

Research Article

Transcending the Boundaries between State Power in Customary Authority in Law Enforcement for Fund Misuse

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ABSTRACT: This study examines the dynamic relationship between state law and customary law in the governance of local financial institutions, with a focus on Village Credit Institutions (LPD) in Bali. As community-based entities rooted in Balinese customary traditions, LPD operate under *awig-awig* and *pararem*, which function as the primary legal references in managing institutional operations. While these customary norms play a vital role in preserving cultural identity and social cohesion, their application often varies among villages, leading to legal inconsistencies and governance disparities. Such variations may generate potential gaps in regulation and accountability, primarily when LPD handles public funds or large-scale financial transactions. Adopting a socio-legal approach that combines interdisciplinary, statutory, conceptual, and comparative perspectives, this research examines how power and responsibility are shared between state institutions and customary authorities. The findings indicate that supervisory duties are frequently transferred from government agencies to local customary leaders. Although this practice reinforces community autonomy, it can also weaken institutional oversight and contribute to recurring cases of financial mismanagement. The study highlights the importance of developing a coherent regulatory system under the supervision of the Financial Services Authority (OJK) to ensure transparency, consistency, and accountability in LPD management. Strengthening coordination between customary values and national legal standards is crucial to align cultural practices with modern financial governance. The results of this research provide policy insights for enhancing local financial regulation that respects cultural identity while upholding institutional integrity and public trust. In a broader sense, the study contributes to ongoing discussions on legal pluralism and the reform of Indonesia's decentralized governance framework.

KEYWORDS: Accountability, Customary Law, Fund Misuse, Law Enforcement

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I. INTRODUCTION

There is a phenomenon in the practice of local financial institutions in Bali that shows the constitutional recognition of customary law has not been fully integrated into the national legal system. This case illustrates that the regulation and resolution of issues at the village level still depend on customary norms and mechanisms that vary from region to region. Lembaga Perkreditan Desa,¹ hereinafter referred to as “LPD”, is a financial institutions that aim to preserve Hindu values. The LPD is a financial entity that mobilises funds from members of the customary village community in the form of savings and subsequently redistributes such funds to the same community.² In addition, the LPD is engaged with, and intersects in, social, cultural, and religious activities within the traditional village.³ The LPD performs its functions through business activities directed towards the improvement of the standards of living of the village community.⁴ The total wealth of LPDs across Bali in 2025 is estimated at 36 trillion rupiah, which is certainly not a small amount for a village-level financial institution. Despite this fantastic number of assets, the basis for establishing LPDs is actually very simple: awig-awig and pararem. Almost every traditional village in Bali has awig-awig and pararem as the legal basis and guidelines for behaviour, which are prerequisites for establishing an LPD. The creation of awig-awig and pararem is adapted to the concept of desa kala patra, which covers aspects of place, time, and local conditions.⁵

The formulation of each awig-awig and pararem that adapts to local conditions creates legal inconsistencies between villages and opens the possibility of legal vacuums. In practice, the resolution of various cases, including financial abuse in local financial institutions, is left to the customary regulations of each village. Returning all matters to the realm of customary law without a positive legal basis can lead to inconsistencies, especially when faced with issues with public law dimensions and significant losses. The absence of specific national legal standards has resulted in weak law enforcement. This condition is further compounded by the predominance of top-down national policies that fail to accommodate local characteristics

¹ Based on Bali Provincial Regulation No. 3 of 2017, Lembaga Perkreditan Desa, or Village Credit Institution, is a financial institution owned by the Pakraman Village, located within the jurisdiction of the Pakraman Village.

² I Nyoman Sujana & Leonito Ribeiro, “Dilemmas of Bad Loan Settlement of Village Credit Institution (Lembaga Perkreditan Desa) in The Covid-19 Pandemic Situation” (2022) 10:2 Jurnal IUS-KHK at 368.

³ I Wayan Pradnyantha Wirasedana et al, “The Role of Capital in Microfinance Financial Performance and Cultural Sustainability” (2024) 11:1 Cogent Business & Management at 3.

⁴ I Wayan Warka, *Determinan Profitabilitas Lembaga Perkreditan Desa (LPD)* (Bali: PT Scopindo Media Pustaka, 2021) at 22.

⁵ Ie Lien Risey Junia, “Mengenal Hukum Adat Awig-Awig di Dalam Desa Adat Bali” (2023) 2:09 JHHWS at 830.

inherent in customary law, thereby generating a disconnect between central policy frameworks and the actual needs of indigenous communities at the local level.⁶

Based on data from the Indigenous Peoples Consultative Assembly, 105 LPDs are not operational, 104 are unhealthy, and 767 are healthy. In addition, data from the Bali Police Criminal Investigation Directorate (Ditreskrim) for 2021–2025 shows that many LPD cases were found in 2024. In that year, there were three reports of criminal acts: embezzlement at the LPD of Selulung Traditional Village, Kintamani, Bangli (LP/B/264/IV/2024), and two cases of fraud at the LPD of Kutuh Traditional Village and the LPD of Sidakarya Traditional Village. The cases that occurred in 2024 are only a small part of the problem. Looking at the data on 24 corruption cases that have been legally binding from 2023 to May 2025, the state has suffered a loss of Rp 267,357,164,940. The problems that have occurred are not only criminal but also civil. This can be seen from the six civil lawsuits that have been legally binding (*inkracht*) from the Singaraja District Court, Amlapura District Court, and Denpasar District Court.

In fact, the number of cases resolved through positive law to obtain permanent legal force remains small, so the potential for abuse through customary law remains high, leading to unhealthy conditions and even bankruptcy, which impacts customer assets that the LPD cannot return. One recent case is that of LPD Bedulu. In this case, it was found that the LPD management had misused funds. The problem was not limited to lending but also extended to LPD Bedulu's overall operations and administration. The various problems that arose since 2021 showed that LPD Bedulu was in an unhealthy condition. Many customer funds could not be withdrawn, prompting law enforcement to intervene. The LPD Bedulu case remains unresolved as of 2025. Numerous public complaints prompted Commission III of the Gianyar Regional People's Representative Council to hold a meeting with stakeholders from the Gianyar Regency Government. However, the meeting did not provide sufficient protection for depositors, as there is still no certainty regarding the disbursement of funds. Furthermore, several assets belonging to LPD Bedulu that were misused by its management are still being sold.

This practice raises serious issues because customary law emphasises the restoration of social harmony rather than legal accountability and community protection. Although there is a legal basis in Bali Provincial Regulation No. 3 of 2017, further elaborated in Bali Governor Regulation No. 44 of 2017 on Village Credit Institutions, it still does not address the complexity of the issue. This shows that there needs to be certain limits to the applicability of living law; customary law cannot be used as the sole instrument for resolution.⁷ The gap between customary law norms and national regulations ultimately affects the implementation

⁶ Rubi Rubi et al, "Dinamika Hukum Dalam Pengaturan Masyarakat Hukum Adat Ditinjau Dari Sistem Hukum Nasional" (2024) 5:3 at 866.

⁷ I Gede Agus Kurniawan et al, "Legal Reform in Business Dispute Resolution: A Study of Legal Pluralism in Indonesia, Vietnam, and Thailand" (2025) 6:2 JLLR at 100–101.

of LPDs, which are often beset by various problems. Based on data from the Special Committee on LPDs of the Bali Regional Representative Council (DPRD) for the 2021 period, 158 LPDs (11.03%) were declared bankrupt.⁸ The sources of these problems include poor-quality human resources, a lack of entrepreneurial spirit, and a lack of innovation, creativity, and professionalism.⁹

The management and supervision of LPD operational activities are entrusted to and regulated by the Bendesa Adat within each customary village.¹⁰ In practice, the Bendesa Adat occupies a central position within the LPD supervisory structure by directly serving as the Pamucuk of the internal supervisory body (Panureksa), while also functioning as the authority responsible for receiving reports from the Prajuru LPD regarding the implementation of activities and the overall performance of the LPD. Beyond its supervisory function, the Bendesa Adat also bears institutional responsibility for the sustainability of the LPD, including the authority to appoint and dismiss LPD administrators through the Paruman Desa mechanism, as well as the obligation to resolve disputes or irregularities that cannot be settled internally by the LPD management.

