ARTICLE 2

India's Urban Local Bodies Accounts and Audit: Challenges and Way Ahead

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Abstract
India's urbanisation trajectory has placed increasing pressure on Urban Local Bodies (ULBs) to deliver essential services efficiently and manage public finances responsibly. Cities already generate a significant share of the country's economic output, and their effective governance depends heavily on robust financial management systems. This article examines the state of accounting and audit practices in India's ULBs through a rigorous survey of the existing literature, highlighting their importance for transparency, fiscal discipline, and improved urban governance. Sound accounting systems enable municipalities to track revenues and expenditures, manage assets and liabilities, and enhance credibility with citizens, regulators, and financial institutions. They are also crucial for accessing central government grants and capital markets, including municipal bonds. Despite reforms such as the National Municipal Accounting Manual and increasing availability of audited accounts through national initiatives, significant challenges persist. These include limited professional accounting capacity within ULBs, fragmented financial management systems, inconsistent adoption of accrual accounting, weak follow-up on audit observations, and political resistance to revenue-related reforms. Smaller municipalities also face resource and scale constraints in maintaining modern financial systems. The article argues that future reforms should focus on state-wide institutional reforms, stronger fiscal incentives linked to audited accounts, integrated digital financial management systems, professionalisation of municipal finance cadres, and greater public disclosure. Embedding accounting and audit within a broader public financial management ecosystem is essential to strengthen accountability, improve service delivery, and enhance the creditworthiness of India's cities.

Keywords
Municipal accounting, Municipal Audit, Municipal Finance, Financial Management and National Municipal Accounting Manual.

2.1 Introduction

India is moving on an upward urban trajectory. The country's economic growth and development depend on its cities. About 31.2 per cent of its population lived in urban areas in 2011, which is projected to reach 39 per cent in 2036 (MoHFW GoI, 2020). About 60 per cent of India's GDP is generated in its cities (NITI Aayog, 2022). Moreover, the economic fulcrum of the country is located in urban areas.

The Census of India, distinguishes urban settlements into 'statutory towns' and 'census towns' to capture both the legal-administrative and functional dimensions of urbanisation. Urban development in India is a state subject. Accordingly, statutory towns are settlements that have been formally notified as urban by a state government under a municipal or local government law. The ULBs which constitute a Municipal Corporation, Municipal Council (Municipality), Nagar Panchayat, Cantonment Board, or Notified Area Committee, are statutory bodies with councillors who are elected for a fixed term.

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Their urban status is based on legal recognition, not on demographic or economic criteria alone. In the 2011 Census, India recorded 4,041 statutory towns, which together formed the country's municipal governance system. Census Towns[1], by contrast, are administratively rural settlements that meet specific demographic and economic thresholds prescribed by the Census by way of which these settlements are designated as urban. In 2011, the Census identified 3,892 Census Towns, a sharp increase from 1362 in 2001 (Census 2011), reflecting the rapid "in-situ" urbanisation of large villages and peri-urban areas. Together, statutory and census towns accounted for 7,933 urban settlements, highlighting the dual nature of India's urban transition: one driven by formal municipal expansion and the other by functional urban growth outside the municipal framework.

Between 2011 and now, about 1000 statutory towns, aka ULBs, have been notified. At present, there are 5006 statutory towns; of these, 264 are Municipal Corporations, 2010 are Municipal Councils, and 2400 are Nagar Panchayats (LGD Directory, Government of India, 2026). The ease of doing business and quality of life in these cities depend on how well the ULBs govern these cities and provide the basic services.

2.2 Importance of Accounting and Audit for ULBs

Accounting and Auditing are vital for Urban Local Bodies (ULBs) to ensure the efficient management of public funds and the transparent delivery of essential urban services. Robust financial systems enable ULBs to track income and expenses accurately, ensuring that financial resources are allocated to the most critical urban needs. Most ULBs across the country also own huge assets in terms of public infrastructure, land and buildings. Maintaining a proper assets register becomes very important for a credit rating. Regular accounting helps ULBs manage their vast portfolio of assets (like land and buildings) and keep track of long-term liabilities. The associated challenge is not only to strengthen the fiscal infrastructure in terms of accounts and audit mechanisms for the existing ULBs, but to create a framework that can be easily adopted by the new ULBs as they make a statutory transition from rural to urban.

Periodic financial statements and independent audits provide a credible frame of reference for citizens, regulators, and stakeholders to verify that public money is being used as intended; hence, enhancing public trust. Audits are essential for detecting and preventing fraud, corruption, and financial mismanagement by identifying deviations from established financial regulations.

Moreover, modern accounting is often a mandatory reform condition for receiving central grants, such as those from the Central Finance Commission or under the AMRUT mission. Reliable financial reporting enhances the credit ratings of ULBs, making them more attractive to institutional investors and lenders. Timely and standardised audited accounts are a prerequisite for ULBs to enter capital markets or issue municipal bonds, which are critical for funding large-scale infrastructure.

