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The Gross Profit Method		LO9-2
Beginning inventory (from records)		\$ 600,000
Plus: Net purchases (from records)		1,500,000
Goods available for sale		2,100,000
Less: Cost of goods sold:		
Net sales at RETAIL	\$2,000,000	
Less: Estimated gross profit of 40%	(800,000)	
Estimated cost of goods sold* (CALCULATED)	(1,200,000)	
Estimated ending inventory (Residual)		\$ 900,000

\*Cost of goods sold can also be calculated as:  
 $\$2,000,000 \times (1 - 0.40) = \$1,200,000$

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~~COST~~

→ COST

× GROSS PROFIT 40%

ESTIMATED  
 CGS IS  
 CALCULATED  
 FIRST -  
 THEN  
 ENDING  
 INVENTORY IS  
 RESIDUAL

GP %

Key point

Illustration 9-4 Gross Profit Method

Suppose a company began 2021 with inventory of \$600,000, and on March 17 a warehouse fire destroyed the entire inventory. Company records indicate net purchases of \$1,500,000 and net sales of \$2,000,000 prior to the fire. The gross profit ratio in each of the previous three years has been very close to 40%. Illustration 9-4 shows how the company can estimate the cost of the inventory destroyed for its insurance claim.

Use Gross Profit  
 to estimate cost of goods sold  
 then ending inventory  
 is the residual