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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

EXPERIMENTAL RATE AND SERVICE CHANGES TO IMPLEMENT NEGOTIATED SERVICE AGREEMENT WITH CAPITAL ONE SERVICES, INC.	Docket No. MC2002-2

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORIES OF OFFICE OF THE CONSUMER ADVOCATE (OCA/USPS–4-5)

The United States Postal Service hereby provides its responses to the following interrogatories of Office of the Consumer Advocate: OCA/USPS–4-5, filed on October 9, 2002. The response to OCA/USPS-3, filed the same day, will be provided as soon as the programming to extract the requested data can be completed and executed. It is expected that this can be done by October 25.

Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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October 21, 2002

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORIES OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-4. Please confirm that mailers that enter First-Class presort or automation presort mail are permit system mailers. If you do not confirm, please explain.

RESPONSE:

Confirmed for all but a small amount of such mail.

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORIES OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-5. Please provide the Postal Service's Fiscal Year (FY) 2003 Integrated Financial Plan.

(a) With respect to the FY 2003 Operating Plan, please provide the operating plan by accounting periods for Postal Service operating revenues, appropriations, investment income, expenses and volumes. Please provide your response in the same format as provided in response to OCA/USPS-T6-1(a) in Docket No. R2001-1.

(b) For each of the thirteen accounting periods presented in part "(a)" of this interrogatory, please provide the FY 2003 Operating Plan with operating revenues broken out by mail class and subclass cost categories. Please provide your response in the same format as provided in response to OCA/USPS-T6-1(b) in Docket No. R2001-1.

RESPONSE:

A copy of the FY 2003 Integrated Financial Plan is attached. The accounting period plan spread is currently being finalized and will not be available until after completion of the FY2002 financial audit.

UNITED STATES
POSTAL SERVICE

INTEGRATED FINANCIAL PLAN
FISCAL YEAR 2003

Operating Plan

Capital Plan

Financing Plan

PREFACE

The FY 2003 Integrated Financial Plan is shaped by the unprecedented events of FY 2002, which ends on September 30, 2002. The FY 2002 plan, formulated in August of 2001, was built on an already deteriorating economic outlook that was later acknowledged as a recession. The Postal Service had originally planned for revenues of $68.8 billion, with expenses of $70.2 billion, and a net loss of $1.35 billion for FY 2002.

The economic downturn was quickly exacerbated by the aftermath of the September 11th terrorist attacks. Economic activity in the country virtually ground to a halt. Transportation networks were disrupted for weeks. The Federal Aviation Administration imposed restrictions on mail flown on commercial airlines that continue today. The impact on the mailing industry was immediate. The last three weeks of FY 2001, which ended on September 30, 2001, saw volume declines of approximately 700 million pieces.

The Postal Service responded to the operational problems caused by transportation network disruption as quickly as possible. Nonetheless, service performance was impacted and additional costs were incurred.

In October 2001, the Postal Service found itself responding to yet another terrorist attack when the mail was used as the delivery method for bio-terrorist attacks. Two postal employees died as a result of exposure to Anthrax. By the end of October 2001, major mail processing and mail handling operations in the country's financial and political centers were shut down, or severely hampered. Employees and the public were naturally concerned about the immediate and long-term safety of the mail. Thousands of temporary shutdowns occurred due to hoaxes or legitimate concerns which turned out to be false alarms. The Postal Service responded by initiating widespread testing of facilities and employing irradiation services to sanitize the mail bound for Federal Government entities in Washington, D.C.

It was quickly apparent these events, coupled with a recession, would depress mail volumes for the remainder of FY 2002 causing a dramatic shortfall in revenue. The Postal Service developed a three-pronged response – manage declining workload by reducing work hours and employment through attrition, settle the R2001-1 Rate Case, and obtain funds from the federal government to offset terrorist impacts. Total expenses will be more than $2.5 billion below plan at year-end. Expense growth, estimated to be only 0.3 percent for FY 2002, will be the smallest expense increase in Postal Service history. Work hour reductions for FY 2002 will exceed 70 million, and there will be over 22,000 fewer career employees than at the beginning of the year. The Postal Service and major stakeholders in the pending R2001-1 Rate Case reached a negotiated settlement that enabled the Postal Service to increase prices on June 30, 2002 – three months ahead of the test year. The Postal Service also was appropriated funds to offset the immediate costs of the mail sanitization process, facility clean-up, and employee protection relating to the Anthrax attacks.

Although management expects to end FY 2002 with a smaller net loss than planned, it is estimated that revenues will be about $2.3 billion below plan and mail volume will decline 2.7 percent, or 5.5 billion pieces.

As FY 2003 begins, significant risks cloud the Postal Service's economic environment. Nonetheless, the Transformation Plan, released in April 2002, commits the Postal Service to substantial improvements in efficiency beyond the significant gains achieved over the last three years. These associated cost savings are a critical component of the FY 2003 Integrated Financial Plan. The underlying structural evolution of the American economy and the operational challenges created by the events of FY 2002 are the launch point for the Transformation Plan and the foundation of the FY 2003 Integrated Financial Plan.

