The Business of Freelancing: Money

by Rhonda Bracey

Rhonda established her technical writing and consulting business – CyberText Consulting Pty Ltd – in 1999. She now runs her business from her home in rural Western Australia, and works remotely with clients all over the world.

In this article on money I'll try to answer questions technical writers have asked me about managing my business finances and money.

First, some disclaimers:

- I'm not an accountant, financial planner, business adviser, lawyer, banker, or a financial or legal professional in *any* jurisdiction—nor do I pretend to be. Please consult financial and legal professionals before using any information in this article.
- All opinions are my own, based on the experiences of running my small (micro) business since 1999. I have never run anyone else's business.
- The advice in this article assumes you are working as an independent contractor or freelancer, or something similar, rather than through an agency.
- Some terms used in this series of articles are specific to Australia, or just to Western Australia. In your state or country the same, or similar, concepts may be known by different names.
- In this article I'm assuming you have sufficient work to generate an income.

The Rules

There are two rules about money that I believe in strongly. All other advice in this article springs from these two rules.

Rule #1: You are in business to make a profit

You may want to save the world, have the best widget, or whatever. That's secondary to the real reason you're in business. You must make enough profit to provide for yourself and your dependents. If you don't, your business will fail.

Rule #2: Positive cash flow is king!

Positive cash flow means more money coming into the business than leaving it.

If you don't get paid, you can't pay your suppliers or creditors and they make take action to recover their money.

If someone's paying you for work, make sure you get their payment in time to pay your expenses. You will have large bills to pay every so often—such as tax or annual insurance premiums—so don't spend all the money you receive just because it's there. That's a slippery slope to financial ruin.

The rest of this article focuses on the "Top Ten" strategies I use to ensure that my business makes a profit and that I have a positive cash flow.

Strategy #1: Get professional advice

Each country has corporations law and tax laws. Knowing what you can and can't do is critical to the financial viability of your business and its longevity. A mistake that puts you in front of a law court can wipe out any gains, and it can also wipe you out professionally, personally, and psychologically. So seek professional advice. If you don't know where to get it, start with your accountant.

Make sure your accountant has small-business experience. You don't want a tax agent or a big name firm that deals with large corporations—you need someone who understands the issues facing small businesses like yours.

Don't scrimp and save on an accountant. A good one's advice may result in long-term profit that far outweighs their cost (remember Rule #1: Make a profit). Besides, an accountant's fees are tax-deductible.

Make sure your accountant has small-business experience.

Strategy #2: Keep your money separate

Keep your business and personal finances separate. Set up separate bank accounts, separate credit cards (if you use them) and separate shoe boxes or filing cabinet drawers for paperwork.

Why should you do this?

- It's easier to supply information at tax time.
- You can see the state of your business finances at a glance.
- Your daily or weekly management tasks are easier if you don't have to keep track of who owes what to whom.
- It deters you from spending the business's money on personal things, leaving the business short when a business expense occurs.
- Your accountant won't have to sort it all out and charge you accordingly.

If you're not disciplined enough to keep money aside for tax, ask your bank if they can do it for you.

Strategy #3: Invoice regularly

Regular invoicing makes you look professional and keeps your cash flow under control (remember Rule #2: Positive cash flow is king!).

Make sure your client knows your payment terms and billing methods (see Strategy #9) and agrees to them in writing before you start work (you do have a contract, don't you?). Will you invoice weekly, fortnightly, or monthly? Your invoicing cycle may depend on your contract.

Chase up each outstanding invoice with the person who you sent it to—it may be on their desk. Always keep a copy in case your invoice 'gets lost'.

I guarantee you will happily accept more work from those who pay you on time.

Let me tell you a story about Harry.

Harry engaged me to do a piece of work, on a colleague's recommendation. I did the work and mailed an invoice to Harry. Within *two days*, he'd paid me. I was so gobsmacked I called to thank him. He told me something that's stuck with me ever since. He said that paying immediately was his way of not only saying thanks and showing respect for my work (Harry's big on respect), but also ensuring that I'd think favourably of him when he wanted me to do more work. You know what? It worked!

Strategy #4: Pay your bills on time

Your creditors will love you for it, and if you ever have to delay paying a bill, they'll be more inclined to give you extra time if you're not a regular late payer.

Whether it seems fair or not, some creditors are more important than others—the tax office, for example. Make sure you pay them as soon as possible. There are severe penalties for defaulting on tax.

If you expect your customers to pay you on time, then offer the same respect to your suppliers.

If you can't pay on time, let your supplier know as soon as possible. Don't do nothing, hoping that things will get better. Take action—even if it's a simple phone call to explain the delay and offering a payment plan.

If things do get better, then pay your oldest creditors first or pay an amount off each creditor's bill.

Strategy #5: Pay yourself

Paying yourself is critical to your own financial survival. However, don't ever assume that your business income is your personal income to spend on whatever you want.

To deal with the ups and downs of business income, I pay myself a fixed salary, which doesn't vary no matter how much my business is bringing in or whether I've worked billable hours that month or not. It's nowhere near the gross income for my business. In good times, the business bank account is nice and healthy and it stays that way. It provides a buffer so I can continue paying myself the same salary even in lean times. My mortgage payments and other household bills don't get smaller just because my business income is less.

There will be lean times and you'll need to cover them. I try to have a buffer of at least three months' salary in the business bank account. Some advisers recommend six to twelve months.