The National Municipal Accounting Manual (NMAM) was formulated in 2004 with the aim of uniform accounting practices and structure across India's ULBs. However, the same has not been achieved across India's ULBs (Sixteenth Finance Commission, 2026). Based on the data available on the cityfinance.in portal[2], 66 per cent of ULBs follow accrual accounting, 21 per cent cash accounting and 13 per cent mixed cash-accrual accounting. This lack of uniformity is primarily because a uniform municipal accounting framework is not statutorily mandated.

The conditionality requiring the publication of audited accounts for availing the 15th Finance Commission grants resulted in greater number of ULBs adopting the practice over the last five years. Audited accounts of more than 80 per cent of ULBs are available on the cityfinance portal (Janaagraha 2026).

Despite the existing efforts (Box 1), there are gaps in terms of the years for which the accounts are available for some ULBs, and in the information shared in the financial statements as data is missing for some accounting heads due to lag in recognising outstanding expenses, non-disclosure of contingent liability, lack of proper system of recognising receivables/ arrear income, irregular reconciliation of the bank book with the cash book, weakness in conducting physical verification of cash, stock and fixed assets (Agarwal 2020[3]).

[1]A place is classified as a Census Town if it satisfies all three conditions:
a. a minimum population of 5,000, b. at least 75 percent of the male main working population engaged in non-agricultural activities, and c. a population density of at least 400 persons per square kilometre. These settlements do not have an urban local body and continue to be governed as rural areas, typically by Gram Panchayats, despite exhibiting urban characteristics.
[2]The portal is said to cover 97 per cent of India's ULBs (16th Finance Commission)
[3]https://cpgfm.icai.org/wp-content/uploads/2022/10/Accounting-System-of-the-Urban-Local-Bodies-Issues-Challenges.pdf

Moreover, the usage of multiple basis of accounting (cash-based, accrual-based, mixed), sometimes even for the same ULB across the years, questions the reliability and diminishes the utility of the financial statements.

To bring about uniformity in accounting practices, the Accounting Standards for Local Bodies (ASLBs) issued by the Institute of Chartered Accountants of India comprise a comprehensive suite of 31 standards, of which 30 are accrual-based and one pertains to the cash basis (Box 2). But it is not mandatory for the ULBs across states, to follow these standards as yet.

Box 1: Efforts by the States and Union Governments in Financial Management

An important, practice-oriented dimension of municipal accounting reform has been the widespread adoption of Tally, a commercial off-the-shelf accounting software, by many states and ULBs as an interim or foundational digital platform. Beginning in the mid-2000s, several state governments—often in partnership with the Institute of Chartered Accountants of India—standardised Tally-based accounting templates aligned to their municipal accounting manuals. This approach offered a low-cost, rapidly deployable alternative to bespoke enterprise systems, particularly for small and medium ULBs with limited IT capacity. Over time some states successfully transitioned to more advanced, finance-integrated e-Governance systems typically treating Tally as a stepping stone rather than an end-state solution.

The 16th Finance Commission notes that "effort is currently underway at MoHUA to develop an Enterprise Resource Planning (ERP) solution for ULBs. It aims to facilitate the entry of financial transactions and the preparation of accounts in a manner integrated with the PFMS. MoHUA is also currently engaged in an effort to map the existing Chart of Accounts[4] (CoAs) of ULBs with the CoA of the Union Government. The Union Government has also announced an Urban Data platform for improved governance. The Commission recommends extending the digital platform's capabilities to support ULBs in preparing accounts and financial reports."

Box 2: Accounting Standard for Local Bodies (ASLBs) by Institute of Chartered Accountants of India

ASLBs establish a uniform financial reporting architecture for Urban Local Bodies (ULBs) covering presentation of the accounts (ASLB 1–3), assets such as property, plant and equipment and intangibles (e.g., ASLB 17, 31), revenue from both exchange and non-exchange transactions (ASLB 9, 23), liabilities and provisions (ASLB 19), and advanced areas such as consolidation, joint arrangements, and service concession agreements (ASLB 32–38).

A critical feature of the ASLB framework is its close alignment with the International Public Sector Accounting Standards (IPSAS) developed by the International Public Sector Accounting Standards Board. This mapping embeds globally accepted principles enabling comparability, transparency, and credibility. IPSAS alignment will enhance creditworthiness and investor confidence, particularly for instruments like municipal bonds. However, the true extent of ASLBs adoption needs to be better understood.

2.3 Challenges affecting ULB accounting and audit

Although the policy framework increasingly recognises the importance of robust financial accounting practices and high-quality audits, their impact is not optimal, as discussed in the NITI Aayog-ICAI (2023) study.

