

Explanatory Note

Issue

Corporations Canada administers federal legislation governing non-financial corporations including business and not-for-profit corporations as well as cooperatives and boards of trades. Currently, not-for-profit organizations wishing to be a federal legal entity can incorporate under the *Canada Corporations Act* (CCA). The CCA has not substantially changed since 1917. It is antiquated and lacks modern corporate governance rules. Its financial disclosure provisions are weak, the duties and responsibilities of directors are ill defined, it does not provide a proper defence against liability, and the ability of members to scrutinize the activities of the corporation is limited. Several issues, including remedies and internal governance, are not addressed directly in the Act, but through administrative policies established by Corporations Canada

In response, *An Act respecting not-for-profit corporations and certain other corporations* (Bill C-4), which received Royal Assent June 23, 2009, will create the *Canada Not-for-profit Corporations Act* (NFP Act) to address the issues identified above with respect to the CCA. The new NFP Act contains leading edge provisions and will be modern framework legislation. These proposed regulations are needed in order to bring the NFP Act into force.

Objectives

The objectives of the proposed regulations are to implement modern corporate governance rules for not-for-profit corporations. Corporate governance is the process that a company uses to control its activities and set out the rights and duties of the board, managers, and shareholders/members.

The NFP Act is modeled on the *Canada Business Corporations Act* (CBCA), which embodies the most modern corporate governance rules. The new NFP Act provides the not-for-profit sector with rules to support sound governance and clarifies roles and responsibilities of board directors, members and officers and other interested parties.

Description

Bill C-4, which received Royal Assent June 23, 2009, will create the *Canada Not-for-profit Corporations Act*. That Act requires regulations before it can come into force because the Act specifies that certain details of its regime will be set out in regulations, including time periods, options for providing notice of members' meetings and absentee voting, and user fees.

A Governor-in-Council Order is required to bring the *Canada Not-for-profit Corporations Act* into force and it cannot be issued until the proposed regulations are ready to receive final approval. While separate steps, the regulatory and statutory provisions need to come into force at the same time because the Act cannot be in force without the regulations and the regulations cannot come into force without the regulatory authority in the Act.

The following are the significant provisions (i.e., significant changes from the CCA) in the proposed regulations, in the order that they appear in the proposed regulations:

- Definition of “soliciting corporation”;
- Corporate Records and Registers;
- Corporate Names
- Electronic Documents;
- Notice of Meetings of Members;
- Absentee Voting;
- Public Accountant and Financial Review; and
- User Fees.

Definition of “soliciting corporation”

The definition of “soliciting corporation” determines which corporations will be considered as soliciting for the rest of the Act. A soliciting corporation has five requirements that are different from non-soliciting corporations, which are:

1. soliciting corporations must have a minimum of three directors, two of which are not officers or employees of the corporation;
2. soliciting corporations may not have a unanimous member agreement;
3. soliciting corporation must send a copy of the corporation’s financial statements and public accountant report, if any, to the Director;
4. on liquidation the assets of a soliciting corporation must go to a “qualified donee” as defined by the *Income Tax Act*; and
5. the categories for financial review are partially determined by whether or not the corporation is a soliciting corporation (See the explanation of Public Accountant and Financial Review below for more information on the categories.).

According to the definition, a corporation becomes a soliciting corporation if in a financial year the corporation has received more than \$10,000 in gross annual revenues from:

- (a) requests for donations or gifts from non-members;
- (b) received grants or other similar financial assistance from a government; or
- (c) received donations or gifts from a corporation that would meet the definition of “soliciting corporation”.

A corporation will cease to be a soliciting corporation if the corporation has not received over \$10,000 in gross annual revenues from the sources listed above in any financial year ending in previous 36 months. A corporation becomes or ceases to be a soliciting corporation as of the day of an annual meeting of members.

Corporate Records and Registers

The proposed regulations set out the information required to be kept in the register of members, directors, officers and debt obligation holders. The requirements are similar to the information in the corporate books kept under the CCA. The information includes the name, address, e-mail

address and the date the person became and ceased to be associated with the corporation. For members and debt obligation holders, the address is a business or a residential address. For directors and officers, a residential address is required so that the person can be served with legal papers, if required. It also provides a contact point for the corporation other than the registered office address.

The proposed regulations also set out the information required to be recorded on a list of members or debt obligation holders (i.e., the name, address, class or group of membership and, for debt obligation holders, the aggregate principal amount of the debt obligation outstanding).

Corporate Names

The objective of the proposed regulations is essentially the same as the existing name regulations under the CCA. They are just worded differently. The objective of the proposed changes is to clarify the rules for the granting of names to not-for-profit corporations. The proposed regulations should be clearer and easier to read while resolving any concerns with the drafting language used in older versions.

The proposed approach to corporate name regulations is to first provide the provisions related to the interpretation of the regulations. The next set of provisions sets out the concept of “confusing names” and related provisions, including the exceptions to that concept. The following set of provisions is related to general prohibitions for corporate names (e.g. prohibition on the phrase “Parliament Hill” and on names connoting royal patronage). The final set of provisions concerns non-distinctive and deceptively misdescriptive names.

