**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.