Such a concentration of authority may potentially create imbalances within the supervisory mechanism. Furthermore, the reporting-based supervisory system has not yet functioned effectively. The discrepancy between administrative reports and the actual conditions of the LPD reflects a compliance gap, namely, the fulfilment of formal administrative obligations without substantive compliance. This pattern indicates that regulatory enforcement tends to emphasize procedural conformity over substantive verification, thereby limiting its effectiveness in ensuring actual compliance.¹¹ Weak supervisory mechanisms have also contributed to various operational problems within LPDs. These issues indicate that constitutionally recognised customary law has not yet been fully harmonised with the national legal system. The absence of clear boundaries between the application of customary law and positive law creates legal uncertainty and difficulties in resolving disputes. Accordingly, this study addresses two fundamental questions: (1) what are the ideal boundaries between customary law and positive law in the implementation of LPD policies; and (2) what policies are necessary to ensure legal protection for community assets deposited in LPDs.

Several studies show that the differences between customary law and positive law pose challenges in determining their respective limits of application in Indonesia. Dina Rahmita et

⁸ Bali Tribune, “158 LPD di Bali Dinyatakan Bangkrut” (Agustus 2021), online: <<https://balitribune.co.id/content/158-lpd-di-bali-dinyatakan-bangkrut#:~:text=balitribune.co.id%20%7C%20Denpasar%20-%20Data%20Pansus%20LPD%20DPRD,Bali%20justru%20dinyatakan%20bangkrut%20atau%20sudah%20tidak%20beroperasi>>.

⁹ I Ketut Yadnyana, Sudarsana Arka & Ni Wayan Alit Erlina Wati, “Model Pemberdayaan LPD Bermasalah di Provinsi Bali” (2022) 12:1 Juara at 25.

¹⁰ Ni Made Anggia Paramesthi Fajar, “Pengaturan Kewenangan Pengawasan Lembaga Perkreditan Desa (LPD) Pekraman Desa Adat di Bali” (2022) 16:1 YUSTITIA at 46.

¹¹ Achmad Ali, *Menguak Teori Hukum & Teori Peradilan: Legal Theory & Judicial Prudence* (Kencana) at 193.

al., in their study entitled *Comparative Analysis of Customary Law and Positive Law in the Harmonisation of Public Policy in Indonesia*, explain that customary law is oriented towards principles of local wisdom, while positive law emphasises certainty and structured governance.¹² Similar research was also conducted by Basrawi, entitled *Legal Certainty in the Settlement of Criminal Cases Through Customary Law as Viewed from the National Legal System*, which explains that various Supreme Court decisions have confirmed the existence of customary law as part of the national legal system, but that there needs to be limits on the application of customary law. Riska Andi Fitriyono, in her dissertation entitled ‘*The Policy of Formulating Customary Criminal Law Regarding the Prevention of Illegal Fishing in the Reform of National Criminal Law*,’ explains that the absence of clear legal provisions regarding fisheries crimes and customary sanctions has resulted in weak protection for coastal communities and the marine environment.¹³ Therefore, integrating customary law values into positive law is seen as a strategic step towards achieving substantive justice. Furthermore, Budi Suhariyanto, in his article ‘*The Problem of Customary Law Absorption by the Courts and Its Influence on National Criminal Law Reform*,’ explains that customary criminal law is recognised by general court judges, but its application is limited in accordance with the constraints of the local community and can be used as a reference for national criminal law reform.¹⁴

II. METHODOLOGY

The research method used was non-doctrinal (socio-legal research). The socio-legal approach is not identical to the sociology of law, but this study used social science methodology.¹⁵ The analytical framework in this study utilises Lawrence M. Friedman's legal system theory, which views law as a system comprising three main components: structure, substance, and legal culture.¹⁶ In addition, this study utilises William J. Chambliss and Robert B. Seidman's theory of law, which emphasises the interrelationships among legal norms, social facts, and the roles of actors.¹⁷ An interdisciplinary approach was used in this study due to the correlation between the characteristics of socio-legal research and the issues discussed. To strengthen the analysis, this study also used legislative, conceptual, and comparative approaches. This study was conducted in Bali Province, in accordance with the distribution of LPDs, which are found only in traditional villages. The legal sources used in this study consist of primary and

¹² Dina Rahmita et al, “Analisis Komparatif Sistem Hukum Adat dan Hukum Positif dalam Harmonisasi Kebijakan Publik di Indonesia” (2025) 2:1 *Presidensial* at 107.

¹³ Riska Andi Fitriyono, *Kebijakan Formulasi Hukum Pidana Adat Mengenai Penanggulangan Illegal Fishing Dalam Pembaharuan Hukum Pidana Nasional* (Disertasi, Universitas Diponegoro, 2023) at 487.

¹⁴ Budi Suhariyanto, “Problema Penyerapan Adat oleh Pengadilan dan Pengaruhnya Bagi Pembaharuan Hukum Pidana Nasional” (2018) 30:3 *Mimbar Hukum* at 434.

¹⁵ Afif Noor, “Socio-Legal Research: Integration of Normative and Empirical Juridical Research in Legal Research” (2023) 7:2 *Jurnal Ilmu Hukum* at 102.

¹⁶ I Bisri, *Sistem Hukum Indonesia: Prinsip-Prinsip & Implementasi Hukum di Indonesia* (Raja Grafindo Persada, 2004) at 8.

¹⁷ S Rahardjo, *Ilmu Hukum* (Citra Aditya Bakti, 1992) at 21.

secondary data. Primary data was collected through interviews with stakeholders, while secondary data included primary, secondary, and tertiary legal materials relevant to the research topic.¹⁸ All collected data was then analysed using the Strauss and J. Corbin approach, which involves analysis while the researcher is in the field.¹⁹

III. IDEALS, LIMITS OF CUSTOMARY LAW, AND POSITIVE LAW IN THE IMPLEMENTATION OF LPD POLICIES

A. Problems in Enforcing LPD Law

Misuse of funds in LPDs is a recurring problem that has legal consequences. The problems caused are not limited to civil disputes, such as default or bad debt, but also criminal acts involving embezzlement, abuse of authority, and corruption. Problems that occur across a number of LPDs often lead to failure and ultimately bankruptcy.²⁰ Based on data from the Indigenous Peoples Advancement Agency, of the 1,439 LPDs established in almost every indigenous village, 105 are not operational, 104 are unhealthy, and 188 are less than healthy. Although LPDs were designed as locally wisdom-based financial institutions that should serve as pillars of the indigenous community's economy, the reality on the ground is different. Various cases of fund misuse, lack of transparency in management, conflicts of interest, and even bankruptcy indicate that the existing legal framework is inadequate in effectively preventing and sanctioning irregularities. In addition, the problem of irregularities is exacerbated by moral hazard among administrators.²¹ Negligence in carrying out obligations that should prioritise the interests of indigenous peoples opens the door to irregularities.²² When adequate supervision and governance are absent, the existence of LPDs as institutions based on trust and cooperation will be threatened.

Friedman shifts the focus of the legal system to legal institutions, which consist of the institutions and their apparatus that enforce the law in society.²³ This perspective emphasizes that the effectiveness of law enforcement depends not only on the existence of legal rules but also on the performance and integrity of the institutions responsible for implementing them. Therefore, weak institutional oversight and a lack of accountability can lead to ineffective enforcement of legal norms. LPD supervision ensures that all activities are carried out as planned and in accordance with applicable regulations, including internal village regulations, local regulations, and their derivatives.²⁴ The internal oversight structure is run by Panureksa,

¹⁸ S Soekanto, *Pengantar Penelitian Hukum* (Jakarta: Penerbit Universitas Indonesia (UI-Press), 2015) at 52.

¹⁹ A Strauss & J M Corbin, *Basics of Qualitative Research: Grounded Theory Procedures and Techniques* (SAGE Publications, 1990) at 19.

²⁰ Ni Komang Urip Krisna Dewi, "Pencegahan Kecurangan Berbasis Catur Purusa Artha Di Lembaga Perkreditan Desa (LPD) X" (2024) 10:2 JIRA at 667.