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INTEGRATED FINANCIAL PLAN

FISCAL YEAR 2003

OPERATING PLAN

The FY 2003 Operating Plan was developed under the four phase *CustomerPerfect!sm* management cycle. The Establish Phase began in January 2002 followed by the Deploy Phase in March. The Implementation Phase will begin with the new fiscal year and the Review Phase is ongoing.

FY 2002 BASELINE ESTIMATES

Revenue and volume growth in FY 2002 were adversely affected by the economic slump and the shocks associated with terrorism. Estimated FY 2002 revenue growth is only 1.0 percent. Volume was most severely affected during Quarter I of FY 2002, when it declined nearly 6 percent. Volume for the year will be down 2.7 percent from FY 2001, a decrease of approximately 6 billion pieces of mail. Revenues were enhanced by the carryover impact of postage rate increases implemented in January and July of 2001. However, if the R2001-1 rate increase had not been accelerated pursuant to the settlement agreement and implemented on June 30, 2002, revenues would have declined about $300 million from last.

For FY 2002, total expenses of $67.7 billion will be about $2.5 billion under plan and 0.3 percent more than FY 2001 expenses. Management controlled expense growth in spite of severe operational disruptions and unanticipated mail security and transportation costs. In addition, higher labor costs, increased workers' compensation costs, and rising health benefit costs put upward pressure on expenses. Though mail volume declines of 2.7 percent are expected for FY 2002, 1.6 million more delivery points have been added to the delivery network.

FY 2003 REVENUE AND VOLUME

Revenue is projected to grow $3.9 billion over FY 2002 revenue. Approximately $3.1 billion of this growth is from the June 30, 2002 rate increase. The remainder, approximately $800 million, is due to forecasted volume growth.

Volume				
	FY 2002 Estimate	FY 2003 Plan	Change	% Change
First-Class	101,744	102,037	293	0.3
Priority	999	945	(44)	(5.4)
Express	62	59	(3)	(4.9)
Periodicals	9,648	9,442	(206)	(2.1)
Standard Mail	87,045	90,870	3,825	4.4
Parcel Post	367	370	3	0.8
Other Package Svcs.	709	707	(2)	(0.3)
International	866	801	(65)	(7.4)
Other Mail	483	451	(32)	(6.4)
Total Volume	201,923	205,682	3,759	1.9
(Pieces in Millions)				

The economy appears to be moving out of a relatively short and shallow economic recession. Further, a deeper and longer (18 month) advertising recession also appears to be coming to an end. These positive influences typically would lead to strong volume and revenue rebounds. However, these positive forces are muted by the impacts of the June 30 rate increases and the continued diversion of transactions and correspondence mail to electronic alternatives. The net result is a projected FY 2003 volume growth of 1.9 percent, to 205.7 billion pieces. Virtually all projected volume growth is in Standard Mail. Projected total volume is below the peak volume of 207.9 billion pieces delivered three years earlier, in FY 2000.

The economy may rebound, but the forecast reflects the negative impact of growing Internet use as an alternative to First-Class Mail. Based on that, First-Class Mail, forecasted to grow only 0.3 percent, will lag any economic recovery. Continuing volume declines are projected for Priority Mail and Express Mail, reflecting the impact of price increases on these price sensitive product lines. Standard Mail is projected to rebound with the end of the advertising recession. There will be little change in Package Service volumes. Declines in Periodicals volume and International volume are projected to continue in FY 2003.

Forecasts and Related Revenue Impacts

The volume and revenue forecast underlying the plan was built using DRI*WEFA's June 2002 baseline macroeconomic projections. Since June, the tilt in economic forecasting has become more pessimistic. This tilt is reflected in the Federal Reserve policy statement released on August 13, 2002 by the Federal Open Market Committee. It states, "The risks are weighted mainly toward conditions that may generate economic weakness." It is therefore possible that the volume and revenue forecast, which is believed to be based on conservative economic assumptions only a few weeks ago, could be more challenging than anticipated. Should the economy stall, significant negative impacts to postal finances will result.

Revenue

	FY 2002 Estimate	FY 2003 Plan	Change	% Change
First-Class	$ 36,287	$ 38,159	$1,872	5.2
Priority	4,751	4,940	189	4.0
Express	927	944	17	1.8
Periodicals	2,188	2,320	132	6.0
Standard Mail	15,882	17,488	1,606	9.9
Parcel Post	1,189	1,207	18	1.6
Other Package Svcs.	897	937	40	4.5
International	1,552	1,490	(62)	(4.0)
Other Revenue	2,865	2,953	88	4.8
Total Revenue	$ 66,538	$ 70,438	$3,900	5.9

($ Millions)

Overall, revenue is projected to grow $3.9 billion, or5.9 percent. The revenue growth for First-Class Mail, Priority Mail, Express Mail, Periodicals and Package Services primarily reflects the June 30 rate increase. The projected revenue growth for Standard Mail is attributable to the impact of rate increases and volume growth. The projected decrease in International revenue relate to volume losses. The planned increases in Other Revenue are generated by increases in the fees for Special Services and postal box rents.

