

**Solution:**

(1)

The changes are summarized as follows:

	2011	2012
Beginning Inventory	N	O \$20
Ending Inventory	O \$20	N
Cost of Goods Sold	O \$20	U \$20
Gross Margin	U \$20	O \$20
Income Before Taxes	U \$20	O \$20
Income Tax Expenses	U \$8	O \$8
Net Income	U \$12	O \$12

(2)

Retained earnings of 2011 will be understated by \$12 but the retained earnings of 2012 will be overstated by \$12.