. *Fulfill the requirements do not have top loan repayment arrears were sourced from the State.*

Then, the steps of Local Government to conduct Municipal Bond issuance are:<sup>257</sup>

1. *Propose the consent principle of Municipal Bond issuance through DPRD includes:*
  - a. *payment of principal and interest arising from the issuance of the Municipal Bond;*
  - b. *The maximum net value of Municipal Bond that issued during the establishment of APBD; and*
  - c. *All the cost that appears from the Municipal Bond issuance.*
2. *Propose the examination through Ministry of Finance and propose the consideration through Ministry of Local Affairs.*
3. *Establish Local Government Regulation against Municipal Bond issuance.*
4. *Doing registration statement of Municipal Bond issuance to OJK.*

Before gaining the approval from the Local Parliament, the Head of the Local Government should fulfill the requirements that relate to the capacity and capability of management of Municipal Bond. The terms include:<sup>258</sup>

1. *The issuance of Financial Statement of the Local Government audited by Public Accountant;*
2. *Has project plan infrastructure development which will be funded by the proceeds of Municipal Bond issuance; and*
3. *The feasibility study shows the success rate of infrastructure development projects that will be funded by the proceeds of Municipal Bond issuance.*

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<sup>257</sup> Article 8-13 Ministry of Finance Regulation No.111 year 2012 on the Procedure of Issuance and Responsibility against Municipal Bond.

<sup>258</sup> Adrian Sutedi, *Aspek Hukum.....*, p.193.

Then, the Head of the Local Government create work unit to manage the Municipal Bond, include:<sup>259</sup>

1. *Determination the strategy and policy of Municipal Bond management include risk control policy;*
2. *Planning and determine the portfolio structure of Local Loan;*
3. *Municipal Bond issuance;*
4. *The Municipal Bond sales through auction for resale;*
5. *The buyback of Municipal Bond before maturity date;*
6. *Repayment on maturity date; and*
7. *Responsibility.*

After creating the work unit for the management of Municipal Bond, the Head of Local Government should make a preparation for the Municipal Bond issuance, including:<sup>260</sup>

1. *Determine the activities;*
2. *Create a frame of reference activities;*
3. *Create the calculation of the limit of loan cumulative;*
4. *Create Debt Service Coverage Ratio (DSCR);*
5. *Propose the consent principle through the Local Parliament; and*
6. *Prepare the structure of organization, working device, and human resources against Debt Management Unit (DMU).*

After gaining the consent principle from the Local Parliament, then the Head of Local Government propose a letter proposal plans of Municipal Bond to the Minister of Local Affairs to obtain the consideration of Municipal Bond issuance and the Ministry of Finance to obtain the approval of Municipal Bond issuance. To obtain the consideration, the Local Government should attach the following documents namely:<sup>261</sup>

1. *The consent principle of the Local Parliament;*

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<sup>259</sup> Article 47-48 Government Regulation No.30 year 2011 on the Local Loan.

<sup>260</sup> Article 8 Ministry of Finance Regulation No.180/2015 on the Revise against Ministry of Finance Regulation No.111 year 2012 of the Procedure of Issuance and Responsibility against Municipal Bond.

<sup>261</sup> Article 35 Government Regulation No.30 year 2011 on the Local Loan.

2. *The copy of the news of the inauguration of the Head of Local Government;*
3. *The statement had no arrears over the repayment of a loan from the State;*
4. *A frame of reference activities;*
5. *The calculation of Debt Service Coverage Ratio for return the loan;*
6. *Financial statement of the Local Government in last three years;*
7. *The Plan of APBD in the years of concern;*
8. *The comparison of the amount of the rest of Local Loan plus the loan amount will be withdrawn does not exceed 75% of the amount of APBD on the previous year's; and*
9. *The financial planning of the loan.*

Meanwhile, to obtain the approval from the Ministry of Finance, the Local Government should attach the following documents namely:<sup>262</sup>

1. *A frame of reference activities;*
2. *The audit result of Financial statement of the Local Government in last three years;*
3. *The Local Government Regulation against APBD in the years of concern;*
4. *The calculation of the amount of cumulative loan of Local Government and the deficit of APBD;*
5. *The calculation of ability ratio of Local Finance for the Debt Service Coverage Ratio;*
6. *The letter of consent principle of the Local Parliament; and*
7. *The structure of the organization, working device, and human resources against Debt Management Unit (DMU).*

The assessment conducted by the Ministry of Finance against the documents above includes as administration assessment and financial assessment. Administration assessments are consist of the complete document of Municipal Bond issuance plan, the conformity of information between documents, and readiness of Debt Management Unit.<sup>263</sup> Meanwhile the financial assessments

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<sup>262</sup> Article 9 Ministry of Finance Regulation No.180 year 2015 on the Revise against Ministry of Finance Regulation No.111 year 2012 of the Procedure of Issuance and Responsibility against Municipal Bond.

<sup>263</sup> Article 9A Ministry of Finance Regulation No.180 year 2015 on the Revise against Ministry of Finance Regulation No.111 year 2012 of the Procedure of Issuance and Responsibility against Municipal Bond.

are include of the amount of cumulative loan based on the amount of the rest of Local Loan plus the loan amount will be withdrawn does not exceed 75% of the amount of APBD on the previous year's , the amount of Debt Service Coverage Ratio minimal 2.5, and the deficit amount of APBD.<sup>264</sup> The Ministry of Finance also asks the Ministry of Local Affairs consideration to assess whether the Local Government can or can't to conduct registration statement in OJK.<sup>265</sup>

After obtaining the approval from the Ministry of Finance, then the Local Government may create the Loan by Municipal Bond agreement in the form of Trustee agreement and signed by the Head of Local Government and the Trustee as the representation of the Investor. The substance of the Trustee agreement should include:<sup>266</sup>

1. *Nominal value;*
2. *Maturity date;*
3. *Date of interest payment;*
4. *Interest coupon;*
5. *Frequency of interest payment;*
6. *Calculate formulation of interest payment;*
7. *The provision about right to buyback of Municipal Bond before maturity date; and*
8. *The provision of ownership transfer.*

After the Local Government obtains the fund upon Municipal Bond, then the Head of Local Government should administer and responsible against the

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<sup>264</sup> Article 10 Ministry of Finance Regulation No.180 year 2015 on the Revise against Ministry of Finance Regulation No.111 year 2012 of the Procedure of Issuance and Responsibility against Municipal Bond.

<sup>265</sup> Article 35 Section (4) Government Regulation No.30 year 2011 on the Local Loan.

<sup>266</sup> Article 43 Government Regulation No.30 year 2011 on the Local Loan.



use and repayment of Municipal Bond. The administering that should be conducted by the Head of Local Government are:<sup>267</sup>

1. *Income and use of funds against Municipal Bond issuance;*
2. *Income and use of funds against the activity that funded from Municipal Bond issuance;*
3. *The payment of responsibility against Municipal Bond issuance; and*
4. *The buyback and sale back of Municipal Bond.*

Then, the Head of Local Government should also conduct the responsibility of Municipal Bond whereas it is a part of the responsibility of APBD implementation and should be delivered to the Local Parliament. The kind of Municipal Bond responsibilities are:<sup>268</sup>

1. *The management of Municipal Bond consists of:*
  - a. *Realization of the strategy and policy of Municipal Bond management include risk control policy;*
  - b. *Transaction report of Municipal Bond; and*
  - c. *Allocation of reserve funds reports settling the Municipal Bond.*
2. *The Municipal Bond fund consists of:*
  - a. *The development of implementation activities; and*
  - b. *Financial statement of Local Government includes fund usage from Municipal Bond and the fund from the acceptance of the result of activities.*

Besides that, the Head of Local Government should also deliver the implementation report of Municipal Bond management to the Ministry of Finance in three months. The kinds of the report are:<sup>269</sup>

1. *The Municipal Bond issuance;*
2. *The fund usage of Municipal Bond;*
3. *The buyback and sale back of Municipal Bond;*

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<sup>267</sup> Article 15 Ministry of Finance Regulation No.111 year 2012 of the Procedure of Issuance and Responsibility against Municipal Bond.

<sup>268</sup> Article 16 Ministry of Finance Regulation No.111 year 2012 of the Procedure of Issuance and Responsibility against Municipal Bond.

<sup>269</sup> Article 18 Ministry of Finance Regulation No.111 year 2012 of the Procedure of Issuance and Responsibility against Municipal Bond.

4. *The realization of principle, interest and/or others cost of Municipal Bond; and*
5. *Allocation of reserve funds.*

Based on the explanation of the procedure of issuance and responsibility of Municipal Bond conducted by the Local Government, it can be concluded that the process of Municipal Bond issuance lengthy and time exhausting due to the making process of work unit to manage the Municipal Bond issuance, the request of consent principle for Municipal Bond issuance to the Local Parliament, the request of approval to the Ministry of Finance, the request of consideration to the Ministry of Local Affairs, until the ratification of the Local Government Regulation about Municipal Bond issuance could be spent time more than one year. Even more, if there is a rejection from one of the Municipal Bond issuance process. In fact, the need of Local Government for alternative revenue sources besides from the Original Revenue (PAD) and Equalization Funds in order to infrastructure development in the regional is extremely urgent. In addition, many investors are interested in invest his money for the construction of regional infrastructure.<sup>270</sup>

Therefore, the Local Governments should create the Local Government Regulations regarding Municipal Bond issuance that contains the contents of the nominal of Municipal Bond to be published, the use of Municipal Bond funds, and the responsibility for the payment of principal, interest, and other costs incurred as a result of the Municipal Bond issuance.<sup>271</sup> The Local

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<sup>270</sup> Adrian Sutedi, *Aspek Hukum.....*, p.179.

<sup>271</sup> <http://www.hukumonline.com/berita/baca/lt5651d28c6ad45/mengupas-kesulitan-penerbitan-obligasi-daerah>, accessed on December 9, 2017.