The Postal Service will employ several initiatives and enlist all employees to build Postal business and generate growth that will exceed this revenue forecast.

EXPENSE

In FY 2003, total expenses are budgeted at $69.8 billion, which is 3.2 percent more than FY 2002 estimated expenses.

FY 2003 Expenses

	FY 2002 Estimate	FY 2003 Plan	Change	% Change
Field	$ 53,711	$55,529	$1,818	3.4
Corporate Transportation	3,227	3,164	(63)	(2.0)
Corporatewide Activities	2,361	2,417	56	2.4
Interest	1,958	1,997	39	2.0
HQ Administrative	1,307	1,307	(1)	(0.1)
OIG and PRC	124	137	13	10.7
Servicewide	5,001	5,288	287	5.7
	$ 67,688	$69,838	$2,150	3.2

($ Millions)

Field Expense

Field expenses will increase by $1.8 billion in FY 2003, with most of the increase due to inflation in salaries and benefits, and the increase in the number of deliveries next year. The growth in field costs will be restrained by $961 million in cost reductions. See "Cost Reduction Programs" on page 6 for specific details. Also, $59 million has been trimmed from administrative work hour expense growth at the Area and District offices.

The total work hours in FY 2003 will be reduced 30 million from the FY 2002 year-end estimate. This will be the fourth consecutive year that the Postal Service has reduced work hours. Work hours were reduced by 12 million in FY 2000, followed by a 23 million reduction in FY 2001, and an estimated reduction in excess of 74 million work hours in FY 2002. The FY 2003 work hour reduction target is equal to over 16,000 full-time equivalent employees.

Headquarters Expense

Headquarters expense includes the headquarters organizations and their field support units, and the Postal Inspection Service. Headquarters administrative costs of $1.3 billion represent no growth from the FY 2002 estimate. In FY 2002, inflationary cost pressures were absorbed through staffing reductions, and other cost controls. This will continue in FY 2003 when Headquarters administrative expenses will be below FY 2001 levels.

Programs and Corporatewide Expense

Program and Corporatewide activity costs are budgeted at $2.4 billion in FY 2003, which is the same level of spending as FY 2002. Almost three quarters of the program and corporatewide activity budget is devoted to ongoing activities that represent legal or contractual requirements or are needed to support operations. These include: Mail Transportation Equipment Service Centers at $313 million, the purchase of Mail Transportation Equipment at $120 million, Stamp Manufacturing at $138 million, and Point-of-Service (POS) ONE at $93 million. (See the table below for the top ten programs.)

Maintaining the same spending level as FY 2002 in FY 2003 will be achieved by offsetting increased spending for major initiatives with reductions in lower-priority items. This prioritization effort is influenced by Transformation Plan strategies. Major initiatives receiving a boost in spending in FY 2003 include financial recordkeeping and reporting systems ($57 million), upgraded information technology ($28 million), initiation of an ESOP for EEO investigations ($20 million), and the development of *PostalOne!* ($17 million). Although each of these initiatives requires substantial upfront investment, the fact that we are undertaking them during an era of unprecedented fiscal restraint testifies to their importance to our long-term operations.

The FY 2003 total program spending actually represents a decrease of $54 million from what was originally planned for FY 2002. The FY 2002 program spending was reduced or postponed by over $100 million to offset the impact of the revenue shortfall.

Major Program Spending
Top Ten Programs FY 2003

Program	FY 2002 Estimate	FY 2003 Plan	Change	% Change
Mail Transport Equip Service Ctrs.	$ 308	$ 313	$ 5	1.6
Stamp Manufacturing	140	138	(2)	(1.4)
Mail Transportation Equipment	145	120	(25)	(17.2)
Corporate Advertising	137	99	(38)	(27.7)
Point-of-Service	117	93	(24)	(20.5)
Expedited Supplies	110	86	(24)	(21.8)
Corporate Contact Management	90	82	(8)	(8.9)
Delivery Confirmation	75	80	5	6.7
Debit/Credit Card Fees	72	74	2	2.8
Associate Office Infrastructure	57	70	13	22.8
	$ 1,251	$ 1,155	$ (96)	(7.7)

($ Millions)

Servicewide Expense

Servicewide expenses are national-level expenses that cannot be isolated and charged to individual operating units and are outside local management control. These expenses are expected to increase by $287 million in FY 2003. This increase is largely driven by workers' compensation, annuitant health benefits and unemployment compensation.

In FY 2003, benefiting from continued low interest rates, interest expense on debt will be about $385 million, an increase of $22 million over FY 2002. In addition, the current portion of the interest expense on Civil Service Retirement System (CSRS) deferred retirement liabilities is expected to increase by $17 million and total $1.6 billion.