²¹ I Wayan Suartana, *Pelaporan Akuntansi Lembaga Perkreditan Desa (LPD)* (Bali: CV. Sastra Utama, 2020) at 23.

²² *Ibid* at 38.

²³ Lawrence M Friedman, *The Legal System: A Social Science Perspective* (New York: Russel Sage Foundation, 1975) at 14.

²⁴ Suartana, *supra* note 21 at 235.

an internal supervisory body formed within the traditional village.²⁵ Panureksa are members of the indigenous community in Bali, selected through pakraman, or traditional deliberation. Responsive supervision by Panureksa across all aspects of LPD management, including transactions, can significantly reduce irregularities.²⁶ Nevertheless, the large number of cases of fund misuse indicates that the supervisory function of the panureksa is not yet optimal. Empirically, discrepancies between accounting reports and the actual conditions of the LPD still frequently occur without any follow-up action from the panureksa.

Weaknesses in the legal structure have prevented the LPD from functioning as it should. Structure is the foundation that ensures the implementation of norms in society. This view is expanded upon through the framework of Chambliss and Seidman, who emphasise that law never stands alone. Law is an instrument whose effectiveness and application are shaped by the social relations and values prevailing in society. The LPD is a financial institution specializing in managing the finances of traditional villages. However, the success of its function depends on attention to other aspects, which, if ignored, can be detrimental to various parties.²⁷

Social relations within communities play a major role in conflict resolution. Bali is a region that frequently deals with customary law. Various social, religious, and community activities often go hand in hand with customary law. In addition, conflict resolution in society often occurs through customary deliberative mechanisms. Customary disputes are resolved through the village council, which consists of the bendesa (traditional village head), petajuh (deputy bendesa), penyarikan (secretary), petangen (treasurer), and the traditional village community living in the area. The existence of the village council shows that conflict resolution is not only normative, but also communal and participatory. However, the stages of dispute resolution through the village council may differ from one village to another as they are adapted to the awig-awig and pararem of each village.²⁸

The involvement of prominent individuals or respected figures in fund misappropriation often makes the community reluctant to bring such cases to formal legal proceedings. This is due to concerns that formal legal proceedings could disrupt social harmony and stability, as the customary dispute resolution mechanism practised in Balinese traditional villages tends to prioritise restorative justice and communal reconciliation over formal accountability.²⁹

²⁵ Ketut Tanti Kustina & Kadek Lyana Prilandewi, "Pengaruh Efektivitas Pengendalian Internal, Moralitas Individu, dan Peranan Panureksa Terhadap Kecenderungan Kecurangan Akuntansi di Lembaga Perkreditan Desa Kecamatan Sukawati Kabupaten Giyar Bali" (2022) 1:1 JIMAK at 25.

²⁶ I Made Jamin Yasa, Ni Ketut Sariyani & I Gusti Ngurah Sanjaya "Antecedents of Accountability Based on Karma Pala Teachings and its Consequences on Panureksa VCI Performance in Badung Regency" (2024) 07:09 JEFMS at 5939.

²⁷ Fajar, *supra* note 10 at 50.

²⁸ Sonny Dewi Judiasih & Hazar Kusmayanti, "Penyelesaian Sengketa Adat Melalui Kerta Desa Pada Masyarakat Desa Adat Di Bali Berdasarkan Asas Perdamaian" (2025) 12:1 Jurnal Ilmiah Penegakan Hukum at 35.

²⁹ I Wayan Weresmana Sancaya et al, "Legal Responsibility of Traditional Villages in Bali for Losses Incurred by Village Credit Institutions (LPD) Based on Applicable Law" (2025) 3:4 ISRG Journal of Arts, Humanities, and Social Sciences at 167–168.

Therefore, the integrity of LPD administrators is key to ensuring LPD management complies with applicable regulations.³⁰ Without high integrity, weak oversight systems, and the dominance of customary-based resolutions, the system actually opens up more space for irregularities. These conditions create a compliance gap. This phenomenon is characterised by formal compliance with administrative rules, while the principle of accountability, which is the essence of financial institutions, continues to be ignored.

Furthermore, legal substance encompasses all forms of legal products established and implemented by legal structures, including both written and unwritten legal norms.³¹ Regulations on LPDs have normatively regulated their position, functions, governance, and supervision. However, several weaknesses remain in these legal regulations. The management of LPDs is entirely left to internal parties, namely traditional villages, so there are no specific standards.³² Each traditional village has the discretion to establish internal rules in the *awig-awig* and *pararem*, so there is no uniform mechanism for resolving issues. The absence of common standards for conflict resolution leads to imbalances in law enforcement and justice.

This approach significantly weakens deterrence. The sanctions imposed place greater emphasis on the recovery of losses through customary mechanisms rather than on formal legal sanctions. This weakens deterrence because perpetrators are often required only to return the funds, without facing criminal consequences. Returning all matters to the realm of customary law without a clear, positive legal basis can create legal uncertainty. This shows that there are no specific boundaries in the application of living law. Ultimately, such a pattern underscores the limitations of customary law as a standalone dispute resolution mechanism in financial accountability, rendering it inadequate for ensuring deterrence, maintaining legal certainty, and providing comprehensive consumer protection.

LPDs do not have a clear categorisation as financial institutions. LPDs are recognised as having formal legal status as customary-based financial institutions under the Bali Regional Regulations and Governor Regulations, but their status is not clearly categorised within the national legal framework. Explicitly, LPDs cannot be included in the Microfinance Institutions (MFIs) group. This is explicitly stated in Article 39, paragraph (3), of Law Number 1 of 2013 concerning Micro Financial Institutions, which provides that LPDs are not subject to the law's provisions. This has consequences for LPDs, as they are not subject to the requirements for establishing an MFI, which must be a cooperative or limited liability company.³³

³⁰ I Nyoman Resa Adhika et al, "Transformational Leadership in Improving Employee Integrity at Lembaga Perkreditan Desa (LPD) in Bali Province" (2023) 7:3 IJSSB at 732.

³¹ Izzy Al Kautsar & Danang Wahyu Muhammad, "Sistem Hukum Modern Lawrence M. Friedman: Budaya Hukum dan Perubahan Sosial Masyarakat dari Industrial ke Digital" (2022) 7:2 SEV at 90.

³² Fajar, *supra* note 10 at 50.

³³ I Wayan Suarjana, "Aspek Hukum Bisnis Lembaga Perkreditan Desa (LPD) Dalam Pemberdayaan Desa Adat di Bali" (2025) 6:2 Jurnal Preferensi Hukum at 184-185.

The consequences of this provision create a double problem. On the one hand, LPDs are recognised as customary financial institutions with formal legal status through local regulations and Bali governor regulations, , but they fall outside the supervisory scope of the Otoritas Jasa Keuangan hereinafter as "OJK", the state institution mandated to regulate and supervise all financial services activities in Indonesia. OJK's jurisdiction under Law No. 21 of 2011 on the Financial Services Authority applies only to nationally regulated financial institutions, whereas LPDs are governed exclusively by provincial-level customary law instruments and therefore do not fall within the categories of financial institutions subject to OJK oversight. Meanwhile, the LPD's internal oversight mechanism is implemented through traditional institutions, such as panureksa, traditional village officials, and various other supporting institutions.³⁴ However, the LPD's supervision is insufficient because it cannot fully ensure accountability and transparency in public fund management. This internal supervision can create conflicts of interest and undermine the effectiveness of the supervisory function.

The legal culture of Balinese society is an important factor closely related to cases of fund misuse that cannot be completely resolved. A strong legal culture contributes to the development of an effective legal system, whereas a weak legal culture may hinder law enforcement.³⁵ The values within indigenous communities, such as harmony, solidarity, and respect for traditional hierarchies, prioritise resolving various cases through customary law.³⁶ Culturally, avoiding conflict and maintaining village harmony are considered top priorities. This emphasis on harmony often trumps demands for transparency, accountability, and the application of formal legal sanctions that could disrupt the existing social order.

