**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.