Expense by Component

To gain a different perspective on the FY 2003 Operating Plan, expense growth can be examined by component. Personnel expense, including annuitant and workers' compensation costs make up $1,572 million, or 73 percent, of the FY 2003 expense growth. Growth in salaries and benefits is driven by wage inflation and is not a result of growth in work hours which, in fact, are planned to be reduced in FY 2003. Health benefit inflation, which had been relatively stable through the end of FY 1999, rose by double digits (10 percent) again in FY 2002 and is forecasted to rise 14 percent in FY 2003. Health care inflation also contributes to the increase in workers' compensation expense that is expected to continue into FY 2003. Workers' compensation expense rose by over $500 million in FY 2002 and is expected to total approximately $1.6 billion in FY 2003, an increase of approximately 5 percent. The FY 2002 increase resulted from an 8.6 percent increase in the number of paid compensation claims along with an 8.5 percent increase in the average cost per medical claim.

FY 2003 Expense by Component				
	FY 2002 Estimate	FY 2003 Plan	Change	% Change
Personnel	$ 51,449	$ 53,021	$ 1,572	3.1
Non-Personnel	9,091	9,623	532	5.8
Transportation	5,190	5,197	7	0.1
Interest	1,958	1,997	39	2.0
Total Expense	$ 67,688	$ 69,838	$ 2,150	3.2

($ Millions)

Non-personnel expense growth in FY 2003 is primarily driven by the investments in program initiatives to update and improve financial reporting and information technology capabilities. Other drivers include depreciation and anthrax costs not reimbursed by the federal government. Deploying capital investments that were committed in prior years will increase depreciation expense by $194 million, or 8.3 percent in FY 2003.

National network transportation, which accounts for over 60 percent of total transportation costs, was significantly impacted by the events of September 11th in FY 2002. Priority Mail was diverted from commercial air carriers due to government regulations restricting the carriage of certain types of mail by passenger airlines. This had a negative impact on transportation savings as supplemental private air carriers were used to transport displaced commercial air mail. Later in FY 2002, our agreements with FedEx were amended due to the continued inability to use commercial air transportation for the expedited package business. This action shifted a greater percentage of Priority volume to the FedEx network. Continuing efforts to reduce the cost of the transportation network, by shifting a greater percentage of transportation from air to ground and rationalizing the network, will reduce transportation costs to $3.2 billion which is nearly $60 million below FY 2002 levels. (See "Cost Reduction Programs" below.) Total transportation expenses will be held to nearly FY 2002 levels due to volume decreases in price-sensitive product lines, savings as a result of the FedEx contract, reductions in terminal dues and operational efficiency gains.

COST REDUCTION PROGRAMS

The FY 2003 budget includes $961 million in cost reductions that are detailed in the table at right. The benefits are spread across several operational pro-grams and productivity initiatives including Breakthrough Productivity (BPI). Operational program reductions total $192 million and are targeted entirely at the field. Roughly 40 percent of the program savings in FY 2003 will come from automated flat-sorting machines. Operational efficiencies include $673 million in cost reductions targeted at disseminating best practices throughout the field. Finally, actions will be taken to capture $33 million in reduced mail volume workload.

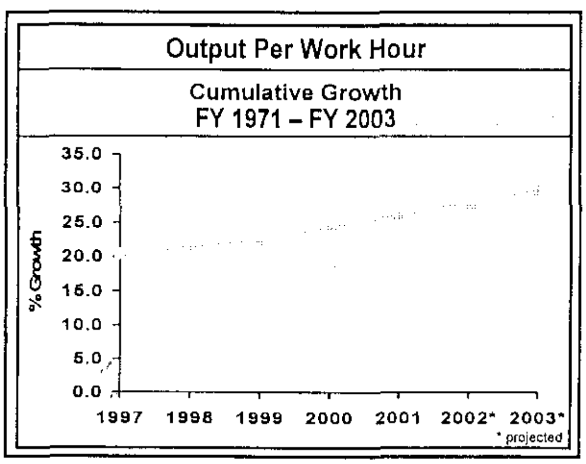
FY 2003 Cost Reduction Overview

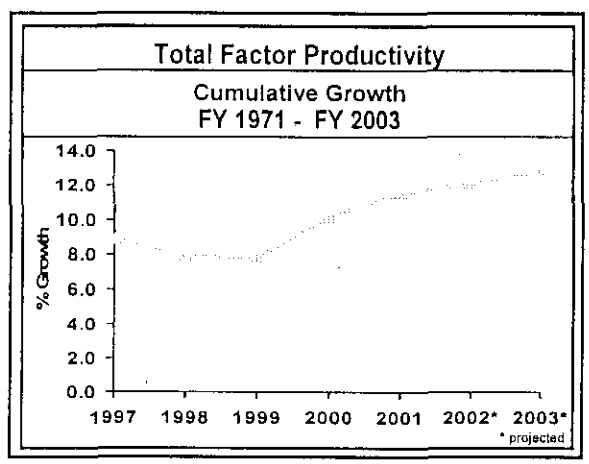
Activity	Savings	Total
Capital Investments:		
Advanced Flat Sorting Machine 100	$ 80	
SAFR - Shared Services / Accounting	24	
Automated Feeders & OCRS	19	
Bar Code Sorting	23	
Recognition Improvement	12	
Letter Recognition Enhancement	11	
AFCS Video Facing Modification	11	
Singulate, Scan, Induction	10	
Other	10	$ 192
Other:		
Operational Efficiency Gains	$ 673	
Transportation	63	736
Total Cost Reductions:		$ 928
Reduced Mail Volume Workload	33	
Total Savings:		$ 961