Social factors related to LPDs also include political and economic factors. Politically, LPD administrators are often figures who wield political power and influence at the customary village level. Strong relationships with decision-makers effectively create conditions of impunity. These conditions critically weaken checks and balances. The social and political position of those who misuse funds acts as a shield against formal legal processes, allowing cases to be resolved privately within the customary sphere. Economically, the LPD is seen as a source of income for traditional villages, and its governance is deeply embedded in customary deliberation (*paruman*) that prioritizes community trust and institutional legitimacy.³⁷ Priority is given to maintaining the LPD's image and sustainability as a financial institution. Concerns that formal legal processes will damage the LPD's reputation and public trust could disrupt the village's funding sources.

³⁴ Fajar, *supra* note 10 at 50.

³⁵ Al Kautsar & Muhammad, "Sistem Hukum Modern Lawrence M. Friedman", *supra* note 32 at 93

³⁶ Tyas Ismi Trialfhianty, Claire Helen Quinn & Maria Beger, "Engaging Customary Law to Improve The Effectiveness of Marine Protected Areas in Indonesia" (2025) 261 *Ocean & Coastal Management* at 7.

³⁷ I Wayan Sudiana et al, "Mengungkap Peran Desa Adat dalam Praktik Tata Kelola Lpd Di Bali" (2025) 16:2 *Krisna: Kumpulan Riset Akuntansi* at 255.

The role of actors in LPD management is a decisive factor. LPD administrators have full power and access to finances. Some parties are aware of loopholes in the supervisory system and exploit their position for personal gain. This fact is consistent with the large number of LPD administrators involved in various cases of fund misuse. Some LPDs in poor condition may go bankrupt due to the misuse of authority for individual gain.³⁸ Traditional village administrators, in their supervisory role, are strategically positioned to promote transparency, but cases are more often resolved through customary means. Local government, as a structural actor, lacks sufficient coercive power.

This situation reflects the framework of thought developed by Chambliss and Seidman, which states that the law does not function according to its normative text, but rather according to the interests and social relations of the dominant actors. Formal laws that demand transparency and accountability become ineffective.³⁹ Without actors who are strongly committed and have high integrity in adhering to professional governance standards, the substance of the LPD law will remain a passive norm easily ignored. Therefore, reforms are needed to reconfigure power among actors to ensure law enforcement is carried out.

Weak legal structures make it difficult to implement legal norms. Ambiguous legal substance creates a gap between legal norms and customs. A legal culture that emphasises harmony reinforces social facts that hinder the enforcement of formal law. This combination results in the continued misuse of LPD funds without any fundamental resolution. The failure of LPD regulation can be explained through three main points. First, from a legal norms perspective, the applicable rules are inconsistent because they are based on *awig-awig* and *pararem*. Local regulations and Bali governor regulations related to LPD are also not fully capable of resolving the problem. Second, from the perspective of the role of actors, traditional village administrators and LPD administrators tend to lack accountability because they are motivated to maintain the traditional village's image. Third, from the perspective of Friedman's legal system, there is a weak supervisory structure, unclear legal substance, and a permissive legal culture. The interaction of these three factors has led to a failure that renders the current regulations unable to address LPD fund misuse.⁴⁰

This situation shows that the root of the LPD problem lies not only in weaknesses in structure, substance, and legal culture, but also in normative arrangements that make customary law the primary reference point for governance. LPD management that relies on customary law can lead to diverse practices that are not always consistent with the principle

³⁸ Ketut Sri Puspita Yanti & Putu Putri Prawitasari, "Fraud Triangle dan Etika Bisnis Sebagai Determinan Risiko Fraud pada LPD di Bali (Studi Empiris pada LPD di Kota Denpasar)" (2025) 12:2 *Jiim* at 479.

³⁹ Yanto Sufriadi, "The Progress of Indonesian Law Enforcement Reform After 25 Years of the Reform Movement" (2024) 51:1 *Asian Affairs: An American Review* at 44.

⁴⁰ AA Ngurah Oka Yudistira Darmadi, "Penentuan Kerugian Negara dalam Tindak Pidana Korupsi pada Lembaga Perkreditan Desa (LPD) di Bali" (2025) 15:7 *Kertha Wicara: Journal Ilmu Hukum* at 432.

of accountability. Differences in mechanisms across customary villages can create legal uncertainty.

B. Comparison of Recognition and Limits of Customary Law Applicability

To clarify the boundaries between customary law and state law, we can review practices in other countries that strongly recognize the rights of indigenous peoples. In this context, the customary law practices of the Maori tribe in New Zealand can serve as a point of comparison. The conditions for LPD management in Bali differ from the customary law practices of the Maori tribe. These conditions contrast with the customary law practices of the Maori tribe in New Zealand. In the case of fisheries, the state has established clear boundaries between the scope of customary law and formal law. The local wisdom of the Maori tribe is still recognized through customary rights mechanisms, but the state also asserts its authority to maintain the sustainability of resources.⁴¹

Māori customary law is recognised by the state, and its scope of application is clearly defined. This demonstrates the differentiation between customary law and national law, which not only provides certainty but also enables joint governance. The Maori, as the indigenous people of New Zealand, have a strong historical and spiritual connection to the sea, which they consider a source of life and identity (taonga). Fishing is not only seen as an economic activity,⁴² but also as a cultural and spiritual activity. The legal basis for the application of Maori customary law is found in the Treaty of Waitangi.⁴³ The Treaty of Waitangi was signed on 6 February 1840, at Waitangi, Bay of Islands. Forty-three Northland chiefs signed the treaty that day. More than 500 Maori chiefs signed it as it was taken around the country over the next eight months.

In its development, recognition of the Treaty of Waitangi did not immediately bring tangible benefits. During the 19th century until the mid-20th century, many colonial practices seized Maori land and resources under the pretext of state law. These conditions led to the serious marginalisation of indigenous peoples. It was not until 1975, with the passing of the Treaty of Waitangi Act, that the agreement gained more tangible legal recognition through the establishment of the Waitangi Tribunal.⁴⁴ The Waitangi Tribunal serves as a forum for the Maori tribes to file claims of treaty breaches, particularly those related to land and fisheries.

The tribunal's decision is not final as it still requires parliamentary approval, but it provides new opportunities for the Maori tribe to fight for their rights. This shows the clear role of customary law, which is recognised as a valid source of law but remains within the framework

⁴¹ Maria Bargh & Carwyn Jones, "Māori Interests and Rights: Four Sites at the Frontier" in Evan Berman & Girol Karacaoglu, eds, *Public Policy and Governance Frontiers in New Zealand* (Emerald Publishing Limited, 2020) 71.

⁴² Davood Askarany & Jenny Lam, "The Role of Māori Values in Corporate Culture and CSR: A Comparative Study in Aotearoa-New Zealand's Fishing Industry" (2025) *Syst Res Behav Sci* at 174.

⁴³ Hekia Bodwitch et al, "Indigenous Self-Determination in Fisheries Governance: Implications From New Zealand and Atlantic Canada" (2024) *11:24 Front Mar Sci* at 4-5.

⁴⁴ *Ibid* at 5.

of national law. In other words, customary law can be enforced as long as it does not conflict with broader public interests and remains under state supervision.⁴⁵

In addition to courts, New Zealand has many tribunals and authorities. These tribunals and authorities are forums with the legal authority to resolve various civil disputes within the District Court or High Court's jurisdiction. There are a number of civil claim tribunals that provide a quick and inexpensive way to resolve disputes because the settlement process is simpler than in court. The Dispute Tribunal, for example, can settle small civil claims valued at NZ\$30,000 or less.⁴⁶

Unlike the Waitangi Tribunal, which is institutionally part of New Zealand's national legal framework, the dispute-resolution mechanism in Bali through the village council (*kerta desa*) is more customary and communal in nature, so its authority is not directly bound by the state judicial system. The village council is a customary court based on Hindu religious values, though it may not exist in every village.⁴⁷ Conflict resolution based on peace is in accordance with the principle of mutual consent. If this cannot be achieved, the case can be resolved through deliberation to reach a consensus. If the problem cannot be resolved, the parties involved can seek assistance from the Customary Village Council (MDA). The MDA consists of various levels, starting with the provincial, regency/city, and sub-district levels, arranged in a hierarchical manner. The MDA has duties and authorities in the field of implementing customs, derived from Hinduism and local wisdom, and functions to provide advice, consideration, guidance, interpretation, and decisions in customs, traditions, culture, socio-religious matters, local wisdom, customary law, and the customary economy.⁴⁸

The position of the village council as a customary court is unique because it is not formally institutionalised within the state court system, but rather operates in parallel, relying on the social and religious legitimacy of the indigenous Balinese community. The village council's existence is based on customary authority and Hindu religious values alive within the community, so its main source of power is the community's trust. This autonomy also affirms the role of indigenous communities in regulating and resolving internal matters without direct state intervention. However, this considerable autonomy also creates fundamental weaknesses. The absence of formal standards means that each indigenous village has full authority to formulate its own dispute-resolution procedures based on its own *awig-awig* and *pararem*. These differences in mechanisms give rise to a diversity of practices that are not always consistent with the principles of accountability and protection of human rights.