Strategy #6: Set aside your tax obligations

You will have business tax to pay—nothing's more certain. And nothing's worse than finding you have no money set aside to pay your tax bill when it's due. Whether you like it or not, the tax office is one of your major creditors, and not paying them carries penalties ranging from hefty (and cumulating) fines to gaol.

Taxes you may have to pay include:

- PAYG (Pay As you Go) for your company's employees, including you
- GST (Goods and Services Tax), quarterly or annually. You pay the difference between GST in and GST out if it's in the tax office's favour; they pay you if it's in your favour
- Annual tax assessment
- Superannuation Guarantee Levy (remitted to employee Super funds).

Strategy #7: Use accounting software

Accounting software should produce customised invoices, keep track of payments made, log your time for billing, report aging receivables, and so on.

It doesn't matter what software you use, though make sure it can deal with GST if you're liable for it.

I use MYOB's Accounting Plus, as it provides for:

- time billing
- quotes, invoices, and statements
- GST
- quarterly BAS figures
- regularly updated tax tables from the ATO
- PAYG
- various reports such as Profit and Loss.

I pay around $300 for an annual support fee that covers new tax tables and software upgrades.

When it's time to do my taxes, I just zip up the MYOB file and email it to my accountant.

Strategy #8: Regularly keep track of your position

At any moment you should know what's been invoiced and is now due. Take these 'aging receivables' seriously. Chase up the client if the delay on a payment is getting out of your comfort zone. You don't want to have a $2000 bill to pay, $10,000 owing to you, and nothing in the bank. Remember *Rule #2: Positive cash flow is king*.

Set aside a regular time to administer your business. This could involve entering income, business expenses and time billing amounts into your accounting software package, reconciling bank statements, generating invoices or statements for overdue accounts, and running reports.

Whether you do this once a day or once a week depends on your business and how many concurrent clients you have. If there are only one or two, you could get away with doing it once a month. I spend between one and four hours per week on it, depending on the time of year. It's time well spent and it makes the end-of-year tasks much simpler.

Consider investing in a casual bookkeeper who checks your accounts every so often.

What should you do with late payers or non-payers?

Fortunately, I've had very few of these. Two were very persistent:

- Bad payer #1: After numerous invoices, statements and letters threatening legal action, I went to his home-based business and got the money from his wife.
- Bad payer #2: I continually sent reminders, phoned, and threatened legal action. *Eventually*, after lots of excuses, they paid too.

I won't work for either again. For the small amounts of money involved, it just wasn't worth it.

For clients I've never dealt with before, and for whom I have no prior or referred relationship, or who are overseas, I ask for 50% payment of the expected time up front in my PayPal account, with the other 50% on completion.

Set aside a regular time to administer your business....

It's time well spent and it makes the end-of-year tasks much simpler.

Strategy #9: Decide on a billing method

For a freelancer, there are two main ways to bill clients for work: by the project or by the hour.

Most of my clients want me available to do whatever they throw my way that's within my skills and available time. As a result, everything I do is by the hour. If I had to quote by the project, I'd spend much of my day updating quotes, chasing up sign-offs for scope changes, and so on. To keep the accounting easy, my hourly rate for a client is the same no matter what work I'm doing for them—for example, creating a website, editing a newsletter, or writing an installation guide.

I log my time in 15-minute blocks and provide the client with a detailed invoice that shows how long I spent on each task. This reduces the likelihood of a dispute.

Here's an example of a detailed invoice:

Date	Hours	Activity
19/03/2007	1.5	Set up and apply styles to Word doc; reformat
20/03/2007	0.25	email to to clarify layout issues
20/03/2007	1	Apply Word styles, define sidebars, apply headers and footers
21/03/2007	0.5	Email with update and first draft
21/03/2007	2.25	Re-create all figures, add to document, repaginate document as required
21/03/2007	0.5	Test PDF creation of document and print; make changes as required
26/03/2007	1	edits from ; republish to PDF and send for review
28/03/2007	0.25	Edit Figure 1 to add bullets
29/03/2007	0.5	final edits based on 's phone call; email master docs and PDFs for printing and web
30/03/2007	0.5	final edits from ; re-PDF'ing document

Strategy #10: Manage any surplus funds

If you have few expenses and steady clients (and thus a steady income stream) or your income stream has very high peaks, you should have surplus funds in the bank account.

Make sure you set aside money for expected expenses, including taxes, insurance premiums, known bills, replacement of equipment, and a three-month salary buffer.

Company tax is calculated on the profit for the financial year, taking into account any taxes already paid (such as the GST) and remitted to the tax office. If you haven't made a profit, then you shouldn't get a tax bill. But the whole point of business is to make a profit (see Rule #1). So how can you legally reduce the amount you'll be taxed on?

For a technical communicator, there aren't many deductible expenses if you're working from home or the client's site. Obviously there's your salary, equipment, software, insurances, internet connection, phone, and so on, but you may still be making a tidy profit. Paying yourself more could push you into a higher income tax bracket.

One option if you don't need the extra income for yourself now or in the foreseeable future is to 'salary sacrifice' into your Super fund, where it's taxed at 15% and helps build up your retirement nest egg. This is not the required Superannuation Guarantee Levy; rather, it's an extra pre-tax drop into Super.

What you do with surplus funds is up to you, but your age, future plans and the like will affect your decision. I strongly recommend that you first seek advice from your accountant (see Strategy #1). He or she should understand the implications of using business funds to invest, or be able to refer you to someone who does.