Parliament as the legislative institution in the region will be not given the consent principle easily against the Head of Local Government due to the Municipal Bond related with APBD and also its implementation. First, APBD should be set fund as a budget reserve to pay interest on Municipal Bond to investors during the project has not returned a profit yet.<sup>272</sup> Second, the professionalism of work unit against Municipal Bond management whereas the Head of Local Government should be recruiting the human resources from government institution and private institution because that unit should be managed of Municipal Bond, from the preparation, issuance, until responsibility.<sup>273</sup> Third, the ability of Local Government to settle the Municipal Bond against the Investor.<sup>274</sup> It refers to the potential of the region, the financial health of the region, and the success of infrastructure development projects funded by the Municipal Bond.

Then, the obstacle of the Local Government to issue Municipal Bond has related the experience to manage Local Loan, both in administration and technical.<sup>275</sup> According to article 2 section (4-7) Ministry of Finance Regulation No.111 year 2012 of the Procedure of Issuance and Responsibility

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<sup>272</sup> Akhmad Solehudin, *Hambatan dan Resiko Penggunaan Obligasi Daerah sebagai Alternatif Pembiayaan Daerah*, Artikel Inspektorat Kabupaten Tegal, Tegal, 2017, <http://inspektorat.tegalkab.go.id/2017/08/15/berita-baru/>, accessed on December 9, 2017.

<sup>273</sup> Dewi Okta and David Kaluge, *Analisis Peluang Penerbitan Obligasi Daerah Sebagai Alternatif Pembiayaan Daerah*, Vol.5 No.2, Journal of Indonesian Applied Economics, 2011, p.168, <https://media.neliti.com/media/publications/37944-ID-analisis-peluang-penerbitan-obligasi-daerah-sebagai-alternatif-pembiayaan-daerah.pdf>, accessed on December 9, 2017.

<sup>274</sup> <http://nasional.republika.co.id/berita/nasional/jawa-barat-nasional/13/10/29/mvf1gg-terkait-obligasi-daerah-dprd-jabar-akan-sowan-ke-ojk-dan-kemenkeu>, accessed on December 9, 2017.

<sup>275</sup> <http://www.hukumonline.com/berita/baca/lt5651d28c6ad45/mengupas-kesulitan-penerbitan-obligasi-daerah>, accessed on December 9, 2017.

against Municipal Bond, the management of Local Loan conducted by the Head of Local Government through Public Service Bodies (BLU) or Local Owned Enterprises (BUMD), either existing or newly formed, has structure of organization, working device, and capacity of human resources to implement the function of Municipal Bond management.<sup>276</sup> The purpose of the establishment of the Debt Management Unit is to arrange and manage the Municipal Bond. With the existence of this unit, besides to function as a Municipal Bond manager, the working unit also makes it easier for the effect of rating agencies to give top-ranked against Municipal Bond.<sup>277</sup> However, the existence of the Debt Management Unit just created by the Local Government is temporarily, unlike General Directorate of Loan Management which is permanent. This condition is not ideal when the assessment rating will be applied by the Local Government because it will show the unpreparedness of Local Government in the loan management that is the existence of weaknesses in the institutional and human resources.<sup>278</sup>

To give confidence to investors, the rating assessment is absolutely necessary because the rating assessment will assess the Local Governments against the creditworthiness and ability to pay loans that will affect the interest rate on the loan. Rating effect agencies as Municipal Bond rating assessors

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<sup>276</sup> Article 2 Section (4-7) Ministry of Finance Regulation No.111 year 2012 on the Procedure of Issuance and Responsibility against Municipal Bond.

<sup>277</sup> Badan Pembangunan Nasional, *Tinjauan Regulasi dan Kelembagaan Penerbitan Obligasi Daerah dalam Pembangunan Infrastruktur di Daerah*, Bappenas, Jakarta, 2014, p.13, <https://www.bappenas.go.id/files/.../kajian/kajian-2014-pendanaan-obligasi-daerah.pdf>, accessed on December 9, 2017.

<sup>278</sup> *Ibid*, p.13.

determine the rating of the Local Governments based on the track record of the Local Finance, the ability of the settlement against Municipal Bond, the feasibility of development projects, proposals plan of guarantee, and the process of procurement project.<sup>279</sup> The rating assessment of Municipal Bond can also affect the ranking of Sovereignty Bond. If the Municipal Bond has failed to settle so the rating of Sovereignty Bond will be falling down.<sup>280</sup>

Lastly, there is no guarantee in the Municipal Bond issuance. According to article 142 section (2 and 3) Ministry of Local Affairs Regulation No.13 year 2006 of the Guidance of Local Finance Management, The State cannot endorse the guarantee against the loan from other parties and Local Income and/or Local Assets cannot be used as a loan guarantee.<sup>281</sup> It greatly influences the attraction to investors to invest in the Municipal Bond. The guarantee is required to avoid the occurrence of a default. In case of default, it may give rise to distrust of Investors to other Municipal Bond.<sup>282</sup>

Based on the explanation above, if those requirements are applied in the Sharia Municipal Bond issuance, the obstacles that will occur are as such:

1. *The benefit payment system of Municipal Bond is used interest. It contradicts with Sharia Bond principle, especially Mudharabah Sharia Bond which is the system of profit payment is by profit sharing.*
2. *All of their regulation not allowed the Local Government to use the asset of Local Government as the Underlying Assets of the Municipal Bond. Whereas in the Sharia Bond principles, especially Ijarah Sharia*

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<sup>279</sup> Akhmad Solehudin, *Op.Cit.*

<sup>280</sup> Adrian Sutedi, *Aspek Hukum.....*, p.180.

<sup>281</sup> Article 142 Section (2 and 3) Ministry of Local Affairs Regulation No.13 year 2006 on the Guidance of Local Finance Management.

<sup>282</sup> Adrian Sutedi, *Aspek Hukum.....*, p.194.

*Bond the issuer should be made his asset as Underlying Asset to prevent interest, fraud, and speculation of Ijarah Sharia Bond*

3. *There is no clarity regarding the form of the Debt Management Unit in preparation, publishing, and management of Sharia Municipal Bond whether is permanent or temporary. Whereas, this condition is not ideal when the assessment rating will be applied by the Local Government because it will show the unpreparedness of Local Government in the loan management that is the existence of weaknesses in the institutional and human resources.*
4. *In the establishment of Debt Management Unit of Local Government, all of the Municipal Bond issuance regulation does not explain the role of Sharia Supervisory Board. Whereas, the Local Government should involve the Sharia Supervisory Board if they want to establish Debt Management Unit so the management activity of the Sharia Municipal Bond does not contradict with Sharia principles.*
5. *If the Central Government does not give a guarantee against Municipal Bond defaulted upon, what is the solution for the Local Government if the default of Sharia Municipal Bond is happen?*

Consequently, the Local Government cannot conduct the preparation, management, and responsibility toward Sharia Municipal Bond due to the set of technical regulation regarding Municipal Bond issuance (Government Regulation No.58 year 2005 on the Local Finance Management, Government Regulation No.30 year 2011 on the Local Loan, Ministry of Local Affairs Regulation No.13 year 2006 on the Guidance of Local Finance Management, and Ministry of Finance Regulation No.111 year 2012 on The Procedure of Issuance and Responsibility against Municipal Bond) are not regulate about Sharia Municipal Bond, include the profit sharing payment, the Underlying Asset, the Debt Management Unit of Sharia Municipal Bond, the role of Sharia Supervisory Body, and the Guarantee in maturity date.

## **2. The Obstacles of the Local Government against Registration Statement of Sharia Municipal Bond Issuance.**

Generally, the Issuers (Company, State, or Local Government) that will be publishing the Bond or Sharia Bond should conduct statement registration first against the authority that is responsible for the Capital Market activities. The registration statement is a requirement for any prospective Issuers in order for public offering against the securities. The registration statement is a permission to conduct public offerings delivered by the issuer to the capital market authority.<sup>283</sup>

Formally, the Law of Capital Market determines that the party may conduct initial public offering only by Issuers who gave the registration statement and the registration statement has been declared effective by the authority.<sup>284</sup> In substance, the registration statement is a set of documents that contains the principles of openness that must be delivered by the Issuer in connection with the initial public offering. Therefore, the registration statement contains all information about the Issuers, includes the opinions from every supporting profession and institution on the Capital Market.<sup>285</sup>

Related with the registration statement of Sharia Municipal Bond, OJK as the institution that has authority to regulate and supervise in Capital Market has not issued a legal product regarding the rules of the registration statement of Sharia Municipal Bond. However, viewed from a set of rules of OJK regarding

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<sup>283</sup> Inda Rahadian, *Pokok-Pokok Hukum...*, p.77.

<sup>284</sup> Article 70 Law No.8 year 1995 on the Capital Market

<sup>285</sup> Hamud M. Balfas, *Op.Cit*, p.56.

the registration statement of the Municipal Bond, the Local Governments could consider the possibility of conducting a registration statement of Sharia Municipal Bond in OJK.<sup>286</sup>

According to the Head of BAPEPAM-LK Decision IX.C.12 of the Guidance of Shape and Substance Registration Statement in order to do Public Offering of Municipal Bond, the document requirements that must be fulfilled by the Local Government to conduct registration statement of Municipal Bond issuance are:<sup>287</sup>

1. *The cover letter of registration statement;*
2. *The Prospectus;*
3. *The Short Prospectus;*
4. *The planned schedule of Public Offering;*
5. *The example of Municipal Bond;*
6. *The Local Financial Statement that audited by Public Accountant;*
7. *Letter from the Public Accountant related to the conversion of Local Finance condition;*
8. *Letter of Statement from the Head of Local Government in the scope of account;*
9. *Legal Due Diligence and Legal Opinion*
10. *The Biography of the Head of Local Government, the Vice of Local Government, the Head of Debt Management Unit, the Head of Project, and the Treasury Project;*
11. *The Trustee Agreement;*
12. *The statement of parties related to the Public Offering of Municipal Bond;*
13. *The report of feasibility study result from the project and the development of project from the Appraiser;*
14. *The approval from the Ministry of Finance; and*
15. *Local Government Regulation on Municipal Bond Issuance.*

For the Prospectus of the Municipal Bond, according to the Head of BAPEPAM-LK Decision No.IX.C.13 of the Guidance of Shape and Substance

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<sup>286</sup> See the Head of BAPEPAM-LK Decision No.IX.C.12, IX.C.13, IX.C.14, VIII.G.14, VIII.G.15, and VIII.G.16 related with the Procedures of Registration Statement of Municipal Bond.