⁴⁵ Heather Came et al, "The Waitangi Tribunal's WAI 2575 report: Implications for decolonizing health systems" (2020) 22:1 Health and Human Rights at 210.

⁴⁶ Bridgette Toy-Cronin, "The Financial Obstacles of Access to the Judge: New Zealand" in Petra Butler & Allannah Colley, eds, *Civil Procedure: Access to Commercial Justice* (Brill | Nijhoff, 2025) at 277.

⁴⁷ Karwiyah Karwiyah, Sonny Dewi Judiasih & Hazar Kusmayanti, "Comparison of Kerta Desa Bali and Malaysian Indigenous Court" (2024) 30:4 SASI at 422.

⁴⁸ I Putu Sastra Wibawa, I Wayan Martha & I Komang Dedi Diana, "Menakar Kewenangan dan Tata Hubungan Kelembagaan Antara Majelis Desa Adat Dengan Desa Adat di Bali" (2020) 3:1 WW at 99.

The limitations of village councils in providing legal certainty are even more apparent when compared to practices in New Zealand. The state not only recognises the customary rights of the Maori tribe, but also formulates them into binding legislation, such as the Fisheries Act 1996. This statute governs both indigenous and commercial fishing through the Quota Management System (QMS), which determines the maximum allowable commercial catch for each fish stock and quota management area.⁴⁹ Maori fishing rights under this framework were further entrenched through Treaty of Waitangi settlements, which allocated quota shares to Maori and established dedicated mechanisms for their participation in fisheries governance.⁵⁰ In addition to using QMS, the New Zealand government also provides several ways to manage customary fisheries, namely mataitai reserves. Basically, the government recognises and provides traditional fishing services through local management. These reserves allow customary and recreational fishing, but do not usually allow commercial fishing.

This situation differs from that of LPDs in Bali. In the case of fisheries in New Zealand, direct involvement is confirmed through national legal instruments such as the Fisheries Act 1996 and the QMS mechanism. However, in the context of LPDs, national regulations are not clearly defined.⁵¹ LPD arrangements are only regulated to the extent of regional provisions, but LPDs do not fall within the national legal framework. As a result, unlike customary fisheries management in New Zealand, which has clear standards regarding the boundaries of customary and state authority, LPD management still relies heavily on internal mechanisms within customary villages.

Furthermore, customary fishing can be carried out through taiapure (local fishing). Estuaries and coastal areas are important for food, spiritual, and cultural purposes. These areas allow all types of fishing and are managed by local communities. The government also implements temporary closures and restrictions on fishing methods. The New Zealand Government's efforts to regulate traditional fisheries include establishing rules in the Fisheries Act 1996 regarding temporary closures of fishing areas and specific fishing methods, as stipulated in sections 186A and 186B.⁵²

Taiapure is an area with special customary significance for iwi or hapu, namely as a source of food, for spiritual reasons, and for cultural reasons. All types of commercial, recreational, and customary fishing are permitted in Taiapure, unless the management committee recommends changes to the fishing regulations and the Minister for Fisheries approves them. The management committee's role is to nominate people from the local Maori community

⁴⁹ Carla Houkamau, Robert Pouwhare & Marcos Mortensen Steagall, "Integrating Māori Perspectives in Environmental Management and Fisheries" (2024) 2:1 LPRAXIS at 130.

⁵⁰ *Ibid* at 133.

⁵¹ Paul Marchal et al, "A Comparative Review of the Fisheries Resource Management Systems in New Zealand and in The European Union" (2009) 22:4 Aquat Living Resour at 464.

⁵² Stephen C Urlich, Faye R White & Hamish G Rennie, "Characterising the regulatory seascape in Aotearoa New Zealand: Bridging local, regional and national scales for marine ecosystem-based management" (2022) 224 Ocean & Coastal Management at 10

when a *taiapure* is established. This committee is appointed by the Minister for Fisheries after consultation with the Minister for Maori Development. The management committee may make recommendations to the Minister for Fisheries regarding regulations (based on the Fisheries Act) for managing *taiapure* fisheries. These recommendations may include: 1) species to be caught, 2) fishing season, 3) size and quantity of fish, 4) fishing area, and 5) fishing methods.⁵³

The main advantage of this system is the clear distinction between customary and state domains. Maori customary law applies within the community, particularly with regard to cultural and spiritual practices, such as which community members are entitled to fish for ceremonial purposes, or when certain seasons are considered sacred for the preservation of fish populations. Conversely, national law applies to matters of broader public interest, such as marine conservation, ecosystem sustainability, and the regulation of large-scale fishing quotas that impact the national economy. In cases of violations, such as illegal fishing practices that exceed quotas or the use of prohibited fishing methods, national criminal law is enforced without exception, including against members of the Maori tribe. Thus, although customary law is recognised, it cannot be used as a reason to avoid obligations under formal law.⁵⁴

The clarity of these boundaries has two important implications. First, customary law is not ignored, but is given space to exist and be practised in accordance with cultural values. This provides strong social legitimacy, as indigenous communities feel that their traditions are respected. Second, national law remains the primary regulator for interests that transcend the community, such as resource sustainability and environmental protection. In other words, this system prevents a legal vacuum while also preventing potential conflicts. On the one hand, the Maori do not feel marginalised because their customary laws are formally recognised. On the other hand, the state does not lose its authority, as national law remains the ultimate authority to be obeyed.⁵⁵

Based on a comparison of Maori customary law and LPD customary law, there are differences, particularly in relation to management. The Fisheries Act 1996 stipulates the government's role in relation to the customary activities of the Maori tribe, particularly in customary fishing. The Maori community must comply with the Fisheries Act 1996 regarding fishing quotas and methods. Violations are subject to criminal sanctions under Section 252(1) of the Fisheries Act 1996.⁵⁶

⁵³ Bradley J Moggridge, Ross M Thompson & Peter Radoll, "Indigenous Research Methodologies in Water Management: Learning from Australia and New Zealand for Application on Kamilaroi Country" (2022) 30:4 *Wetlands Ecol Manage* at 859.

⁵⁴ Meg Parsons, Lara Taylor & Roa Crease, "Indigenous Environmental Justice within Marine Ecosystems: A Systematic Review of the Literature on Indigenous Peoples' Involvement in Marine Governance and Management" (2021) 13:8 *Sustainability* at 11.

⁵⁵ Medes Malaihollo, "On Due Diligence and the Rights of Indigenous Peoples in International Law: What a Māori World View Can Offer" (2023) 70:1 *Neth Int Law Rev* at 75.

⁵⁶ Fitriono, *supra* note 14 at 399.

The government continues to enforce formal laws regarding catch quotas, marine conservation, and criminal penalties for violations. However, the Maori tribe is given considerable leeway to implement customary-based governance, including regulating who is entitled to fish, when fishing activities can be carried out, and the purpose of fishing. When compared to LPD governance, the difference lies in the integration of customary law with state law. In the case of the Maori, state law actively seeks ways to accommodate customary law without compromising the principles of accountability and sustainability. In contrast, in LPD management, state law is less capable of resolving issues that arise. The state tends to cede its supervisory responsibilities to customary villages without a clear mechanism for integrating them into national law.

The concept, as applied to the Maori tribe, demonstrates a balance between custom and the state. Indigenous communities remain sovereign over their cultural practices, the state is protected from losses from illegal fishing, and the wider community benefits from a sustainable marine ecosystem. In many cases, oversight by the Maori tribe is carried out by *kaitiaki* (guardians of tradition), who are selected for their moral integrity and knowledge of customary law. These *kaitiaki* have high social legitimacy, while also working within the framework of national regulations. Compare this with Panureksa in LPD, which has only formal authority, not legal power.