[4] It is a structured, organised list of every account in a company's general ledger, used to categorize financial transactions into assets, liabilities, equity, revenue, and expenses. It serves as a "financial roadmap" for reporting and tracking.

1. Capacity Constraints – Due to the absence of trained accounting professionals at the ULB level, ULBs rely on generalist staff for bookkeeping and on external Chartered Accountants for annual account conversion. This model undermines institutional memory and sustainability, as reforms often regress once consultants exit.

2. Fragmented Systems and Data Quality - Municipal financial management systems are frequently siloed. Property tax, water charges, payroll, procurement, and grants may be managed through separate software or manual registers, making reconciliation difficult. Weak data quality undermines both accounting accuracy and audit reliability.

3. Audit Fragmentation and Weak Follow-Up – There are parallel audit arrangements. Statutory compliance audits by statutory bodies like the CAG on one hand and financial statement auditors on the other. This creates gaps in accountability. Audit observations are rarely tracked through a formal Action Taken Report (ATR) mechanism, and there are limited sanctions for persistent non-compliance.

4. Political Economy of Revenue and Reform - Reforms that improve accounting transparency often expose inefficiencies in revenue collection, particularly in politically sensitive areas such as property taxation and user charges. Elected representatives may resist changes perceived as increasing the tax burden on constituents. This misalignment of political and administrative incentives can slow or dilute reform implementation.

5. Resource and Scale Constraints - Small and medium ULBs face acute resource limitations. Maintaining dedicated finance departments, professional staff, and modern IT systems is often financially unviable at the individual ULB level, necessitating shared or state-supported institutional arrangements.

2.4 Way Ahead

1) State-Wide Reform Models

One of the important findings of the NITI Aayog–ICAI (2023) study is that state-wide reform programmes outperform fragmented, ULB-by-ULB approaches. States that anchored reforms in Urban Development Departments or specialised municipal finance institutions achieved better scale, consistency, and sustainability. All states should adopt similar state-wide reform programmes.

Early-mover states such as Karnataka and Tamil Nadu adopted centralised project management units, standardised charts of accounts, and state-wide financial management software. These institutional arrangements enabled economies of scale in procurement, training, and audit coordination.

2) Incentives and Conditionality

The Fifteenth and Sixteenth Finance Commissions introduced a major policy shift by linking the release of basic and performance grants to the availability of audited annual accounts. The FC16 Report reinforces this approach, positioning accounting and audit compliance as core eligibility criteria for intergovernmental transfers. This has created a strong fiscal incentive for states and ULBs to prioritise financial reporting reforms.

3)Technology Adoption

Technology occupies a central place in the reform discourse, but it should be recognised as an enabler of sound accounting rather than as a panacea. Policy frameworks should prioritise finance-integrated municipal e-Governance systems that link budgeting, accounting, revenue management, procurement, payroll, and treasury functions.

Such integration enhances real-time financial control, strengthens audit trails, and enables the generation of performance dashboards that combine financial and service delivery indicators. Systems must be configured around standardised accounting principles and supported by trained personnel. From a policy perspective, this creates a bridge between financial compliance and outcome-based governance.

4) Human Resource Strategies

States need to invest in professionalisation of municipal finance cadres, including recruitment of qualified accountants, continuous training programmes, and career pathways within municipal services. External consultants should be used only strategically for system design and initial rollout, but long-term sustainability depends on building in-house expertise.

5) Citizen Interface

The ultimate beneficiaries of improved municipal accounting and audit systems are citizens. Public disclosure of audited financial statements, procurement contracts, and performance indicators transforms accounting data into a tool of democratic accountability.

Policy instruments should therefore mandate minimum standards for online publication of financial information and encourage the use of simplified, citizen-friendly formats. Participatory budgeting and social audit mechanisms can further strengthen the link between financial reporting and community oversight.

6) Continuity and Political Support

Reforms that enhance financial transparency often expose inefficiencies in revenue collection and expenditure management, generating political resistance. A realistic policy agenda must therefore incorporate stakeholder engagement strategies, including consultation with elected representatives, municipal associations, and civil society organisations.

Communication strategies that emphasise the developmental benefits of robust financial management—such as improved access to infrastructure finance and enhanced service quality—can help reframe reforms as enablers of political success rather than as administrative burdens.

2.5 Conclusion

To conclude, the overall policy challenge is no longer confined to persuading ULBs to adopt accrual accounting or to produce audited financial statements on a periodic basis. Rather, it lies in embedding accounting and audit within a broader, institutionalised public financial management ecosystem that supports strategic planning, performance management, and intergovernmental fiscal accountability on a sustained basis. These initiatives can enhance creditworthiness of ULBs to access the urban challenge fund to build Viksit Bharat by 2047.

Data Availability

None

Ethics Statement

This document meets the ethical guidelines and legal requirements of the country.

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Conflict of Interest

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