<sup>287</sup> The Head of BAPEPAM -LK Decision No.IX.C.12 on the Guideline of Shape and Substance Registration Statement in order to do Public Offering of Municipal Bond.



of Prospectus in order to do Public Offering of Municipal Bond, there are 4 specific information of the Prospectus related with the issuance of Municipal Bond, namely the inside, the outside, table of content and the specific information. For the outside of Prospectus, the information that should be stated in the Prospectus are:<sup>288</sup>

1. *The effective date;*
2. *The bidding period;*
3. *The date of allotment;*
4. *The date of bidding money repayment;*
5. *The date of Municipal Bond submission;*
6. *The maturity date;*
7. *The date of interest payment;*
8. *The interest;*
9. *The full name of Trustee;*
10. *The Sinking Fund;*
11. *The name, address, logo, phone, email, website, and postcode of Local Government Office and also the project;*
12. *The Project;*
13. *The kind of offering, include the information of characteristic, amount, short explanation, nominal value, and price of Municipal Bond;*
14. *The information of buyback, guarantee, the Guarantor, result of ranking, date of listing, and the Underwriter of Municipal Bond;*
15. *The date and place of Prospectus Issuance;*
16. *The statement related to registration statement from OJK;*
17. *The responsibility statement from the Local Government and the Underwriter; and*
18. *The short statement related to the risk of Municipal Bond.*

Meanwhile, for the information on the inside of Prospectus consists of:<sup>289</sup>

1. *Remarks that the registration statement was submitted to the capital market institution in accordance with the regulations of the capital market;*
2. *A statement that the supporting institutions and profession on capital stated in the prospectus are responsible for data, information, and opinions delivered;*

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<sup>288</sup> The Head of BAPEPAM -LK Decision No.IX.C.13 of the Guideline of Shape and Substance of Prospectus in order to do Public Offering of Municipal Bond.

<sup>289</sup> The Head of BAPEPAM -LK Decision No.IX.C.13 of the Guideline of Shape and Substance of Prospectus in order to do Public Offering of Municipal Bond.

3. *A statement that the other party is responsible for the opinions or information contained in a registration statement;*
4. *A statement that the Local Government prohibit any party to provide information or statement concerning the data disclosed in the prospectus without written consent from the Local Government or Underwriter; and*
5. *A description of the initial approval of the stock exchanges over the preliminary agreement of the listing of the Municipal Bond and the Local Government action in question if the stock exchange rejected a proposal of the listing of the Municipal Bond.*

Then, the explanations that are stated in the table of contents and the specific information are:<sup>290</sup>

1. *Explanation of Public Offering;*
2. *Allocation of budget based on Public Offering;*
3. *Statement of debt;*
4. *Analysis and discussion by the Local Government;*
5. *The Local Government risk;*
6. *The important events after the financial statements;*
7. *Information of the Local Government;*
8. *General Information about the Project;*
9. *Feasibility Study of the Project and the Project Development;*
10. *The project risk;*
11. *The operational plan of the Project;*
12. *The overview of important financial data;*
13. *The Tax;*
14. *The Underwriter;*
15. *Supporting Institution and Profession on the Capital Market;*
16. *The Trustee;*
17. *The Guarantee;*
18. *Legal Due Diligence and Legal Opinion;*
19. *Financial Statements;*
20. *The assessment of the Feasibility Study of the Project and the Project Development;*
21. *The procedure of order and buying of Municipal Bond; and*
22. *Dissemination of the Prospectus and order and buying form of Municipal Bond.*

The Local Government also attach a Short Prospectus whereas it is an integral part of the registration statement. According to the Head of

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<sup>290</sup> The Head of BAPEPAM -LK Decision No.IX.C.13 of the Guideline of Shape and Substance of Prospectus in order to do Public Offering of Municipal Bond.

BAPEPAM-LK Decision No. IX.C.14 of the Guidance of the Shape and Substance of Short Prospectus in order to Public Offering of Municipal Bond, the substance of Short Prospectus is similar with the Prospectus namely show the information that complete, appropriate, objective, clearly, and easy to understand.<sup>291</sup> However, there is some difference between the Prospectus and Short Prospectus of Municipal Bond. Related to the Hamud Balfas theories regarding the Prospectus, there are 2 indicators which differentiate between Short Prospectus and the Prospectus (Final Prospectus), namely the time of issuance and completeness of data. For the time of issuance, Short Prospectus is an issue earlier instead of the Prospectus due to Short Prospectus is issued prior to a registration statement declared effective. For the completeness of data, Short Prospectus more briefly instead the Prospectus.<sup>292</sup> Even, the Local Government and the Underwriter should declare that there are plans to revise or add some information in Short Prospectus.<sup>293</sup>

Furthermore, the Local Governments should compile financial statement as one document of the registration statement in order to the public offering of Municipal Bonds that proposed by the Authority of the Capital Markets. This should be done by the Local Government so that the public know how the region financial condition at the time of the Local Government issued the Municipal Bond. According to the Head of BAPEPAM-LK Decision

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<sup>291</sup> The Head of BAPEPAM-LK Decision No.IX.C.14 of the Guideline of the Shape and Substance of Short Prospectus in order to Public Offering of Municipal Bond.

<sup>292</sup> Hamud M. Balfas, *Op.Cit*, p.62-64.

<sup>293</sup> Head of BAPEPAM -LK Decision No.IX.C.14 on the Guideline of the Shape and Substance of Short Prospectus in order to Public Offering of Municipal Bond.

No.VIII.G.14 of the Guidance of Financial Assessments Presentation of Local Financial, the form, content, and requirements of the financial statement of Local Government in the form of presentation must follow the statement of government accounting standards issued by the accounting standards committee of Government.<sup>294</sup> According to article 1 number 3 Government Regulation No.71 year 2010 of the Standard of Government Account (GR 71/2010), statement of standard accounting of government are accounting principles applied in compiling and presenting the financial statements of the Government who is given the title, number, and effective date.<sup>295</sup> Meanwhile, Government Accounting Standards Committee is an independent standard committee and set by the Government Regulations after obtaining the consideration from Financial Examiner Agency (BPK).<sup>296</sup> The task of the Government Accounting Standards Committee is drafting a government accounting standards applicable (both of the State and the Local Government) in accordance with accepted accounting guidelines.<sup>297</sup>

Hence, the matters that are presented in the financial statement of the Local Government includes as realization report of APBD, balance sheet, cash flow statement, notes to financial statements of the Local Government, financial performance reports on accrual-based, and Report changes in equity. The presentation must be accompanied by a statement that notes to financial

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<sup>294</sup> The Head of BAPEPAM-LK Decision No.VIII.G.14 on the Guideline of Financial Statements Presentation of Local Financial.

<sup>295</sup> Article 1 Number 3 Government Regulation No.71 year 2010 on the Standard of Government Accountant.

<sup>296</sup> Article 32 Section (2) Law No.17 year 2003 on the State Financial.

<sup>297</sup> Article 57 Section (2) Law No.1 year 2004 on the State Treasury.

statements of the Local Government is an integral part of the financial statements. The submission of financial reports of the Local Government should be presented in comparison to the last two years.<sup>298</sup>

Then, the accountant who has to create a financial statement of the Local Government is obliged to create a Comfort Letter upon the financial statements of the Local Government. According to the Head of BAPEPAM-LK Decision No.VII.G.15 of the Drafting Guidelines of Comfort Letter in order to Public Offering of Municipal Bond, Comfort Letter is a letter which created by the accountant stating yes or not the information or material facts that occur after the date of the last financial statements up to the date of this letter, which could result in significant change or compromise the financial position or earnings presented in the financial statements attached as part of the registration statement and contained in the prospectus.<sup>299</sup>

Comfort Letter should be proposed to the OJK and the Underwriter due to:<sup>300</sup>

1. *Comfort Letter is the additional information for the OJK;*
2. *Comfort Letter is a media for the Underwriter to obtaining Local Financial data that are not yet in the financial report that audited by the accountant as contained in this Prospectus; and*
3. *Comfort Letter is a material for prepare the Underwriting Agreement.*

Then, the substance of Comfort Letter is consist of:

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<sup>298</sup> The Head of BAPEPAM Decision No. VIII.G.14 on the Presentation Guidelines of Local Financial Statements.

<sup>299</sup> The Head of BAPEPAM -LK Decision No. VII.G.15 of the Drafting Guidelines of Comfort Letter in order to Public Offering of Municipal Bond.

<sup>300</sup> The Head of BAPEPAM -LK Decision No. VII.G.15 of the Drafting Guidelines of Comfort Letter in order to Public Offering of Municipal Bond.