IV. IDEAL ASSET PROTECTION POLICY FOR COMMUNITIES THAT DEPOSIT FUNDS IN LDP

A. Design of LDP Deposit Supervision and Guarantee

LPD is a customary-based financial institution that performs financial intermediation functions similar to those of banks within a limited scope.⁵⁷ Its operations also reflect the integration of local cultural values, which support financial sustainability.⁵⁸ LPD contributes to the provision of savings, loans, and credit services to indigenous communities.⁵⁹ It also supports MSMEs and the financing of productive activities such as trade, agriculture, and services.⁶⁰ As a local financial institution, LPD focuses its services on customers from the local indigenous community, as almost every indigenous village has its own LPD. However, people from other indigenous villages or regions may conduct transactions at LPD under certain conditions.

⁵⁷ I Gusti Ngurah Bagus Gunadi et al, "Corporate Governance and Financial Performance of Village Credit Institution in Badung, Bali" (2025) 12:2 Jurnal Ekonomi dan Bisnis Jagaditha at 239.

⁵⁸ Ni Luh Putu Wiagustini et al, "Financial Sustainability Berbasis Budaya (Studi Pada Lembaga Perkreditan Desa di Bali)" (2024) 9:2 EEB at 301

⁵⁹ Fajar, *supra* note 10 at 50.

⁶⁰ Made Putri Ariasih & I Nengah Suarmanayasa, "Fungsi Sosial Lembaga Perkreditan Desa (LPD) Sebagai Penggerak Utama Pembangunan Ekonomi Desa" (2024) 7:2 JESYA at 1239.

The source of assets owned by LPDs differs from that of other financial institutions, as one of them comes from the indigenous village's own resources. Based on Article 34 of the Bali Governor Regulation No. 44 of 2017, the initial capital of LPDs may be obtained from village deposits, derived from contributions from indigenous communities living in the village.⁶¹ These funds are resources allocated by traditional villages for operational requirements. Funds managed by LPDs are often used to finance religious ceremonies, public facility development, and village community welfare programmes. LPDs play a significant role in supporting village level infrastructure development.⁶² They also contribute to the preservation of local culture and traditional values.⁶³ Therefore, misuse of funds can affect the financing of religious activities, which are central to social and religious life in Bali.

In addition, the development and maintenance of traditional infrastructure, such as temples, village halls, and public facilities that serve as centres for social and cultural activities in traditional villages, requires stable funding. The LPD, as a financial institution that manages community funds, is the primary pillar of support for these needs. If the LPD encounters difficulties in protecting the funds obtained from traditional villages, this can hamper its operations. Protection of these assets must be treated as protection of intangible cultural wealth in the form of financial funds.

Although LPDs perform financial intermediation functions similar to banks, LPD customers do not have access to the National Financial System Safety Net, particularly the Lembaga Penjamin Simpanan,⁶⁴ hereinafter as “LPS”. The LPS functions as an institution that guarantees deposits and ensures the stability of the banking system.⁶⁵ The establishment of a cooperative deposit insurance institution is intended to enhance protection for customers or members of cooperative financial institutions.⁶⁶ In addition, deposit insurance contributes to banking stability and reinforces market discipline in Indonesia.⁶⁷ The urgency of customer protection is closely related to deposit protection, but this is unclear because there are no regulations or institutions that govern such matters. Weak protection raises concerns for

⁶¹ Article 34 of Bali Governor Regulation Number 44 of 2017 concerning the Implementing Regulation of Bali Provincial Regulation Number 3 of 2017 concerning Village Credit Institutions.

⁶² Xixiong Xu et al, “Does Religion Matter to Corruption? Evidence From China” (2017) 42 *China Economic Review* at 40–41.

⁶³ Ni Made Yudiantini & David Jones, “The Catuspatha Pattern in Balinese Palace: Architectural Conservation and Challenges” (2015) 28 *Procedia Environmental Sciences* at 545.

⁶⁴ Based on Law No. 24 of 2004, Lembaga Penjamin Simpanan or Deposit Insurance Corporation is an independent institution that guarantees bank customer deposits in Indonesia.

⁶⁵ Lembaga Penjamin Simpanan, “Profil LPS”, online (Government Website): *Lembaga Penjamin Simpanan* <<https://lps.go.id/profil/>>.

⁶⁶ Arif Budi Sosiawan & Suparno Suparno, “Urgensi Pembentukan Lembaga Penjamin Simpanan Koperasi Dalam Upaya Perlindungan Hukum Terhadap Anggota Koperasi Simpan Pinjam” (2024) 5:2 *RLJ* at 457.

⁶⁷ Irwan Trinugroho et al, “Deposit Structure, Market Discipline, and Ownership Type: Evidence From Indonesia” (2020) 44:2 *Economic Systems* at 2.

people who deposit funds in LPDs, especially given the many cases of fund misuse that have come to light.⁶⁸

If a bank experiences liquidity failure, customers are guaranteed that some or all of their deposits will be returned by the LPS. Meanwhile, if an LPD collapses, customers face the risk of total loss. This has occurred in several cases involving people who deposited funds with problematic LPDs. This phenomenon highlights the protection gap between LPDs and formal financial institutions. Unlike formal financial institutions that are backed by the LPS under Law Number 24 of 2004, LPDs lack an equivalent formal deposit guarantee mechanism, leaving their customers without adequate legal certainty over the safety of their deposited funds.⁶⁹ Furthermore, this gap also has an impact on economic inequality between indigenous communities and communities that already have access to formal banking services. The absence of this protection mechanism actually undermines the original purpose of establishing LPDs, which was to strengthen the economic welfare of krama adat and foster the financial independence of customary villages in Bali.

As a financial institution based on local wisdom, LPDs need the involvement of LPS and other smaller institutions in their operations. With assistance from LPS and similar institutions, public deposits in LPDs can be partially or fully guaranteed in the event of fund misuse. This protection maintains public trust and aligns with the LPD's function of ensuring the continuity of financing. This supports the LPD's principle as an institution that must earn the community's high trust.⁷⁰ The involvement of LPS and similar institutions helps close the protection gap between LPDs and formal financial institutions, ensuring indigenous communities are not left in a vulnerable position.

In practice, the operation of LPDs is closely related to social structures and customary laws. In line with LPDs' operational ties to social structures and customary laws, the formal regulation of these institutions within the national legal framework remains limited. LPDs are regulated only at the regional level in formal legal provisions. LPDs are not included in the scope of national financial sector laws, such as the Banking Law or Law No. 1 of 2013 concerning Lembaga Keuangan Mikro,⁷¹ hereinafter as "LKM". As a result, LPDs face regulatory uncertainty, particularly regarding supervision and asset protection.

⁶⁸ Ni Kadek Meila Anggraeni & Gede Adi Yuniarta, "Pengaruh Fraud Hexagon Theory Terhadap Kecurangan Dalam Pengelolaan Dana Pada Lembaga Perkreditan Desa (LPD): (Studi Kasus pada LPD di Kecamatan Banjarangkan)" (2023) 14:03 JIMAT at 789.

⁶⁹ Ni Putu Ari Setyaningsih, I Ketut Satria Wiradharma Sumertajaya & Fanny Priscyllia, "Legal Protection for Customer Funds at Village Credit Institutions (LPD) Through a Deposit Guarantee Scheme by The Empowerment Institution for LPD" (2022) 7:2 Jurnal Notariil at 57.

⁷⁰ Warka, *supra* note 4 at 5.

⁷¹ Based on Article 1, Paragraph (1) of Law Number 1 of 2013, Lembaga Keuangan Mikro or Microfinance Institution is a financial institution specifically established to provide business development and community empowerment services, either through loans or financing for micro-scale businesses to members and the community, deposit management, or the provision of business development consulting services that are not solely profit-oriented.

LPDs are financial institutions spread across nine districts/cities, totaling 1,439 units. Some LPDs even manage assets worth billions to trillions of rupiah. This shows that LPDs are not small-scale traditional financial institutions, but rather financial entities that make a real contribution to the local economy. The large assets owned by LPDs underscore the importance of supervision and customer protection. Thus, the absence of external institutional supervision creates a regulatory gap.