($ Millions)

PRODUCTIVITY

Output Per Work Hour measures the change in the relationship between workload (mail volume and deliveries) and the labor resources used in producing those outputs. Total Factor Productivity (TFP) measures the change in relationship between outputs, or workload, and all resources used in producing those outputs. It is not uncommon for TFP growth to fluctuate from one year to another. During FY 2002, Output Per Work Hour is expected to grow 1.7 percent and TFP is projected to grow 0.6 percent. Projected TFP growth is equivalent to $420 million in expense reductions. FY 2002 marks the third consecutive year of positive TFP growth, with equivalent expense reductions totaling almost $3 billion over this time period. Productivity growth continues to be fueled by substantial restraint on resource usage. FY 2002 will mark the second year of positive TFP growth in the face of declining workload. In





earlier years, strong TFP growth was fueled largely by absorbing workload growth. The charts above show the cumulative growth since Postal Reorganization in Output Per Work Hour and Total Factor Productivity for the years 1997 through 2003. Since 1971, Output Per Work Hour and TFP will have grown 29.9 percent and 12.8 percent, respectively.

The FY 2003 financial plan assumes a 1.9 percent increase in Output Per Work Hour and a 0.7 percent TFP growth rate. This is in spite of a small increase in workload (0.2 percent), which is entirely attributed to the expanding delivery network.

NET INCOME

Total revenue is estimated to grow 5.9 percent, from $66.5 billion to $70.4 billion. Total expense will grow 3.2 percent, from $67.7 billion to $69.8 billion. Net income for FY 2003 is $600 million.

FY 2003 Operating Budget

	FY 2002 Estimate	FY 2003 Plan	Change	% Change
Revenue	$ 66,538	$70,438	$3,900	5.9
Expense	67,688	69,838	2,150	3.2
Net Income (Loss)	$ (1,150)	$ 600	$ 1,750	

($ Millions)

Net Income and the Rate Case

The June 30, 2002 price changes referenced above were a result of the R2001-1 Rate Case approved for filing by the Board of Governors on September 10, 2001. The filing set rates to "breakeven" in the FY 2003 test year, which is the same year addressed in this Integrated Financial Plan. The table below compares the Operating Plan projections and the rate case test year projections produced eleven months ago. The rate case projections covered projected expenses, plus a 3 percent contingency provision and an allowance for the recovery of prior years' losses.

Since the development of the data used in the rate case, filed less than 11 months ago, projected revenue has decreased by $4.4 billion due to the impacts of the national economy, terrorist activities, and mailing industry conditions. This under-run in revenue is double the $2.2 billion provided in the rate case for contingencies. Expenses will be reduced to capture $2.2 billion not covered by the contingency provision. Thus, before the rate case test year has even started, the contingency provision will have been consumed.

Some have questioned the necessity of a rate case contingency provision as large as 3 percent. Recent experience as presented in this table suggests that those questions are not well founded and that a contingency provision is necessary to protect against unforeseen adversities.

FY 2003
Operating Plan Versus Rate Case

	FY 2003 Plan	Rate Case	Variance
Revenue	$ 70,438	$74,800	$ (4,362)
Expense	69,838	72,000	(2,162)
	$ 600	$ 2,800	
Contingency	- 0 -	2,200	$ 2,200
Net Income	$ 600	$ 600	

($ Millions)

CAPITAL INVESTMENT PLAN

The FY 2001 and FY 2002 plans for capital commitments were significantly reduced to minimize cash outlays. This action was necessitated by the impact of the soft economy on postal revenue and the corresponding declines in cash from operations. Accordingly, the FY 2003 capital commitment plan reflects continued constraint on new capital commitments. The Fiscal Year 2003 capital commitment plan totals $2.5 billion. Capital investments will focus on funding projects that provide a positive return on investment, and address infrastructure necessities.

FY 2003 CAPITAL COMMITMENTS

The FY 2003 capital commitment plan of $2.5 billion is driven by the strategic focus outlined in the Transformation Plan and those items that can be accommodated within affordability constraints. The capital investment plan supports improved efficiency through automation and mechanization projects that apply to distribution, processing, and delivery systems. Also included are projects that improve the quality of customer interactions. Investments in support equipment will be necessary to accomodate delivery network growth, to repair or replace aging assets, and to provide necessary information and communications technology networks. The current portfolio of capital investment opportunities is expected to produce an overall positive return on investment. As information, the Board of Governors previously approved approximately $335 million of the $2.5 billion commitments. According to their bylaws, the Board of Governors must approve the capital budget each year. This approval represents a general concurrence with the capital investment plan. In addition, following a rigorous and in-depth review by management, each capital investment greater than $10 million is presented to the Board of Governors for review.