1. *The Independence of Accountant;*
2. *Compliance between generally accepted accounting principles, the principle of accounting standards of governance, and accounting provisions in the field of capital market;*
3. *Conformity with the Standards of the State Financial Inspection (SPKN);*
4. *The procedures and results of the examination of the interim financial statements are unaudited;*
5. *Exceptions upon negative conviction;*
6. *Procedures and examination results after the date of the interim financial statements are unaudited up to Comfort Letter date;*
7. *Proforma financial information;*
8. *Financial forecast and/or financial projections;*
9. *Alignment of data or financial projections presented in the Prospectus with the financial statement audited by the accountant; and*
10. *The inquiry against minutes of a meeting between the Local Government and the Local Parliament and also non-financial information that relevant to the Comfort Letter date.*

After the accountant creates a Comfort Letter to financial statements of the Local Government, the Head of Local Government obliged to make a statement in the field of accounting to OJK due to this letter used as a document in the registration statement in public offering of the Municipal Bond. According to the Head of BAPEPAM-LK Decision No.VIII.G.16 of the Drafting Guidelines of the Head of Local Government's Letter of Statement in Field of Accounting in order to Public Offering of Municipal Bond, the substances of this letter are:<sup>301</sup>

1. *The compliance between the principle of accounting standards and accounting of governance provisions in the field of capital market;*
2. *Statements regarding the recording of the assets specified in this Prospectus has been recorded and reported in the financial statements;*
3. *Statements regarding the recording of obligations specified in the Prospectus have been recorded and reported in the financial statements;*

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<sup>301</sup> The Head of BAPEPAM -LK Decision No.VIII.G.16 of the Drafting Guidelines of the Head of Local Government's Letter of Statement in the Field of Accounting in order to Public Offering of the Municipal Bond.

4. *Statement regarding the recording of equity funds specified in the Prospectus have been recorded and reported in the financial statements;*
5. *Statement regarding the recording of revenue, expenditure, deficit/surplus, transfer, financing, more/less the rest of the financing of the budget specified in the Prospectus have been recorded and reported in the financial statements;*
6. *Statement regarding the recording of commitments and contingencies that are specified in the Prospectus have been recorded and reported in the financial statements;*
7. *Statements regarding the entire incident is important after the balance sheet date up to the date of accounting reports;*
8. *Statement regarding financial information throughout the project will be financed by the result of public offering of the Municipal Bond; and*
9. *Others important statements such as the minutes of meeting between the Local Government and the Local Parliament, there is no dispute that relates to the activities of the Organization of the Local Government, demands or lawsuits that arise because of violations of laws and regulations, all transactions with outside parties, all accounting and financial records, no suspicious transactions, and there is no cheating during the process of auditing the financial statement.*

Then, OJK will declare the effective of registration statement against the public offering of Municipal Bond by considering on the basis of the time of 45 days from the date of the registration statement received by OJK is complete, on the basis of the time of 45 days from the date the fulfillment of the last up this prospectus received by OJK, and on the basis of effective OJK that no more changes and/or additions more information.<sup>302</sup> After that the Local Governments can do the listing of Municipal Bond through stock exchange with terms should convey information material to the stock exchange namely:<sup>303</sup>

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<sup>302</sup> The Head of BAPEPAM -LK Decision No.VIII.G.16 of the Drafting Guidelines of the Head of Local Government's Letter of Statement in Field of Accounting in order to Public Offering of Municipal Bond.

<sup>303</sup> PT. Bursa Efek Surabaya Regulation No.I.F.3 of the Listing of Municipal Bond.

1. *The replacement of the Head of Local Government, the Vice of Local Government, the Head of Debt Management Unit, the Head of Project, and the Treasury Project;*
2. *The amendment of legislation that has influenced significantly against the Local Governance and the impact to the Local Financial;*
3. *The change of Borderline and the Nomenclature of Local Government;*
4. *Material Information that related to the Project;*
5. *The result of Municipal Bond rating;*
6. *The change of Debt Management Unit; and*
7. *The change of Debt Service Coverage Ratio.*

Based on the explanation above, there are several problems faced by the Local Government in terms of the registration statement in order to the public offering of Municipal Bond. Based on the interview result from Mrs. Mita Ekawati, one of the OJK's Officer in Company Assessment in Real Sector Department, she said that the kind of problems are procurement service on the institution support and profession support on the capital market and also the authority between OJK and BPK in terms of audit of the Local Financial report.<sup>304</sup>

For the first problem, the Local Government could not appoint the supporting institutions (the Underwriter, the Trustee, and the Rating Agencies) and supporting professions (Legal Consultant, Public Accountant, the Notary, and the Appraiser) on the Capital Market as a service provider to perform the registration statement in connection with the public offering of Municipal Bond because local governments must obey the article 14 of MFR No.111/2012<sup>305</sup> related to the implementation of President Regulation No.54/2010 on the

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<sup>304</sup> The result of interview with Mrs. Mita Ekawati, OJK's Officer in Company Assessment of Real Sector Department, interviewed on August 31, 2017.

<sup>305</sup> Article 14 Ministry of Finance Regulation No.111 year 2012 of the Procedure of Issuance and Responsibility against Municipal Bond.



Procurement of Goods and Services.<sup>306</sup> In contrast, when the company wishes to issue the Bonds or Sharia Bond where the company can freely appoint directly supporting institutions and supporting professionals on the capital market to help companies conduct a registration statement in order to public offering against Corporate Bonds or Sharia Corporate Bond.

In general, the procurement of goods and services by the Local Governments must comply with the principle of efficient, effective, transparent, open, fair/not discriminatory, and accountable.<sup>307</sup> In terms of implementation of the procurement of goods and services, particularly the provision of other services, the Local Governments through the Official Maker of Commitment (PPK) and Service Procurement Unit (ULP) conducts elections to other service providers by:<sup>308</sup>

1. *General Procurement*  
*General procurement is a method of the selection of other service providers for all the work that can be followed by all other service providers that qualify.*
2. *Simply Auction;*  
*Simply Auction is a method of the selection of other service providers to the procurement which is not complex and is worth a maximum of Rp 5,000,000,000.00 (Five Billion Rupiah).*
3. *Direct Appointment;*  
*Direct Appointment is a method of the selection of other service providers by means of pointing directly against 1 or other service providers by means of negotiations (technical and/or cost).*
4. *Direct Procurement;*  
*Direct Procurement is a method of the selection of other service providers without going through the auction, selection, and*

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<sup>306</sup> See President Regulation No.54 year 2010 on the Procurement of Goods and Services.

<sup>307</sup> Article 5 Presidential Regulation No.54 year 2010 of the Procurement of the Goods and Services.

<sup>308</sup> Article 35 Section (2) Presidential Regulation No.54 year 2010 of the Procurement of the Goods and Services.

*appointment directly against other procurement services with the maximum value Rp 200,000,000.00 (Two Hundred Million Rupiah).*

5. *The Contest.*

*The contest is a method of the selection of other service providers with the results of the industry put forward a creative, innovative, and culture of the domestic.*

The problem comes when there is a corruption case in the procurement of goods and services. According to Indonesia Corruption Watch (ICW), almost 80% of cases dealt with by the Corruption Eradication Commission (KPK) comes from the procurement of goods and services. ICW adding the corruption of the procurement of goods and services, starting from planning and budgeting to occur where marks up the price between the prices that are on the market with prices written on the proposal.<sup>309</sup> The next problem is due to the procurement of goods and services by the Local Government using the APBD, then it should also the absorbance of APBD should be increased at the time of the procurement of goods and/or services. However, the reality is not quite the absorption of APBD is decreased after the procurement of goods and/or services. This can happen due to a lack of professionalism of Official Maker of Commitment and Service Procurement Unit in organizing the procurement of goods and/or services.<sup>310</sup>

For the second problem, there is a dispute of authority between OJK and BPK in conducting on financial audit against Local Financial Statement in

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<sup>309</sup> <http://nasional.kompas.com/read/2017/09/28/19204361/ini-celah-kecurangan-pengadaan-barang-dan-jasa-yang-berpotensi-korupsi>, accessed on December 22, 2017.

<sup>310</sup> Nafsi Hartoyo, *Op.Cit*, p.2.

order to Public Offering Municipal Bond.<sup>311</sup> Generally, the authority to conduct financial audit against the Issuers in order to Public Offering of the Bond/Sharia Bond is Public Accountant based on article 64-69 Law No.8/1995 of the Capital market *jo.* article 55 (1) Law No.21/2011 of the Financial Services Authority.<sup>312</sup> This provision re-affirmed in the Head of BAPEPAM-LK Decision No.IX.C.12 of the Guideline of Shape and Substance Registration Statement in order to do Public Offering of Municipal Bond. This BAPEPAM-LK decision stated that the document of the registration statement in order to the public offering that should be applied is the last of Local Financial Statements that audited by Public Accountant and the Comfort Letter that signed by the Public Accountant.<sup>313</sup> In article 12 Ministry of Finance Regulation No. 111/2012 of the Procedure of Issuance and Responsibility against Municipal Bond stated that the Local Government which apply the registration statement of public offering should be obeyed to the Capital Market provision and the implementation of Public Offering of the Municipal Bond should involve one of supporting profession on Capital Market namely the Public Accountant.<sup>314</sup>

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<http://bisniskeuangan.kompas.com/read/2015/03/13/155000226/Soal.Obligasi.Daerah.OJK.Temui.Sejumlah.Hambatan>, accessed on December 23, 2017.

<sup>312</sup> Article 64-69 Law No.8 year 1995 of the Capital Market *jo.* Article 55 Section (1) Law No.21 year 2011 of Financial Services Authority.

<sup>313</sup> Head of the BAPEPAM -LK Decision No.IX.C.12 of the Guidelines of Shape and Substance Registration Statement in order to do Public Offering of Municipal Bond.

<sup>314</sup> Article 12 Ministry of Finance Regulation No. 111 year 2012 of the Procedure of Issuance and Responsibility against Municipal Bond.

However, in article 2 of MFR No. 111/2012 stated that the issuance of Municipal Bond could be implemented by the Local Government that gets a reasonable opinion without exceptions or reasonable with the exception of the last Local Financial Audit from BPK.<sup>315</sup> According to article 31 (1) Law No.12 year 2003 on the State Financial stated that only the BPK which could conduct auditing of the Local Financial.<sup>316</sup> Moreover, it is strengthened with Law No.15 year 2006 on the Financial Examiner Body<sup>317</sup> and Law No.15 year 2004 on the Examination of Management and Responsibility of State Financial.<sup>318</sup>

Thus, in the context of fulfilling the requirements of the Municipal Bond Issuance Namely Local Financial Statements are needed financial statements that audited by the Public Accountant that registered in OJK and the BPK. The existence of two authorities audit the same object can potentially give rise to doubt and confusion for the parties involved in the process of implementing the bond area whereas the opinion of the financial statements is given differently.<sup>319</sup>

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<sup>315</sup> Article 2 Ministry of Finance Regulation No. 111 year 2012 of the Procedure of Issuance and Responsibility against Municipal Bond.