Supervision of LPDs has so far been carried out by internal supervisors in traditional villages, commonly known as panureksa, who are required to report to the governor annually.⁷² The task of the internal supervisory body in monitoring LPD operations can be carried out by anyone in the relevant traditional village.⁷³ Internal supervision is very risky because it can benefit certain parties, as the absence of independence and professionalism among supervisors creates conditions that are susceptible to conflicts of interest between LPD management and the customary village community as fund owners.

The OJK is an institution established under Law No. 21 of 2011. The OJK is an independent body with the authority to regulate, supervise, and protect the financial services sector in Indonesia, including banking, capital markets, and non-bank financial institutions. The OJK's involvement in supervising LPDs is not only based on institutional considerations, but also on the fact that, in recent years, there have been various cases of financial irregularities, ranging from fictitious loans and bad debts to the abuse of authority by LPD managers. This phenomenon indicates a serious gap in supervision, as LPDs are supervised without the involvement of external supervisory institutions with adequate technical competence.

The purpose of the OJK's existence in the national financial system is to implement an integrated regulatory and supervisory system for activities in the financial services sector.⁷⁴ The purpose of the OJK's existence in the national financial system is to implement an integrated regulatory and supervisory system for activities in the financial services sector. Thus, if LPDs continue to be excluded from the OJK's supervisory mechanism, this could weaken the legal protection of indigenous peoples as customers. The principle of prudence, which is always emphasised in the banking system, should also be a minimum standard for LPDs, especially since, in practice, LPDs not only provide credit to indigenous peoples within a single village but also to indigenous peoples outside their area. Expanding the scope of credit in this way does indeed provide broader economic benefits, but it also increases the risk of bad debt, especially if it is not accompanied by credit analysis procedures that meet the standards. The presence of the OJK in this context is very important to ensure that every loan

⁷² Fajar, *supra* note 10 at 49.

⁷³ Kustina & Kadek Lyana Prilandewi, *supra* note 26 at 26.

⁷⁴ Otoritas Jasa Keuangan, "Tugas dan Fungsi", online (Government Website): *Otoritas Jasa Keuangan* <<https://ojk.go.id/id/tentang-ojk/pages/Tugas-dan-fungsi.aspx>>.

granted by LPDs is subject to the principle of prudence, including the application of the know-your-customer principle, business feasibility verification, and risk management.

OJK supervision of LPDs is not intended to diminish customary law, but rather to strengthen it. Customary law continues to play a vital role in regulating social relations, including governing social ethics and maintaining harmony among members of indigenous communities. However, when it comes to fund management, especially those sourced from public funds, adequate external oversight mechanisms are necessary, given that customary governance mechanisms alone have proven insufficient to ensure depositor protection and long-term financial stability. This requires a model of contextual harmonisation integrating customary norms with essential safeguards such as clear accountability structures and depositor protection mechanisms through collaboration between customary oversight mechanisms and formal state supervisory institutions.

In addition, part of the LPD's capital is a grant from the local government, which is essentially included in the category of state finances. If these grant funds are misused, the losses incurred will not only harm the indigenous community but also state finances. Thus, OJK supervision can be an important tool for strengthening the LPD accountability system, as this institution has the competence to supervise and enforce accounting standards and financial institution governance. Integrating LPDs within a broader regulatory framework would also enhance transparency and risk management, while ensuring that the management of public funds is subject to consistent oversight and legal accountability.

On the other hand, there is a view that placing LPDs under OJK supervision will eliminate their identity as customary institutions. OJK supervision does not mean changing LPDs' status to that of conventional financial institutions, but rather ensuring that their governance meets the minimum standards of the financial services sector, especially given the large amounts of assets they hold. The identity of LPDs as customary institutions can still be maintained, for example, by preserving the role of customary villages in determining internal policies, customary sanction mechanisms, or the use of profits for the social interests of indigenous communities. However, in terms of fund management, financial reporting, and risk management, the OJK's involvement is necessary to ensure that LPDs do not fall short of the governance standards applicable to other financial institutions.⁷⁵

B. Design of LDP Deposit Supervision and Guarantee

In essence, cooperation between the government and indigenous communities can be established through the formulation of national-level regulations governing indigenous communities' activities. This is important to resolve issues within the LPD, particularly cases of fund misuse. Although Article 2 of Law Number 1 of 2023 concerning the Criminal Code

⁷⁵ I Nyoman Darmayasa et al, "Anti-Aggressive Accounting Creative Pada Lembaga Perkreditan Desa Menuju Pembangunan Inklusif Berkelanjutan" (2024) 4:1 Asersi at 2.

recognises living law as the basis for criminalising a person, Indonesian law still uses the principle of legality. To avoid violating the principle of legality, Article 2 of Law Number 1 of 2023 concerning the Criminal Code must be adjusted by coordinating with autonomous regions that have the authority to determine regional regulations that include criminal penalties, in accordance with living law or customary law that applies in their respective regions.⁷⁶

With regard to law enforcement related to abuse of authority in LPDs, it needs to be clarified whether acts of misuse of customer funds, such as fictitious loans, constitute general or specific criminal offences. From the perspective of criminal corruption, abuse of authority in the LPD can be classified as corruption because there is a flow of money from the local government that is included in the LPD's capital. Based on the opinion of I Wayan Ramantha, when a deviation occurs, the loss is returned to the traditional village, not to the state treasury, because it is a loss to the traditional village. The capital from the local government is not comparable to the assets owned by the traditional village, which are managed independently by the indigenous community.⁷⁷

LPD is not merely a financial institution, but a reflection of the identity and pride of the indigenous Balinese community. Every fund managed through the LPD is part of the social bond that unites the village community. Therefore, when irregularities occur, the community feels that the losses are their own, not the state's. This is taken into consideration in the enforcement of laws related to LPD irregularities, where there must be specific regulations governing the calculation of state losses in the LPD so that the amount to be returned to the state is clear.

The subordination of LPD to customary law must also be considered in relation to the types of customary offences that can be resolved through customary means to avoid deviations from the principle of legality. The provincial government of Bali can compile a list of acts that fall under customary law, so that enforcement can be organised to prevent the community from fearing criminalisation of customary offences. By compiling a list of types of acts that can be categorised as customary offences, the government helps to provide clear boundaries so that indigenous peoples no longer live in fear of criminalisation. This list can also serve as formal recognition by the state of customary law, thereby strengthening the community's sense of belonging. In this way, indigenous peoples do not feel that they have lost their authority, while the state can still ensure that there are no loopholes for abuse.

⁷⁶ Afandono Cahyo Putranto & Irwan Triadi, "Konsep Hukum Pidana Adat Pasca Pemberlakuan Undang-Undang Nomor 1 Tahun 2023 tentang Kitab Undang-Undang Hukum Pidana Perspektif Living Law" (2025) 3:5 *Al-Zayn: Jurnal Ilmu Sosial & Hukum* at 7321.

⁷⁷ Ida Bagus Wahyu Diatmika & I Wayan Ramantha, "The Effect of Good Corporate Governance on the Performance of Village Crediting Institutions (LPD) Using Awig-Awig Village Protection as Moderation Variables (Empirical Study on LPD in Mengwi District, Badung Regency)" (2021) 5:6 *American Journal of Humanities and Social Sciences Research* at 223.

In addition, it should also be considered that within the framework of Indonesian positive law, everything related to public financial management must ultimately be accountable to the state. Therefore, if LPDs are subject only to customary law, serious problems will arise for law enforcement. For example, if there is an abuse of authority in the form of granting fictitious credit, is this considered a customary crime or a criminal act of corruption? Under Articles 2 and 3 of Law Number 31 of 1999 concerning the Eradication of Corruption, misuse of funds sourced from state finances constitutes a criminal act of corruption.⁷⁸

State financial calculations need to be considered to determine the status of LPD, as stated by Prof. I Wayan Ramantha. LPD is subject to customary law and therefore belongs entirely to the indigenous community. Funds from the local government are included in grant funds that do not have to be repaid to the state. About the calculation of losses by the local government inspectorate, referring to Article 3 paragraph (2) of Permendagri No. 64 of 2007 concerning the duties and functions of the inspectorate, it is stated that the regency/city inspectorate is the internal auditor of the local government, which has the task of supervising the implementation of government affairs in the regency/city, guiding the administration of village government and the implementation of village government affairs.⁷⁹ The village referred to in this article is an administrative village, not a traditional one, and therefore does not fall under the inspectorate's authority. Consequently, when there is a misappropriation of funds in the LPD, the authorised body is the Supreme Audit Agency (BPK), not the regional inspectorate.

