

Solution:

(1)

| Particulars | Effect on Fiscal Year | |
|---------------------|-----------------------|--------|
| | 2011 | 2010 |
| Beginning Inventory | O \$20 | N |
| Ending Inventory | N | O \$20 |
| Cost of Sales | O \$20 | U \$20 |
| Gross Profit | U \$20 | O \$20 |
| Income Before Taxes | U \$20 | O \$20 |
| Taxes on Income | U \$8 | O \$8 |
| Net Income | U \$12 | O \$12 |

(2)

The effect on retained earnings is an overstatement by \$12 million in fiscal 2010 and a corresponding understatement in fiscal 2011.