<sup>316</sup> Article 31 Section (1) Law No.17 year 2003 of the State Financial.

<sup>317</sup> Article 6 Law No.15 year 2006 of the Financial Examiner Body.

<sup>318</sup> Article 17 Law No.15 year 2004 of the Examination of Management and Responsibility of the State Financial.

<sup>319</sup> I Made Dharma SP, *Peran BPK dalam Melaksanakan Pemeriksaan atas Pengelolaan Obligasi Daerah*, Badan Pemeriksa Keuangan, Jakarta, Unknown Year, p.9-10, <http://manado.bpk.go.id/wp-content/uploads/2016/03/2.-Obligasi-Daerah-Pwk-Sulut-Tulisan-Hukum-edit-1.pdf>, accessed on December 27, 2017.

Based on the explanation above, if those requirements applied in the Sharia Municipal Bond issuance the obstacles that will be faced by the Local Government are:

1. In Sharia Bond issuance, the issuers must involve the Sharia Expert on the Capital Market as an investment advisor. If issuer is the Local Government, then they have to open the procurement services to the Sharia Expert on the Capital Market.
2. If the Local Government want to issue the Sharia Municipal Bond, whether the auditor should apply the principle of Islamic finance audit in the audit of the financial statements of the Local Government?

Consequently, the Local Government cannot conduct public offering of the Sharia Municipal Bond issuance due to the set of the Head of BAPEPAM-LK Decision regarding public offering of Municipal Bond (the Head of BAPEPAM-LK Decision No.IX.C.12, IX.C.13, and IX.C.14 regarding the Procedures of Registration Statement of Municipal Bond) not regulate the public offering of the Sharia Municipal Bond, include the role of the Sharia Expert on the Capital Market and the implementation of Islamic finance audit principle against financial statement of the Local Government.

#### **B. The Solutions for the Related Parties in terms of Sharia Municipal Bond Issuance.**

From the explanation regarding the Local Government obstacle to issue Sharia Municipal Bond, there are several obstacles blocking the Local Government to

issue Sharia Municipal Bond, starting from the part of pre-registration statement until the part of the public offering. In the part of pre-registration statement, the types of obstacles that exist is the absence of a legislation which regulates the procedures for the preparation of the Sharia Municipal Bond issuance, then a system for results in the profit sharing of Sharia Municipal Bond is not yet regulated. In addition, the applicability of the Underlying Asset in the issuance of Sharia Municipal Bond is unclear. Then there has been no clarity about the type of business form against the Debt Management Unit in order to manage the Sharia Municipal Bond. Then, yet the existence of provisions on Sharia Supervisory Board positions in the Debt Management Unit of the Local Government. Lastly, the prohibition for the Local Governments to make collateral for the Sharia Municipal Bond issuance.

Then, in the part of public offering, the types of obstacles that exist are such as the existence of OJK regulations related registration statement over Sharia Municipal Bond, the procurement problems in other services for the supporting institution and supporting profession on the Capital Market in order to registration statement over the Sharia Municipal Bond, and the dispute of authority between OJK with BPK regarding authority in conducting an audit of the financial statements of the Local Government.

However after seeing the development of Sharia Municipal Bond in the overseas such as the *Ijarah* Sharia Municipal Bond by the Local Government of Saxony-Anhalt in Germany with the value is €100 million in 2004<sup>320</sup> and the *Mudharabah*

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<sup>320</sup> <https://www.sukuk.com/article/islamic-finance-germany-2074/>, accessed on December 27, 2017.

Sharia Municipal Bond by the Local Government of Johor, Malaysia with the value is RM80 million in 2005.<sup>321</sup> Additionally, the State starts doing a study of the Sharia Municipal Bond issuance since the Sharia Municipal Bond essentially an instrument that uses the investment approach as well as its appropriate for encouraging the process of regional development.<sup>322</sup>

The best way to solve the Local Government obstacle against Sharia Municipal Bond Issuance is by synchronizing and harmonizing the existing regulations starting from the level of the Act, Government Regulation, Ministerial Regulation, and the Regulation of State Institutions related with the Sharia Municipal Bond issuance. To that end, the author should require a deeper examination of a comparison between the regulations of one with other regulations. According to Endang Sumiarni, Synchronize is notice of conformity or harmony in vertical legislation based on the systematization of positive law i.e. between legislation as the cause of contention regarding the regulations that are more appropriate to use for a particular case.<sup>323</sup> Meanwhile, Harmonize is changing differences in different measurements and procedures or schedules to make them uniform and compatible.<sup>324</sup> In this study the words of harmonizing used as an effort to locate the alignment of legislation.

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<sup>321</sup> <http://www.theedgemarkets.com/article/aminvestment-eyes-more-islamic-municipal-bonds>, accessed on December 27, 2017.

<sup>322</sup> <https://www.cnnindonesia.com/ekonomi/20170409155616-78-206127/genjot-pembangunan-kemenkeu-dorong-penerbitan-sukuk-daerah>, accessed on December 27, 2017.

<sup>323</sup> Endang Sumiarni, *Metodologi Penelitian Hukum dan Statistik*, UAJY Press, Yogyakarta, 2013, p.5.

<sup>324</sup> <https://thelawdictionary.org/harmonization/>, accessed on December 28, 2017.

According to Peter Mahmud Marzuki, synchronization of regulation by applying the principle of *Lex Superior Derogat Legi Inferior* which means that if there is a contradiction between legislation that has a lower hierarchical with higher instead the lower legislation should set aside. Meanwhile, the Harmonize of regulations applying the principle of *Lex Specialis Derogat Legi Generali* which means that if there are two regulations which are in the same position have hierarchical but material charge between the scope of the legislation is not the same, that is, that one is the General settings and the other is a special arrangement.<sup>325</sup> The difference between Synchronization and Harmonization is based on the legislation that is examined. Synchronization uses to examine the alignment of legislation in vertical in positive law system. Whereas harmonization uses to examine the alignment of horizontal legislation in the system of positive law.<sup>326</sup>

#### **1. The Solutions for the Related Parties in terms of Pre-Registration Statement of Sharia Municipal Bond Issuance.**

There are a few obstacles against the efforts of the Local Governments to obtain the approval from the Local Parliament and the Ministry of Finance as well as to obtain the consideration from the Ministry of Local Affairs. The constraints of the beginning of the preparation of the Sharia Municipal Bond issuance is the absence of a special rule regarding the authority of the Local Governments to issue Sharia Municipal Law because Law No.33 years 2004

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<sup>325</sup> Peter Mahmud Marzuki, *Penelitian Hukum*, Kencana Prenada Media, Jakarta, 2011, p.99.

<sup>326</sup> Endang Sumiarni, *Loc.Cit*, p.5.



of Financial Equalization between Central Government and Local Government, and Law No.23 year 2014 of Local Government only regulate that the Local Government has the authority to issue Municipal Bond. It implicates against technical regulations concerning the authority of the Local Governments to issue Municipal Bond such as Government Regulation No.58 year 2005 of Local Finance Management, Government Regulation No.30 year 2011 of the Local Loan, Ministry of Local Affairs Regulation No.13 year 2006 of the Guidance of Local Finance Management, and Ministry of Finance Regulation No.111 year 2012 of The Procedure of Issuance and Responsibility against Municipal Bond.

The technical regulations state that the Local Governments are forbidden to make regional asset as collateral for the Bond Area and the State not gives warranties related to the default of the Municipal Bond. Then the application of the system of profit over the results of the bond Area applies the system of interest. Then obscurity towards the establishment of the Debt Management Unit by the local authorities and has not set the position of the Sharia Supervisory Board against the Debt Management Unit in preparation, management and accountability over the Sharia Municipal Bond. The Local Parliament and the Ministry of Finance, as well as the Ministry of Local Affairs, definitely will not give approval and consideration over the issuance of Sharia Municipal Bond due to basically the Local Government only granted the authority to issue Municipal Bond.

According to the author's opinion, the parties involved in the preparation of the local government for approval in order to perform the registration statement of Sharia Municipal Bond such as the Local Parliament, the Minister of Finance and the Minister of Local Affairs must immediately address the barriers to regional Governments to issue Sharia Municipal Bond by way of Synchronizing and Harmonizing between the technical regulations concerning the issuance of Municipal Bond with the basic rules concerning the issuance of Sharia Sovereignty Bond that issued by the State. It should immediately be done because in the base of the Bond and Sharia Bond is securities that have very different characteristics, namely:<sup>327</sup>

1. *Sharia Bonds represents a claim on ownership of asset and cash flow as opposed to Conventional Bonds whose claim is on debt instrument;*
2. *Their return is expected from underlying asset as opposed to the Conventional Bond whose return as interest is pre-determined;*
3. *There is a possibility of capital appreciation, that is, investors can get more return on their invested capital as opposed to Conventional Bonds that return is fixed and cannot vary with the performance of Bond Issuer;*
4. *Their return on invested capital is not guaranteed as opposed to the Conventional Bond that the issuer is obligated to pay at maturity;*
5. *The contract of Sharia Bonds are based on seller-buyer as opposite to the Conventional Bonds are based on borrower-lender;*
6. *Sharia Bonds may have fixed or variable rates of return as opposed to a fixed rate in Conventional Bonds;*
7. *The Sharia Bond Issuers should have types of business activities and the result of income that spared from non-halal items as opposite to Conventional Bond which is not spared from non-halal items; and*
8. *There is Sharia Supervisory Body in the supervisory activities related to Sharia Bond management as opposite with Conventional Bond management which has no Sharia Supervisory Board.*

Therefore, the Local Parliament and the Ministry of Finance who can give the approval as well as the Ministry of Local Affairs who can give the

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<sup>327</sup> Tahmoures A. Afshar, *Loc.Cit*, p. 47-48.

consideration against the Local Government to issue Sharia Municipal Bond. Then those also who have to do the Synchronize and Harmonize between the technical regulations concerning the Municipal Bond issuance with the basic rules concerning the issuance of Sharia Bond to create a new regulation regarding the issuance of Sharia Municipal Bond because logically the Local Government can only carry out those powers if such authority is governed by legislation and hierarchically of legislation the regulations must not conflict with the others regulation above.