Furthermore, the large number of bad credit problems at LPDs stems from customers who are already listed on BI Checking's blacklist, meaning they cannot take out loans from any bank and therefore turn to LPDs to apply for credit. This has become a pattern due to the weak supervisory system at LPDs. In this case, the OJK's oversight of LPDs will also enhance transparency and accountability. The OJK has a technology-based reporting and supervision system that enables early detection of potential irregularities.⁸⁰ If this system is implemented in LPDs, indigenous peoples, as both owners and customers of LPDs, will have better access to information about the financial performance of these institutions. This will increase public trust in LPDs, thereby strengthening their sustainability as indigenous-based

⁷⁸ Gatot Triyanto, "Ratio legis perbedaan rumusan delik Pasal 2 dan Pasal 3 Undang-Undang Nomor 31 Tahun 1999 jo. Undang-Undang No. 20 Tahun 2001 tentang pemberantasan tindak pidana korupsi" (2017) 6:1 Jurnal Rechtsens at 50.

⁷⁹ Article 3 paragraph (2) of Minister of Home Affairs Regulation Number 64 of 2007 concerning Technical Guidelines for the Organization and Work Procedures of Provincial and Regency/Municipal Inspectorates.

⁸⁰ Otoritas Jasa Keuangan, "Kembangkan Pengawasan Berbasis Digital Ojk Luncurkan Suptech Integrated Data Analytics (Osida)" (29 March 2022), online (Government Website): *Otoritas Jasa Keuangan* <

financial institutions. Transparency is also important to minimise the abuse of authority that often occurs in systems that rely solely on inadequate oversight mechanisms.

The LPD business activity monitoring system can also be carried out through the regional inspectorate, given that traditional villages do not have officially established customary courts. In this case, the interpretation of ‘village government’ in the inspectorate's duties and authorities must be broader, as traditional villages in Indonesia differ from administrative villages. This is important because the subordination of customary villages to customary law means their economic activities often operate outside the central government's control or supervision. Therefore, synergy between the regional inspectorate and the OJK can be an ideal solution, in which the inspectorate conducts internal audits of the use of regional grants, while the OJK supervises the LPD's risk management and financial governance.

Ideally, the presence of the OJK should be translated into the formulation of specific Peraturan OJK,⁸¹ hereinafter as “POJK” that comprehensively regulate governance, supervision, and consumer protection in LPDs. The substance of the POJK should include governance standards that emphasise transparency and accountability, periodic external audit requirements, and dispute resolution mechanisms that allow for a combination of traditional and national forums. Thus, LPDs can continue to operate as culture-based institutions, but with formal legal protection that provides certainty to customers.

From a normative perspective, an ideal asset protection policy must at least fulfil three fundamental aspects, namely independence, speed, and legal certainty. Independence means that supervisory institutions and fund managers must be free from conflicts of interest, both political and customary. Speed is the importance of a protection mechanism that can provide certainty quickly, given that delays will exacerbate the socio-economic impact on rural communities. Meanwhile, legal certainty is an absolute requirement to ensure the protection provided to LPD customers is equivalent to that provided to bank customers, thereby preventing discrimination in legal treatment.⁸²

In practice, protection of LPD assets will be effective only if it is built on a hybrid model that combines customary law with positive law. Harmonisation between *awig-awig* and *pararem* with national standards needs to be carefully designed and still recognised as the basis for LPD internal norms, but minimum standards for governance, risk management, and consumer protection are set by the OJK. Any disputes that arise can be resolved first through customary mechanisms, but there must be an option to escalate to a formal forum when substantial financial interests are at stake. With this model, the community continues to feel

⁸¹ Based on Article 1(11) of Law No. 21 of 2011, Peraturan OJK or OJK regulations are written regulations established by the OJK based on legislation.

⁸² Dewa Adnyana, “Kepastian Hukum mengenai Penjamin Simpanan bagi Nasabah pada Lembaga Perkreditan Desa di Bali” (2020) *Jurnal Magister Hukum Udayana* (Udayana Master Law Journal) at 885.

that the LPD is part of the local culture, while at the same time obtaining legal certainty from the state.

Recommendations for institutional strengthening of LPDs include three main points. First, management integrity must be strengthened through competency-based recruitment, risk management training, and the enforcement of strict sanctions for violations. Second, the supervisory system needs to be reformed by retaining traditional internal supervisors but supplementing them with external audits and special OJK units at the regional level. This unit functions not only as a supervisor, but also as an early warning system to detect potential failures at an early stage. Third, the establishment of a Joint Protection Fund must be realised immediately to provide guarantees for public deposits, with management based on the principle of customary solidarity but still within the framework of national law.

The ideal asset protection policy model for LPDs is one that neither simply replicates the national banking system nor relies entirely on customary mechanisms. Both must coexist within a legal framework. Customary law forms the basis of identity, while national law provides formal protection that guarantees certainty. If this can be realised, LPDs can develop into community financial institutions that not only support the economies of rural communities but also preserve culture and provide constitutional protection for all citizens.⁸³

Thus, OJK supervision of LPDs is not only important but necessary to ensure the achievement of LPDs' socio-economic objectives while preventing irregularities. Clear regulations regarding the OJK's role in supervising LPDs will provide legal certainty, reduce the potential for conflict between customary law and national law, and strengthen LPDs' position as transparent and accountable customary-based financial institutions.

V. CONCLUSION

The misuse of LPD funds is a recurring problem that leads to civil and criminal disputes. Weak internal supervision by panureksa and the dominance of customary settlement mechanisms make accountability difficult to enforce. The legal structure of the LPD is fragile, and the substance of the law is inconsistent because it relies on ad-hoc practices and precedents. In contrast, the community's legal culture prioritizes harmony over formal sanctions. This situation creates a compliance gap that allows administrators to abuse their authority without deterrent effects. The LPD has legal status through the Bali Regional Regulation and the Governor's Regulation; however, it is not regulated in the Banking Law or the LKM Law, and therefore falls outside the supervision of the OJK. When compared to the Maori tribe, there are fundamental differences. The state recognises Maori customary law and clearly regulates it through the Treaty of Waitangi and the Fisheries Act 1996. The state

⁸³ I Gede Surya Pratama Putra, I Nyoman Sukandia, & Ni Made Puspasutari Ujianti, "Pertanggungjawaban Lembaga Perkreditan Desa (LPD) Desa Adat Ungasan Atas Ketidakmampuannya dalam Memenuhi Hak Nasabah Pemegang Simpanan" (2021) 2:2 *Juinhum* at 359.

allows for customary practices, but still sets quotas, conservation rules, and criminal sanctions. This mechanism maintains a balance between customary law and national law. In contrast, in the management of LPD, the state has relinquished its supervisory responsibility to indigenous villages without integrating it with national law. As a result, indigenous practices in LPD often conflict with the principle of accountability, leading to repeated cases of fund misuse.

LPD, as a traditional financial institution with assets valued at trillions of rupiah, plays a vital role in supporting the economic, social, and religious activities of the Balinese community. However, the absence of external supervision and deposit protection schemes makes community funds, which are also collective assets of traditional villages, vulnerable to misuse. LPD customers face the risk of total loss if the institution were to collapse. This situation demonstrates legal inequality and weakens the protection of traditional village assets. Therefore, the OJK needs to issue a special OJK Regulation (POJK) governing the governance, external audit, and risk management of LPD. This POJK must also be designed to protect traditional village assets as cultural heritage, while ensuring legal certainty for customers. Additionally, a deposit guarantee mechanism needs to be established. With a clear POJK and asset protection scheme, LPD can maintain its traditional identity while operating with modern accountability standards and ensuring the security of public funds.

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COMPETING INTEREST

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