Electronic Documents

The proposed regulations fix the manner in which consent to electronic communication may be given (and revoked) and allow documents to be posted on websites provided the addressee receives notice about the location of the document. However, documents required by the NFP Act to be sent to a specific place, such as a registered office, cannot be posted on websites. When documents must be sent to several addressees, the proposed regulations state that the documents must be sent to the addressees at the same time. Documents may also be sent electronically to a specific information system instead of a specific mailing address. Finally, the proposed regulations clarify that an electronic document is considered to have been received when it enters an information system, such as a server, or when it is accessed by the addressee if made available through a website or other electronic source.

This part of the proposed regulations does not apply to documents or information sent to or issued by the Director. The Director administratively specifies how this information is communicated.

Notice of Meetings of Members

The proposed regulations set out four options for providing notice of a meeting of members. The by-laws are to set out the selected option or options. If the by-laws do not include an option,

there is a statutory default of sending (i.e. mailing by Canada Post or personal delivery) a notice to each member, between 21 and 60 days before the meeting. Each option also includes the time period for providing notice. The four options are:

1. notice sent by mail, courier or personal delivery, between 21 and 60 days before the meeting;
2. notice communicated by telephone or other electronic communication means, between 21 and 35 days before the meeting;
3. notice communicated via a publication:
 - a. at least once a week for three weeks prior to the meeting if using a newspaper; or
 - b. between 21 and 60 days if using a publication of the corporation that is distributed to members; and
4. notice affixed to a notice board not less than 30 days before the meeting.

This section also requires notice of the meeting to be sent (e.g., mailing by Canada Post or personal delivery) to the public accountant and directors of the corporation between 21 and 60 days before the meeting.

The section requires an alternative non-electronic option to be selected whenever an electronic option for providing notice of meeting is selected. This alternative method would only be used if a member requested a non-electronic copy of the notice of meeting. If a non-electronic alternative is not selected, then the corporation would be required to send (e.g., mailing by Canada Post or personal delivery) a copy of the notice at the request of a member.

Absentee Voting

The proposed regulations set out three options for absentee voting. The by-laws of the corporation set out the selected option or options, if any, to be used to allow members to vote. Each option also sets out the criteria for using that option. The options are:

1. voting by proxy with requirements for the form of proxy set out in the regulations;
2. voting by mailed-in ballots provided the corporation has a system to allow votes to be verified and not identify the member voting in the tally presented to the corporation; and
3. voting by telephone or other electronic means provided the corporation has a system to allow votes to be verified and not identify the member voting in the tally presented to the corporation.

Public Accountant and Financial Review

The NFP Act establishes five (5) categories of corporations for the purpose of the financial review of annual financial statements. The regulations set the dollar thresholds for each category. The financial review provisions are designed to balance oversight of corporations with the cost of conducting the financial review.

Each category has different permissible levels (i.e. a default type of review and possible optional types of review) of financial scrutiny from which the members can choose (i.e. audit engagement, review engagement or none). The categories and the permissible levels of financial scrutiny are:

- non-soliciting corporations with gross annual revenues less than \$1 million – the members can choose: not to appoint a public accountant; leave the level of review at the default of a review engagement; or raise the level of review to an audit engagement;
- non-soliciting corporation with gross annual revenues of \$1 million or more – the members have no choice other than an audit engagement;
- soliciting corporations with gross annual revenues less than \$50,000 – members can choose: not to appoint a public accountant; leave the level of review at the default of a review engagement; or raise the level of review to an audit engagement;
- soliciting corporations with gross annual revenues between \$50,000 and \$250,000 – the members can leave the level of review at the default of an audit engagement or lower the level of review to a review engagement; and
- soliciting corporations with gross annual revenues of more than \$250,000 – the members have no choice other than an audit engagement.

User Fees

Before the NFP Act can come into force, the fees and related service standards must first be established in accordance with the *User Fees Act* process, which is as follows:

1. Public consultation on the proposed fees and related service standards;
2. Publication of the Official Notice of Fee Proposal setting out the proposed fees and related service standards which provides a timeframe for clients to submit complaints. This notice is published after the public consultation period;
3. Creation of an independent complaint review panel, if complaints received cannot be resolved;
4. Tabling of the proposal in each of the House of Commons and Senate for 20 sitting days for review.

At the moment the fees have completed steps 1 and 2 of the *User Fees Act*. Consultations have resulted in two comments being received. The first one stated that the proposed fees, costing methodology and service standards were fair and reasonable. The second one also supported the fee proposal and service standards. The remaining steps of the *User Fees Act* process should overlap with consultation and pre-publication of the proposed regulations.