In the problems of Sharia Municipal Bond issuance, the author will give an example against the issuance of Sharia Sovereignty Bond by the State. According to article 4 Law No.19/2008 of the Sharia Sovereignty Bond (Law of Sharia Sovereignty Bond), the purpose of the issuance of Sharia Sovereignty Bond is to finance State Budget of Income and Expenditure include finance the project development. The establishment of the Law of Sharia Sovereignty Bond is referred to the Fatwa DSN MUI No.32/DSN-MUI/IX/2002 of Sharia Bond, Fatwa DSN-MUI No.40/DSN-MUI/IX/2002 of *Mudharabah* Sharia Bond, and Fatwa DSN-MUI No.41/DSN-MUI/III/2004 of *Ijarah* Sharia Bond. The kinds of Sharia Bond that issued by the State are:<sup>328</sup>

1. *Ijarah* Sharia Bond;
2. *Mudharabah* Sharia Bond;
3. *Musyarakah* Sharia Bond;
4. *Isthisna* Sharia Bond;
5. *Sharia* Bond based on others agreement and not contradict with the *Sharia* principles; and
6. *Sharia* Bond based on a combination of two or more agreement which applied.

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<sup>328</sup> Article 3 Law No.19 year 2008 on the Sharia Sovereignty Bond.

In the *Mudharabah* Sharia Sovereignty Bond, the State as the *Mudharib* applies the payment of rewards to the Investors or the *Shahibul Mal* by the way for results or margin granted at maturity. The payment of funds derived from the allocation of State Budget of Income and Expenditure (APBN) that approved by the House of Representative<sup>329</sup> and the allocation of funds come from profits *Mudharib* upon the management of the *Shahibul Mal* fund such as the profit from the airport, toll road, or port development.

Meanwhile, in the *Ijarah* Sharia Sovereignty Bond, the State as the *Mu'jir* applies the payment of rewards to the Investors or the *Musta'jir* by using state assets as the basis for the issuance of *Ijarah* Sharia Sovereignty Bond that has been approved by the House of Representative.<sup>330</sup> The use of the State assets, in this case, is the State providing assets against *Ijarah* Sharia Sovereignty Bond to the *Musta'jir* in the form of beneficiary ownership and then the asset leased to the State so that the *Musta'jir* gain the profit upon *Ijarah* Sharia Sovereignty Bond from the results of the rented asset to the State.<sup>331</sup> In other words, the State applies the Asset-Based Sharia Bond principle to the *Ijarah* Sharia Sovereignty Bond issuance.

In reality, the application of the State assets as the Underlying Asset of *Ijarah* Sharia Sovereignty Bond is still on debate due to refer to the article 49 section (5) Law No.1 year 2004 of State Treasury stated that the State asset included in the State-owned Goods an integral part should not be sold or made

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<sup>329</sup> Article 9 Section (1) Law No.19 year 2008 of the Sharia Sovereignty Bond.

<sup>330</sup> Article 9 Section (1) Law No.19 year 2008 of the Sharia Sovereignty Bond.

<sup>331</sup> Article 11 Section (1) Law No.19 year 2008 of the Sharia Sovereignty Bond.

into asset guarantees in Sovereignty Bond issuance. That is because the removal of State-owned Goods can threaten the sovereignty of the unitary State of the Republic of Indonesia.<sup>332</sup> However, due to the Law of Sharia Sovereignty Bond regulate that the *Musta'jir* just obtain beneficiary owner upon the State assets so that application has been out of the concept of State-owned goods based on the Law of State Treasury.<sup>333</sup> The conflict of law phenomena in the Sharia Sovereignty Bond asserts that the existence of legal needs to break down this obstacle with the groundbreaking of the new law by legal engineering between Indonesian positive law and *Muammalah*. If the State simply refers to positive law, the country will not be able rapidly to the future because of the positive law has yet to recognize the concept of the Sharia Bond and the accompanying instrument at the time of its formation in the past.<sup>334</sup>

As for the preparation, issuance, management, and accountability over the Sharia Sovereignty Bond, the State create a legal entity to do preparation, issuance, management, and accountability over the Sharia Sovereignty Bond based on the Government Regulation or in other words is called as the Special Purpose Vehicle (SPV).<sup>335</sup> SPV is a legal entity that created in accordance with the Law of Sharia Sovereignty Bond provisions which has the special

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<sup>332</sup> Arifin P. Soeria Atmadja, *Keuangan Publik dalam Perspektif Hukum, Teori, Kritik, dan Praktik*, Rajawali Press, Jakarta, 2010, p.165.

<sup>333</sup> Ridovi Kemal, *Pengaturan Badan Hukum Special Purpose Vehicle dan Pemindahtanganan Barang Milik Negara didalam Undang-Undang No.19/2008 tentang Surat Berharga Syariah Negara dan Menurut Hukum Islam*, Thesis, University of Indonesia, Depok, 2013, p.4, <http://lib.ui.ac.id/naskahringkas/2015-09/S-Ridovi%20Kemal>, accessed on December 28, 2017.

<sup>334</sup> *Ibid*, p.4.

<sup>335</sup> Article 13 Law No.19 year 2008 of the Sharia Sovereignty Bond.

characteristic that different with others legal entity that knowing in Indonesia such as Limited Liability Company, Foundation, Coop, State Owned Enterprises, and others.<sup>336</sup> The special characteristic that possessed by the SPV having only a single company organs namely the Board of Directors, has no employees and has no business results (the result of Sharia Sovereignty Bond issuance should be transferred to the State general account).<sup>337</sup> SPV In addition to acting as the Issuers also serves as a Trustee who will carry out the agreement with the State, supervise the assets of the Sharia sovereignty Bond, dan do other legal action for the *Mustajir* interest.<sup>338</sup> It can be said that the Debt Management Unit of the Sharia Sovereignty Bond is the SPV which established based on the Government Regulation in order to the preparation, issuance, management, and accountability over the Sharia Sovereignty Bond.

The following table is a comparison between Limited Liability Company and SPV.<sup>339</sup>

Differences	LLC	SPV of Sharia Sovereignty Bond
Form	Public or Private	Company of Sharia Sovereignty Bond

<sup>336</sup> Ridovi Kemal, *Op.Cit*, p.9.

<sup>337</sup> Explanation of Government Regulation No.56 year 2008 of the Company of Sharia Sovereignty Bond.

<sup>338</sup> Article 8 Section (2) Government Regulation No.56 year 2008 of the Company of Sharia Sovereignty Bond.

<sup>339</sup> Ridovi Kemal, *Op.Cit*, p.13.

Kinds	Business Entity and Non-Business Entity	Only for Sharia Sovereignty Bond Issuance
Capital	Money, Goods, or anything that valued by Money. Authorized Capital and Paid-Up Capital	Only Money (minimum Rp 10,000,000.00)
Organ	GMS, BOC, and BOD	BOD ( <i>ex officio</i> ) “paper company”
Establishment	Articles of Association and Bylaws	Government Regulation related Sharia Sovereignty Bond
Liability	Limited Liability	Ministry of Finance and appropriate to the role and function
Tax	Yes	No
Legal Basis	Law No.40/2007 of LLC and Law No.19/2003 of State-Owned Enterprises	Law No.19/2008 of the Sharia Sovereignty Bond

The Sharia Sovereignty Bond issuance should follow the Sharia Compliance. Sharia Compliance means that the Sharia sovereignty Bond issuance must first obtain a Sharia Compliance Endorsement to convince the Investors that the Sharia Sovereignty Bond issuance is appropriate with the Sharia principles such as there is no element of interest, speculation, gambling,

or anything that contradict with Al-Qur'an and *Hadist*; whether in the preparation, issuance, management, and responsibility.<sup>340</sup> To gain the Sharia Compliance Endorsement, the issuers should propose the Sharia Compliance to the DSN-MUI and then DSN-MUI will be issue a letter related the approval of Sharia Compliance against the Issuers of the Sharia Sovereignty Bond.<sup>341</sup>

To conduct its matter, the DSN-MUI appoint Sharia Supervisory Board as the representatives of DSN-MUI in Sharia Capital Market.<sup>342</sup> Sharia Supervisory Board acted as Supervisor of the Sharia Capital Market related the products, management, and administration so that the institution running in accordance with the Islamic guidance.<sup>343</sup> The functions of Sharia Supervisory Board are; First, as an advisor and mentor to the Board of Directors, the Chairman of the Sharia unit, and the Chief of Sharia branch offices on matters related to the Sharia aspects; Second, as a mediator between the institution of Sharia capital market with the DSN-MUI in giving advice and suggested the development of products and services of Sharia Capital Market that require study and the fatwa of DSN-MUI.<sup>344</sup> The relationship between Sharia Compliance and Sharia Supervisory Board is the task of Sharia Supervisory Body to verify all contracts and relevant document, monitor their applications

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<sup>340</sup> Muhammad Anwar, *Loc.Cit*, p.866-867.

<sup>341</sup> Adrian Sutedi, *Pasar Modal Syariah.....*, p.9-10.

<sup>342</sup> DSN-MUI Decision No.2 year 2000 on the Guidance of DSN-MUI.

<sup>343</sup> DSN-MUI Decision No.3 year 2000 on the Instruction of Establishment Implementation of Board of Sharia Supervisory Member on Sharia Financial Institution.