Capital Commitments FY 2003

	FY 2002 Estimate	FY 2003 Plan
Automation/ Mechanization	**$ 854**	**$ 938**
Facilities	**233**	**755**
Support Equipment	**247**	**431**
Retail Equipment	**12**	**210**
Vehicles	**127**	**191**
Total	**$1,473**	**$2,525**

($ Millions)

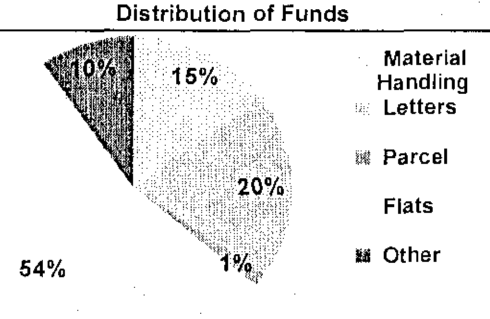
The capital plan major categories are summarized below.

Automation and Mechanization

The FY 2003 capital commitment plan for automation/mechanization equipment is $938 million or 37 percent of the total plan, for programs that generate reduced operating costs. The chart at right reflects the percentage of funds in the plan for automation/mechanization equipment tied to handling equipment or mail types. Automated equipment not only saves work hours and associated indirect costs but also improves efficiency and service quality. Automation provides management with data-gathering capabilities that can be used in future information-based services. In the FY 2003 capital commitment plan, approximately 54 percent of the automation/mechanization equipment portion of the plan is dedicated to flats processing. For example, the Automated Handling System (AHS) is expected to yield savings by eliminating the manual removal, labeling and replacement of flat mail trays on the Automated Flat-Sorting Machine 100 (AFSM100). Other major automation

Capital Commitments FY 2003

Automation and Mechanization Distribution of Funds



projects directed towards the processing of flat-mail volume include the Flats Optical Character Reader, the Flats Identification Code Sort, and the Flats Feeder Enhancements program.

Letter mail processing equipment represents approximately 20 percent of the automation/mechanization category. The Delivery Bar Code Sorter Input/Output Sub-System (DIOSS) program, which replaces outmoded Multi-line Optical Character Reader Machines, includes benefits such as improved productivity and significant reductions in maintenance costs.

Low cost tray sorters are the primary piece of equipment in the Material Handling segment which represents roughly 15 percent of the automation/mechanization major investment category. Another segment, which is 10 percent of this category, is to support ongoing automation/mechanization programs, which include environmental and energy conservation projects. Finally, the package segment represents roughly 1 percent of the capital commitments for this category. This will involve deployment of the Automated Package Processing System (APPS) and the Bulk Mail Center Singulate, Scan, Induction Unit (SSIU) projects.

Facilities
In FY 2003, the planned commitments for facilities projects total $755 million. Consistent with the constraint on new commitments, rather than build new facilities, management will optimize the use of existing space whenever possible and avoid investing in more costly new construction. The customer service facility infrastructure must be maintained to support growth in delivery points.

In the last two years, facility-related investments were limited to those which addressed emergency, safety, and legal issues; modifications to ongoing construction; planning funds for a small number of major projects; and opportunities for revenue generation by selling assets or significant savings. In FY 2003, the criteria are expanded to address high growth areas, facility obsolescence, and necessary maintenance of our real property assets. Projects will be considered on a case-by-case basis. Pending project approval by the Board of Governors, funding is also included for the Philadelphia, Pennsylvania, Processing and Distribution major facility project.

The Postal Service is currently in the process of evaluating the overall network and the results of that evaluation are expected to impact the current infrastructure, including facilities. Therefore, plans beyond FY 2003 will assume the expanded criteria for facility-related investments.

Support Equipment
Capital commitments in the support equipment category total $431 million. These investments include communications equipment, network systems, and information technology needs as well as daily operating equipment such as scissor lifts, forklifts, and tow motors. The *PostalOne!* Phase Two implementation project is an example of a support equipment system-related investment. During this phase, full postage statement generation capabilities will be developed that will help protect revenue at acceptance and verification by flagging improperly prepared mail.

The Advanced Computing Environment (ACE) ongoing infrastructure replacement initiative is addressed in the plan and reflects the transition to a more centralized and controlled approach to information technology infrastructure. The General Ledger project is another support system-related investment. It is designed to replace the existing antiquated system, to provide the capacity for cash reporting and to modernize the accounting systems with best business practices.

Retail
In FY 2003, $210 million is earmarked for the final phase of Point-of-Service (POS) ONE. When fully deployed, POS ONE will capture detailed sales and customer information at all First-Class post offices. This, when integrated with the technology platform, will assist in reducing workload, integrate debit/credit card functionality, provide inventory management, enable automatic reordering, and provide post office box administration capability.