The proposed fees were determined in accordance with the process set out in Treasury Board's *Guide to Establishing the Level of a Cost-Based User Fee or Regulatory Charge*. The first step was to estimate the full cost of administering the new NFP Act using a methodology consistent with Treasury Board's *Guide to Costing*. Since the NFP Act was based on the *Canada Business Corporations Act* (CBCA), the costing for CBCA services provided the basis for the cost estimates for NFP Act services.

The proposed fees under the new Act will be the same as the fees charged under the CBCA. The services to be provided under the Act are similar to those under the CBCA which fees are already at a level that overall complies with the Treasury Board's guides.

Similar to the CBCA fees, some of the proposed fees take into account the cost of several related services (i.e. the services are bundled under one fee). This is the case where several

activities are interrelated. For example, instead of charging a separate fee for each action related to the incorporation process (e.g., issuing certificates, filing bylaws, entering information on the board of directors), one fee is proposed. Another purpose of bundling related services under one fee is to encourage and promote better compliance with legislative requirements. For instance, the annual return fee relates to the cost of filing an annual return as well as the costs of filing changes related to the directors and the registered office address. Imposing a fee to file a change related to the directors and the registered office address may discourage not-for-profit corporations from updating their information. Instead, the cost to administratively process those changes is included in the annual return fee. Our data indicates that almost all active not-for-profit corporations change their information at least once a year.

It should be noted that the total revenue from the proposed fees will not recover fully the costs of administering the NFP Act. This is because several of the CBCA fees are not at a level to fully recover the costs of those services since to do so would have a detrimental impact of the accessibility of the service. This same rationale applies for NFP Act services. If the fee level supported by the cost estimates would have been prohibitively high for the not-for-profit community, it was determined to charge the lower fee that is set out in the fee schedule under the CBCA. Such was the case for exemptions. The cost estimates suggested a fee level almost 20 times higher than the CBCA fee for exemptions. This fee level would significantly limit requests for exemptions, effectively denying the benefits to many not-for-profit corporations. Similarly, the annual return fee is proposed at the same level as the CBCA annual return fee even though cost estimates suggest charging a higher fee.

The proposed fees should not have a significant impact for not-for-profit corporations since the proposed fees for the high volume services - incorporation and filing of annual returns - are only slightly higher than the fees for letters patent and filing of annual summaries under the CCA. Once an online service is offered for these two services, the proposed fees will be lower when submitted electronically. While the fees under the CCA are slightly lower, it should be noted that these fees were set in the 1970's and are far below the costs of the services. For instance, using the same full costing methodology as prescribed by Treasury Board's *Guide to Costing*, issuing letters patents cost almost \$1000 in 2008/2009 and processing annual summaries cost \$70.

The proposed service standards under the NFP Act will greatly benefit federal not-for-profit corporations. Applications will be processed within 5 business days instead of 20 business days under the CCA.

Regulatory and non-regulatory options considered

Non-regulatory options were not considered because the NFP Act requires the details to be in regulations.

Consultation

Informal consultations on previous versions of the proposed regulations have been done while the various NFPC bills have been before Parliament. The proposed regulations were posted on Corporations Canada's website and were given to Members of Parliament during their committee

deliberations. Comments received either directly by Corporations Canada or made during hearings on the Bill have been considered as part of the drafting of the current version of the proposed regulations.

Before the NFP Act can come into force, the fees and related service standards must first be established in accordance with the *User Fees Act* process. That process requires public consultation on the proposed fees and related service standards. That consultation was held from January 4 to February 5, 2010, and resulted in two comments being received. The first response stated that the proposed fees, costing methodology and service standards were fair and reasonable. The second response also supported the fee proposal and service standards.

Implementation, enforcement and service standards

The NFP Act and regulations will be implemented together through a comprehensive outreach strategy that includes training and educating key representatives of the legal and not-for-profit communities as well as other government officials. It will be supported by a full complement of policies, pamphlets and other documents, available by paper and on the website, that will inform and assist those who are affected by the new legislation.

The NFP Act, like other modern corporate statutes, is designed to be primarily self-enforcing in nature. It provides members and other stakeholders with direct access to many previously unavailable remedies, such as the oppression remedy, derivative action and compliance orders. Members and stakeholders are generally considered to be in the best position to initiate and to pursue those remedies because they have first-hand knowledge of the issues. Affected parties, therefore, will be encouraged to resolve internal disputes through means available to them and not through the use of public funds, which is consistent with the federal government's responsibility to ensure that public funds are used appropriately. It should be noted, however, that the Director appointed under the NFP Act has the discretion to act in extraordinary cases that impact the greater public interest. This discretion will be exercised based on the consideration of such factors as seriousness of conduct, deterrence, and clarification of case law and availability of other remedies.

With regard to the new filing requirements under the NFP Act and regulations, Corporations Canada will encourage voluntary compliance, which is the most efficient and effective way to administer a corporate law regime. This will be done through education, user-friendly filing services and assistance. Voluntary compliance will be supplemented by initiatives that seek to identify and correct non-compliance, including examination and audits of corporate files. No additional resources are required.

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