<sup>344</sup> Akhmad Faozan, *Loc,Cit*, p.26.



and assure that the process is in compliance with the stipulation and requirements defined by Sharia standards.<sup>345</sup>

Lastly, the guarantee of the Sharia Municipal Bond when this bond is the default. As we know that the State does not give the guarantee against issuance of the Municipal Bond. This question is also similarly asked to the concept of Sharia Municipal Bond. The best solution for the Sharia Municipal Bond guarantee in default case is appointed the Sharia Guarantee Company to guarantee the Sharia Municipal Bond in the default case. According to article 4 section (2a) Law No.1 year 2016 of the Guarantee stated that Sharia Guarantee Company can guarantee the Sharia Bond.<sup>346</sup> In doing its duty, Sharia Guarantee Company has the right charged over fulfillment of obligations to financially secure when the guarantor has fulfilled its obligations to meet the financial rights of the recipient of the guarantee if a guaranteed fail to meet its obligations and such activities should be listed in the *Kafalah* agreement.<sup>347</sup> *Kafalah* agreement is the *Muammalah* agreement between the Guarantors (*Kafiil*) with the parties who owe (*Ashiil*) whereas the *Kafiil* will be pay off the debt from the debt giver (*Makfuul Anhu*) upon the object of guarantee (*Makful Bihi*).<sup>348</sup>

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<sup>345</sup> Abdulkader Thomas, *Op, Cit*, p.37.

<sup>346</sup> Article 4 section (2a) Law No.1 year 2016 on the Guarantee.

<sup>347</sup> Article 38 section (2 and 3) Law No.1 year 2016 on the Guarantee.

<sup>348</sup> Fatwa DSN-MUI No.11/DSN-MUI/IV/2000 of the Sharia Guarantee (*Kafalah*).

According to the Author's opinion, the implementations of collateral of the Sharia Municipal Bond when the Local Government is default in the maturity date are:

1. Local governments must have budgeted reserve fund in the APBD for the use of the Sharia Municipal Bond guarantee as long as the Sharia Municipal Bond is run.
2. Then, the Local Government appoints the Sharia Company of Guarantee for guarantee of Sharia Municipal Bond settlement in the maturity date.
3. The Local Governments give the reserve fund from the APBD to the Sharia Company of Guarantee as the collateral agreement of the Sharia Municipal Bond settlement.
4. The Sharia Company of Guarantee will be take the guarantee fund from the Local Government if the default of the Sharia Municipal Bond is happen.

## **2. The Solution for the Related Parties in terms of Registration Statement of Sharia Municipal Bond Issuance.**

There are a few obstacles against the efforts of the Local Governments to conduct a registration statement in order to the public offering of the Sharia Municipal Bond. The initial obstacle in public offering of the Sharia Municipal Bond is the appointment of the supporting institutions and supporting profession on the capital market to create the Prospectus in order to make the registration statement.

For this issue, the State should regulate and coach the Commitment Maker Official and Procurement Service Unit so that the procurement of goods and/or services can run in an efficient, open, competitive, and affordable way to achieve output in the form of goods and/or services in high quality. With the goods and/or services of high quality, it will have an impact on the improvement of public services.<sup>349</sup> To do so, the State should uphold seven principles of the procurement of goods and/or services namely efficient, effective, transparent, open, fair/is not discriminatory, and accountable.<sup>350</sup>

There are weaknesses in the procurement of goods and/or services by the Local Government, namely:<sup>351</sup>

1. *The weaknesses of legal framework;*
2. *The weaknesses of supervision;*
3. *The weaknesses of bureaucracy;*
4. *The weaknesses of human resources;*
5. *The weaknesses of law enforcement; and*
6. *The weaknesses of companies.*

There are several matters why the corruption case are often occur in the procurement of the goods and/or services by the Local Government, the reasons are:<sup>352</sup>

1. *The public procurement tends to involve large and visible projects.*
2. *The Local Governments have the complex function when awarding the contract through a tender process.*
3. *The low income of civil servants can encourage them to engage in the practice of corruption.*

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<sup>349</sup> Consideration on Presidential Regulation No.54 year 2010 of the Procurement of Goods and Services.

<sup>350</sup> Article 5 Presidential Regulation No.54 year 2010 of the Procurement of Goods and Services.

<sup>351</sup> Direktorat Penelitian dan Pengembangan KPK, *Kajian Pencegahan Korupsi Pada Pengadaan Barang dan Jasa Pemerintah*, Chapter III, Commission of Corruption Eradication, Jakarta, 2014, p.36-38.

<sup>352</sup> *Ibid*, p.46.

4. *The existence of the abuse of power by the holder of the Public Officer.*
5. *Political pressure facing the Head of Local Government to maintain his position.*
6. *The Local Government has a special responsibility to eradicate the negative practice of the public procurement market.*

The characteristics of the criminal acts of corruption that occur in the procurement of goods and/or services are:<sup>353</sup>

1. *The goods/services being held truly are not necessary or not appropriate to the needs, but a surrogate and an order of "persons" whom it may concern.*
2. *There is a markup and markdown of goods/services price as a form of scenario carried out by "persons" whom it may concern.*
3. *The existence of an arrangement that was not fair in its procurement of goods/services;*
4. *The acceptance of rewards (money/goods) to a "person" interested parties cause prices of goods/services not in accordance with the existing market; and*
5. *Awarding of deposit/tribute to "persons" who may concern.*

The appropriate solutions for the problems of procurement of goods and/or services by the Local Government are:<sup>354</sup>

1. Synchronizing the rules on the procurement of goods and/or services with other regulations related to the procurement of goods and/or services.
2. The change of provision in the APBD, whereas the implementation is not to change the Local Government Regulation related to the APBD (revise the budget).
3. Transfer of accountability for the Policies Agency of Procurement of goods and services of Government (LKPP) towards the procurement of

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<sup>353</sup> *Ibid*, p.46-47.

<sup>354</sup> Direktorat Penelitian dan Pengembangan KPK, *Kajian Pencegahan Korupsi Pada Pengadaan Barang dan Jasa Pemerintah*, Chapter IV, Commission of Corruption Eradication, Jakarta, 2014, p.2-22.

goods and/or services from the Ministry of National Development Agency (BAPENAS) to the Ministry of Finance.

4. Strengthening the system of e-procurement (procurement of goods/services online-based) in organizing the procurement of goods and/or services by the Local Governments.
5. Strengthening the procurement committee such as Maker of Commitment and Service Procurement Unit to create a human resources professional and integrity.
6. Form a legal entity over the Procurement Services Unit permanently and independently.
7. Strengthening the inspection of participant's providers of goods and/or services by the LKPP.
8. The preparation of standardization of quality and price of goods and/or services as a reference in drafting technical specifications.
9. The application of the efficiency of the procurement of goods and/or services with the value for money, not the cheapest price.
10. The strengthening of administrative sanctions and criminal sanctions as well as the addition of strengthening law enforcement against deviation of the procurement of goods and/or services.

Regarding the above explanations, the local Government may conduct procurement services against supporting institutions (the Underwriter, the Trustee, and the Rating Agencies) and supporting professions (Legal Consultant, Public Accountant, the Notary, and the Appraiser) on the Capital

Market in order to public offering of the Sharia Municipal Bond with notes the solutions regarding problems of procurement of goods and/or services be applied properly by the stakeholders.

In addition, OJK as the authority institution in the Capital Market should be Harmonize the regulation between the set of the Head of BAPEPAM-LK Decision regarding the Procedures of Registration Statement of Municipal Bond<sup>355</sup> with the set of OJK Regulation regarding Sharia Bond issuance<sup>356</sup> in order to the implementation of the Sharia Expert on the Capital Market against the Sharia Municipal Bond Issuance. As the supporting profession on the Capital Market, the Sharia Expert on the Capital Market has important role in term of Municipal Bond issuance due to the duty of the Sharia Expert on the Capital Market is provide advice and/or enforcing the application of sharia principles in business activities in the capital markets issuers and/or give up sharia compliance in public offering of Sharia Bond.<sup>357</sup> If the OJK have Harmonized those regulations, the Local Government can hold the services procurement of the Sharia Expert on the Capital Market.

Then, the obstacle of the Local Government in conducting the registration statement in order to the initial public offering of the Sharia Municipal Bond is

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<sup>355</sup> See the Head of the BAPEPAM-LK Decision No.IX.C.12, IX.C.13, and IX.C.14 regarding the Procedures of Registration Statement of Municipal Bond.

<sup>356</sup> See OJK Regulation No.18 year 2015 on the Issuance and Requirement of Sharia Bond and OJK Regulation No.7 year 2017 on the Document of Public Offering in order to Public Offering of Securities and Sharia Securities.

<sup>357</sup> Article 5 Section (1) OJK Regulation No.18 year 2015 on the Issuance and Requirement of Sharia Bond.

a dispute between OJK with BPK regarding the authority to audit the financial statements of the Local Government.

According to Mita Ekawati, OJK and BPK had a meeting three-times to resolve the dispute the authority to audit the financial statements of the Local Government.<sup>358</sup> In the first meetings (March 31, 2015) that were attended by high-level officials of OJK and BPK, they collectively discuss who is authorized to audit the financial statements of the Local Government to perform the registration statement in connection with the initial public offering of Municipal Bond/Sharia Municipal Bond. In the second meetings (May 4, 2015) also attended by high-level officials of OJK and BPK, they temporarily agreed to make public accountant as auditor of the financial statements of the Local Government with the mechanisms of the BPK pointed the Public Accounting as a third party in performing the audit the financial statement of the Local Governments. But the outcome of the second meeting has not yet said to be final and binding because OJK and BPK should conduct technical meetings to consider the outcome of the second meeting.