Vehicles
In FY 2003, the planned commitments for vehicles total $191 million. These funds include $163 million for the purchase of cargo vans, which are used for transporting mail between processing mail centers. The remaining funds are for commitments associated with carrier route vans, plus vehicle security and auxiliary equipment.

FY 2003 CAPITAL CASH OUTLAY PLAN

The FY 2003 plan calls for approximately $2.0 billion in cash outlays. Approximately $1.2 billion of the planned outlays in FY 2003 relate to commitments made in prior years. The remaining $800 million planned cash outlays are attributed to new commitments to be made in FY 2003.

Capital Cash Outlays FY 2003

	FY 2002 Estimate	FY 2003 Plan
Automation/ Mechanization	**$ 881**	**$ 682**
Facilities	**373**	**574**
Support Equipment	**244**	**279**
Retail Equipment	**54**	**204**
Vehicles	**125**	**244**
Total	**$1,677**	**$1,983**

($ Millions)

FINANCING PLAN

The Financing Plan is integrated across fiscal years with the Operating and Capital Plans. With numerous uncertainties facing the Postal Service, a multi-year strategic view of our financing needs is required, especially in light of the statutory limits on our debt. By statute, total debt outstanding cannot exceed $15 billion. In addition, annual increases are limited to $2 billion for capital purposes and $1 billion for operating purposes. The annual change in debt within a fiscal year is driven by the interaction of cash flow from operations, capital cash outlays, and changes in our cash balance. In recent years, cash outlays for capital have been greater than cash flow generated from operations and debt has increased. The FY 2003 plan projects the first reduction in debt since FY 1997.

FY 2002 Borrowing

Last August, when the FY 2002 Plan was formulated, management contemplated financing our capital outlays by reducing cash by $400 million and borrowing $1.6 billion. Since then, a number of influences both negative and positive have significantly altered our projected borrowing needs for the year. On the negative side, we had the economic recession coupled with multiple acts of terrorism. However, on the positive side we had offsetting developments that served to increase our cash flows. Positive influences included stringent expense control measures, the early implementation of rates, emergency appropriations, and reduced capital spending. On balance, these positive factors outweighed the negative influences. FY 2002 borrowing needs total approximately $700 million. (See table) Assuming a net loss of $1.2 billion, cash flow from operations will be approximately $600 million. This amount does not include the unspent portion of the emergency appropriations that will be properly set aside until used. The reduced outlays for capital are estimated at $1.7 billion and cash will be reduced by $400 million. Management remains committed to borrowing only amounts necessary to ensure liquidity.

Financing Plan

	FY 2002	FY 2003
Cash from Ops	$ 0.6*	$ 2.8
- Capital Cash Outlays	1.7	2.0
+ Cash Reduction	0.4*	0.0
= Borrowing	0.7	(0.8)
Debt Outstanding	$ 12.0	$ 11.2

($ Billions)

****does not include undisbursed emergency appropriations***

FY 2003 Debt Repayment

For FY 2003, management projects that cash flow from operations will be $2.8 billion based mainly on net income and (non-cash) depreciation expenses. Capital cash outlays will increase modestly to $2 billion. There are some payments to be made early in the new fiscal year that were accrued in prior years. Additionally, the undisbursed portion of the emergency appropriations should remain part of reported cash balances until disbursed. These factors will prevent debt reduction in the early part of FY 2003. Nevertheless, FY 2003 remains a year whereby meaningful debt reduction of approximately $800 million should be accomplished. In conclusion, management will not seek a Board Resolution authorizing an increase in debt for FY 2003. However, a resolution authorizing management to substitute long-term debt for short-term debt as appropriate to manage liquidity, interest expense, and interest rate risk will be necessary.

On a cautionary note, the cash flow figures can be no more than approximate, since they are based on underlying assumptions and judgments regarding cash versus non-cash expenses and changes in working capital accounts. In addition, risks to the net income plan translate into risks to cash flow from operations that could lessen the amount of debt reduction.

FINANCIAL SUMMARY

The chart below shows the critical elements of the financial condition for FY 2002 and FY 2003. The first four lines of this chart reflect the generation of cash from operations as outlined in the Operating Plan. Cash flow from operations will total $2.8 billion in FY 2003. The next line in the chart shows anticipated capital cash outlays. The difference between cash flow from operations and capital cash outlay, net of any planned changes to cash on hand, is the amount needed to borrow, or the amount available to repay debt. The remainder of this chart provides additional information on the Postal Service's financial condition. Debt represents the expected outstanding debt at the end of each fiscal year. The capital commitment plan reflects the estimated new capital commitments in each year. The equity amount -- the sum of contributions from the federal government and prior years' losses -- is shown in the last line of this chart.