In the final meetings on 2016, attended by the technical team of OJK and BPK decided that the BPK will conduct an audit of the financial statements of the Local Government to perform the registration statement in order to the public offering of the Municipal Bond/Sharia Municipal Bond. Later, OJK will not provide comment/rebuttal against the audit of financial statements of the

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<sup>358</sup> The result of interview with Mrs. Mita Ekawati, OJK's Officer in Company Assessment of Real Sector Department, interviewed on August 31, 2017.

Local Government stated in this Prospectus. For the first consideration is according to Law No.8 year 1995 of the Capital Market stated that only Public Accountant that has authority to audit financial statement of issuers. However, Law No.8 year 1995 of the Capital Market also not explain that Public Accountant can audit of Local Financial Statement. Additionally in Law No.15 year 2006 of the Financial Examiner Body stated that only BPK who has authority to audit Local Financial Statement. For the second consideration, because their position is same according to the hierarchy of law, OJK do not put BPK as the Public Accountant who registers in OJK. It can be concluded that OJK and BPK are harmonized their regulation in order to assist Local Government for issue Municipal Bond/Sharia Municipal Bond.<sup>359</sup>

Finally, since December 29 2017, OJK has been establishing the new set of OJK regulations regarding the Municipal Bond/Sharia Municipal Bond issuance namely OJK regulation No.61 year 2017 on the Document of Registration Statement in order to Public Offering of Municipal Bond and/or Sharia Municipal Bond, OJK Regulation No.62 year 2017 on the Shape and Substance of the Prospectus and Short Prospectus in order to Public Offering of Municipal Bond and/or Sharia Municipal Bond, and OJK Regulation No.63 year 2017 on the Report and Announcement of the Issuers of Municipal Bond and/or Sharia Municipal Bond.<sup>360</sup> Those OJK regulations replace the Head of

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<sup>359</sup> The result of interview with Mrs. Mita Ekawati, OJK's Officer in Company Assessment of Real Sector Department, interviewed on August 31, 2017.

<sup>360</sup> <http://www.hukumonline.com/berita/baca/lt5a462141dd498/akhirnya--ojk-terbitkan-3-peraturan-tentang-penerbitan-obligasi-dan-sukuk-daerah>, accessed on December 30 2017.



BAPEPAM-LK Decision regarding registration statement in order to public offering of the Municipal Bond<sup>361</sup> due to these regulations make the Local Government cannot issue the Municipal Bond and/or Sharia Municipal Bond.

Furthermore, the other BAPEPAM-LK regulations regarding financial statements of the Local Government is not applicable due to the auditors of financial statements of the Local Government in order to the Municipal Bond and/or Sharia Municipal Bond issuance is BPK, not Public Accountant which registered in the OJK.<sup>362</sup>

Then to audit the financial statements of the Local Government in order to public offering of the Sharia Municipal Bond, BPK should also implement the Sharia accounting standards beside implement Government accounting standards. That is because to conduct public offering of Sharia securities (Sharia Shares, Sharia Bond, and Sharia derivative products), the Auditors generally must apply Islamic accounting standards in the audit of financial statements.

This provisions is referred to the AAOIFI's Financial Accounting Standard No.17 on the Accounting for Investments in Sharia Bond as the universal standards to audit the sharia-based financial statements in order to public offering of the Sharia Bond<sup>363</sup> and also the Fatwa DSN-MUI regarding the

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<sup>361</sup> See the Head of BAPEPAM-LK Decision No.IX.C.12, IX.C.13, and IX.C.14 regarding the Procedures of Registration Statement of Municipal Bond.

<sup>362</sup> The result of interview with Mrs. Mita Ekawati, OJK's Officer in Company Assessment of Real Sector Department, interviewed on August 31, 2017.

<sup>363</sup> Abdul Rahman, *Accounting Regulatory Issues on Investments in Islamic Bonds*, Islamic Financial Services, Vol.4, No.4, 2003, p.1,

Sharia Bond as the guidance for the auditor to implement Sharia accounting standards in Indonesia.<sup>364</sup> The application of accounting standards in Islamic Sharia Bond public offering should take place in addition to the financial disclosure to the public, are also carried out to obtain Sharia compliance from the Sharia Supervisory Body where these financial statements should not contain interests, speculation, gambling, and other uncertain and prohibition matters in Islam.<sup>365</sup>

## CHAPTER IV

### CLOSURE.

#### A. Conclusion.

The obstacles of Pre-Registration Statement of Sharia Municipal Bond issuance are:

1. The absence of regulation regarding the application of profit sharing regarding the profit payment of *Mudharabah* Sharia Municipal Bond in the

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<http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.195.7676&rep=rep1&type=pdf>, accessed on December 30, 2017.

<sup>364</sup> See DSN MUI No.32/DSN-MUI/IX/2002 of Sharia Bond, Fatwa DSN-MUI No.40/DSN-MUI/IX/2002 on the *Mudharabah* Sharia Bond, and Fatwa DSN-MUI No.41/DSN-MUI/III/2004 on the *Ijarah* Sharia Bond.

<sup>365</sup> Abdul Rahman, *Op,Cit*, p.2-5.

Ministry of Finance Regulation No.111 year 2012 on the Procedure of Issuance and Responsibility against Municipal Bond

2. The absence of regulation regarding the application of Local Asset by the Local Government as the Underlying Asset of the *Ijarah* Sharia Municipal Bond in the Ministry of Local Affairs Regulation No. 13 year 2006 on the Guidance of Local Finance Management
3. The Ministry of Finance Regulation No.111 year 2012 on the Procedure of Issuance and Responsibility against Municipal Bond did not explain whether the form of the Debt Management Unit in preparation, publishing, and management of Sharia Municipal Bond is permanent or temporary.
4. The Ministry of Finance Regulation No.111 year 2012 on the Procedure of Issuance and Responsibility against Municipal Bond did not explain the role and position of Sharia Supervisory Board.
5. Government Regulation No.30 year 2011 on the Local Loan stated that the State does not guarantee of Sharia Municipal Bond if the default happens.

Subsequently, the obstacles of Registration Statement of the Sharia Municipal Bond are:

1. The lack of professionalism of the committee against the procurement of good and services so that the implementation of procurement of the supporting institutions and supporting professions on the Capital Market is doubtful.

2. The role of Sharia Expert on the Capital Market in order to Sharia Municipal Bond issuance is absent in the set of the Head of BAPEPAM-LK Decision regarding the Procedures of Registration Statement of Municipal Bond.
3. The existence of dispute between OJK and BPK regarding the authority to audit the financial statements of the Local Government in order to the public offering of the Sharia Municipal Bond so the Local Government cannot issue the Sharia Municipal Bond.
4. The Head of BAPEPAM-LK Decision No.VIII.G.14 of the Guidance of Financial Assessments Presentation of Local Financial only stated the form, content, and requirements of the financial statement of Local Government in the form of presentation must follow the statement of government accounting standards issued by the accounting standards committee of Government.

The solution for the Local Government against Pre-Registration Statement of Sharia Municipal Bond issuance are:

1. The related parties should refer to Law No.19 year 2008 on the Sharia Sovereignty Bond in order to apply for the profit sharing payment in the *Mudharabah* Sharia Municipal Bond.
2. The related parties should refer the Law No.19 year 2008 on Sharia Sovereignty Bond in order to apply the Local Assets as the Underlying Assets of the *Ijarah* Sharia Municipal Bond.
3. The related parties should refer to Government Regulation No.56 year 2008 on the Company of Sharia Sovereignty Bond for the implementation of the SPV as the Debt Management Unit of the Sharia Municipal Bond.

4. The related parties should harmonize the regulation between DSN-MUI Decision No.3 year 2000 on the Instruction of Establishment Implementation of Board of Sharia Supervisory Member on Sharia Financial Institution with the set of technical regulation regarding the preparation of the Local Government in order to Municipal Bond issuance.
5. The related parties should Synchronize the regulations between Law No.1 year 2016 of the Guarantee with the set of technical regulation regarding the preparation of the Local Government in order to Municipal Bond issuance.

Subsequently, the solutions for the Local Government to conduct the Registration Statement of Sharia Municipal Bond are:

1. The Policies Agency of Procurement of goods and services of Government (LKPP) must strengthen the application of e-procurement services, strengthening the inspection of participant's providers of goods and/or services, strengthening of administrative and criminal sanction in the procurement of goods and/or services, and shape the Official Maker of Commitment (PPK) and Service Procurement Unit (ULP) into becoming professional.
2. OJK should Harmonize the regulation between the set of the Head of BAPEPAM-LK Decision regarding the Procedures of Registration Statement of Municipal Bond with the set of OJK Regulation regarding Sharia Bond issuance.

3. BPK has authority to audit the financial statements of the Local Government in order to fulfill the document of the registration statement for the public offering of the Sharia Municipal Bond.
4. BPK should implement the Sharia accounting standards beside implementing the Government accounting standards in order to fulfill sharia compliance against the Local Government.

**B. Recommendation.**

In order to assist the Local Government to conduct the public offering of the Sharia Municipal Bond, The State should:

1. Revise Law No.8 year 1995 on the Capital Market due to this Law does not regulate yet regarding the implementation of the Sharia Capital Market and the products of Sharia Capital Market;
2. Add the authority of the Local Government to obtain the loan from the society through Sharia Municipal Bond in the Legislation;
3. Harmonize the regulation between Law No.19 year 2008 on the Sharia Sovereignty Bond and Government Regulation No.56 year 2008 on the Company of Sharia Sovereignty Bond with the set of technical regulations regarding Municipal Bond issuance.
4. Add a guaranteeing provision to the set of technical regulations regarding Sharia Municipal Bond issuance;
5. Create a Law regarding Government Procurement of good and service and also Transfer of accountability for the Policies Agency of Procurement of goods and services of Government (LKPP) towards the procurement of goods

and/or services from the Ministry of National Development Agency (BAPENAS) to the Ministry of Finance; and

6. Allow BPK to apply the Sharia standard account beside apply Government standard account to audit the financial statements of the Local Government in order to conduct public offering of the Sharia Municipal Bond.

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