Board Resolution 95-9, concerning restoration of equity and recovery of prior years' losses, established a policy of planning for net incomes that "equal or exceed the cumulative prior years' loss recovery target" set in the last omnibus rate proceeding. Due to accumulated impacts of earlier net incomes that exceeded annual targets, the Postal Service entered FY 2002 $1.1 billion ahead of the cumulative target. The projected net loss of $1.2 billion in FY 2002 combined with net income of $600 million in FY 2003 will leave the Postal Service nearly on target to achieve this goal.

Because cost levels are expected to continue to rise in FY 2004 and considerable lead time is required to prepare and litigate rate filings, management will be briefing the Board of Governors on options for phasing in rate increases during Fiscal Years 2004 and 2005. These options will be consistent with plans discussed with representatives of the Postal Rate Commission and various stakeholders at the Ratemaking Summit sessions held in May and June of this year.

Financial Summary FY 2003

	FY 2002 Estimate	FY 2003 Plan
Net Income	(1.2)	0.6
Depreciation	2.3	2.5
Adjustments	0.5	(0.3)
Cash Flow From Operations[1]	0.6	2.8
Capital Cash Outlay	1.7	2.0
Cash Reduction[1]	0.4	(0.0)
Net Borrowing	0.7	(0.8)
Debt	12.0	11.2
Capital Commitment Plan	2.4	2.5
Equity	(3.5)	(2.9)
Prior Year Losses	(6.6)	(6.0)

($ Billions) [1]Does not include undisbursed emergency appropriations

RISKS

The FY 2003 Integrated Financial Plan is the product of an extensive development process, during which numerous scenarios were examined. Management has established a solid foundation for achieving the plan. Aggressive actions to manage expenses in response to the declining volume during FY 2002 have been successful. However, the $600 million net income in the FY 2003 represents less than a one percent margin over costs. Therefore, risk factors must be acknowledged.

Revenue

New rates were implemented in June 2002, impacting all domestic classes of mail and special services. Historically, mail volume growth has slowed after a rate increase. Other factors, such as a weak economic recovery and migration of mail toward lower-contribution categories could compound the normal post-rate slowdown in growth.

Economic Risk

The DRI*WEFA forecast assumes economic growth of 3.0 to 3.5 percent, annually, during the first two years of the new economic expansion and that corporate profits will grow 6 to 7 percent, on average. The DRI*WEFA forecast reflects an assumption that wealth effects from increases in the value of owner-occupied housing have offset the negative equity impacts from stock market declines. If, however, the stock market continues to tumble, consumer confidence may be shaken to the point where a reduction in consumer demand causes the economic recovery to stall. This presents significant dangers and risks to the Postal Service's economic environment for FY 2003.

The uncertain direction of the U.S. economy presents the greatest external risk to achieving the plan. The Commerce Department recently revised its estimates of Gross Domestic Product for 1999 – 2001, indicating that the economy was, in fact, in recession during the first three quarters of calendar year 2001. It also showed that economic growth in the two most recent complete quarters had been weaker than initially believed. Some economists are forecasting that the economy could suffer a "double-dip" recession, although this is a decidedly minority viewpoint. A more likely scenario is that economic growth will continue to be slow and uneven well into 2003. Corporate profits, which are a driver of advertising expenditures, may not materialize if productivities from cost savings cannot be maintained or if global deflation limits price increases. Also, the recent stock market slump, if prolonged, could erode wealth and restrain consumer spending, which in turn will restrain economic growth. Mail, particularly advertising mail, is particularly sensitive to economic conditions. Recovery in mail volume has historically tended to lag improvement in the economy by several months. It is therefore possible that the volume and revenue forecast, which we believed to be based on conservative economic assumptions only a few weeks ago, could be more challenging than we believed. Should the economy stall, significant negative impacts to postal finances will result.

Inflation

Inflation has generally been moderate in recent years, except for a spike in fuel costs in FY 2001. Fuel costs, of course, are subject to wide fluctuations due to world-wide political and economic events. Any significant upward movement in fuel costs will adversely affect our financial results. Most of our bargaining employees receive cost-of-living adjustments based on changes in the consumer price index. Since most economists are forecasting low levels of inflation for the foreseeable future, there is a relatively low risk that inflationary pressures will impact labor costs.

Health Benefits Costs

After several years of moderate increases, health care inflation returned with a vengeance in 2000. Since then, health benefits premium increases for the Postal Service have been about 11 percent each year. The plan for FY 2003 incorporates an expected increase of 14 percent. The actual will not be known until January 2003.

Aggressive Work Hour Reductions

The FY 2003 operating budget calls for a fourth consecutive year of work hour reductions. Since FY 1999, the Postal Service has eliminated over 105 million work hours. It is expected that work hours will be reduced by 30 million more in FY 2003. During this same time period, we have added over five million daily deliveries. Work hour reductions in FY 2003 rely primarily on process improvements, rather than capital investment programs. As the work hour mix becomes more heavily weighted toward deliveries, it becomes more challenging to realize efficiencies.

As always, the potential for the occurrence of unplanned events, such as natural disasters which could adversely impact the Postal Service's finances, must be acknowledged as a risk.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

Scott L. Reiter

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October 21, 2002