UNITED STATES
POSTAL SERVICE

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

February 21, 2003

Hon. Steven W. Williams, Secretary
Postal Rate Commission
1333 H Street, NW, Suite 300
Washington, D.C. 20268-0001

Dear Mr. Williams:

In connection with the Commission's rules pertaining to periodic reports, 39 C.F.R § 3001.102 (2002), I have enclosed copies of the following:

United States Postal Service Annual Report, 2002.

Sincerely,

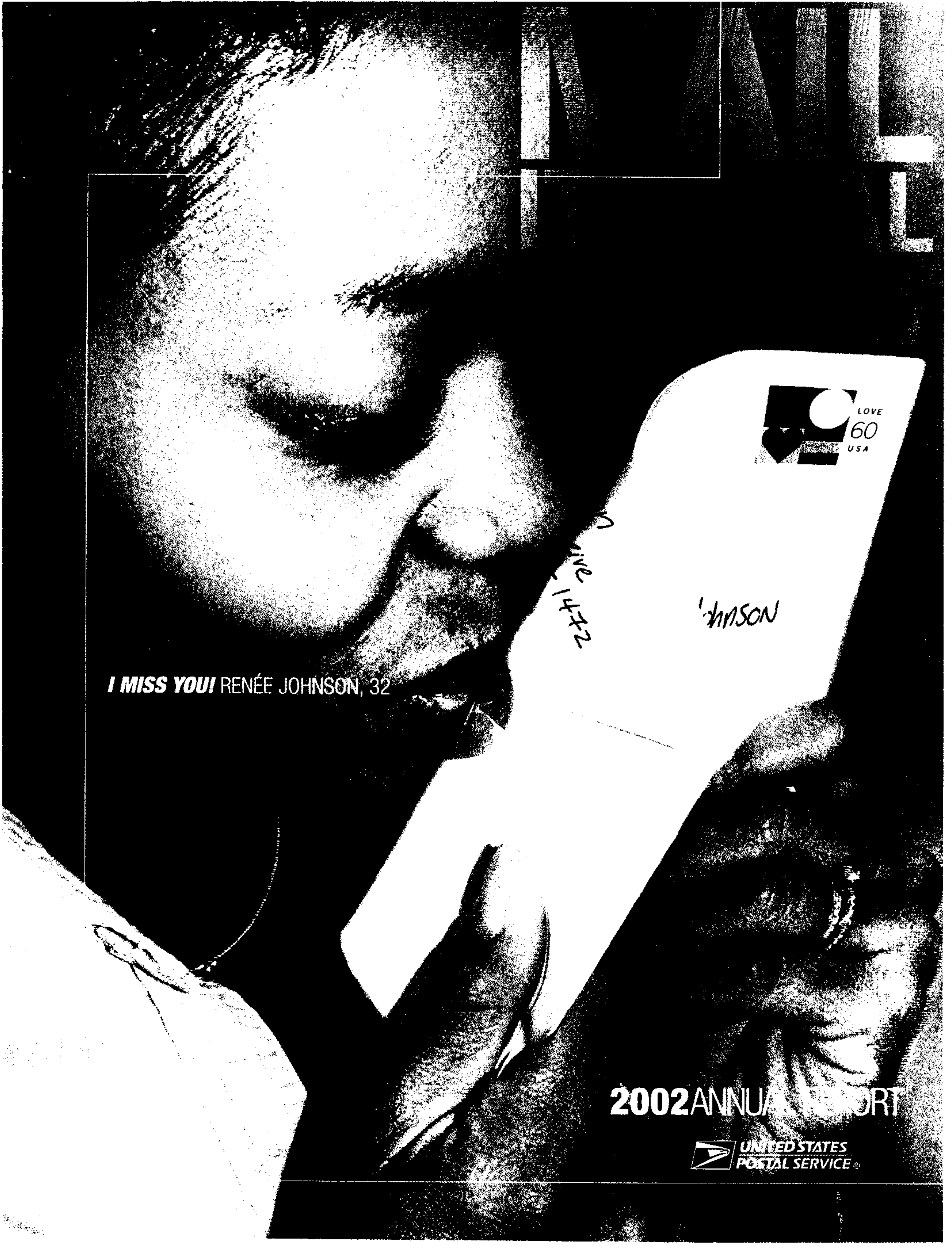
Daniel J. Foucheaux, Jr.

Daniel J. Foucheaux, Jr.
Chief Counsel, Ratemaking

Enclosures

cc: Ms. Taylor

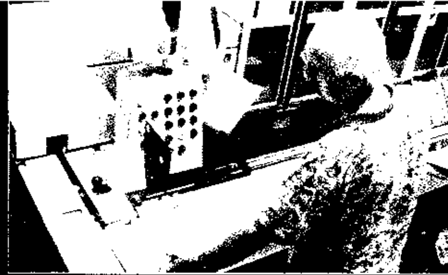
475 L'ENFANT PLAZA SW
WASHINGTON DC 20260
WWW.USPS.COM



I MISS YOU! RENÉE JOHNSON, 32

2002 ANNUAL REPORT

UNITED STATES POSTAL SERVICE®



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EXPRESS M D IS PRICED RIGHT FOR OUR SMALL BUSINESS HSIAO LIU, 25

Val-ue *n* [from Latin *valere* to be worth, to be strong] **1:** a fair return on payment for goods or services **2:** what Americans receive each time they use the United States Postal Service.

2002HIGHLIGHTS

TRANSFORMING OURSELVES. The Postal Service's comprehensive Transformation Plan explains how we're changing to continue to fulfill our historic mission of providing affordable, universal mail service for everyone in America. It's about improving operational efficiency, growing by adding value for our customers and enhancing our performance based culture. The communications world has changed dramatically. The Postal Service has to change, too.

DELIVERING RECORD SERVICE. The year started with severe restrictions on our ability to move mail by air as a result of the 9/11 attacks. Then bioterrorism disrupted portions of our system, with two key processing facilities indefinitely closed. Despite these challenges, we ended the year with record First-Class service performance and among the highest levels of customer satisfaction we've ever achieved.

HOLDING THE LINE. Transformation began with the new year and a focused plan to reduce cost by $5 billion through 2006. By aggressively balancing work hours and workload, reducing 23,000 career positions through attrition, realigning our headquarters and field management structure and postponing most capital spending, we reduced/avoided costs by $2.8 billion.

MAKING HISTORY. With the leadership of the independent Postal Rate Commission and cooperation of the mailing community, we forged an unprecedented negotiated rate settlement that resulted in new revenue of about $1 billion through the early implementation of new rates.

SETTING STANDARDS. *Fortune* magazine ranked the Postal Service eighth among the nation's top 50 employers for minorities. This is the third straight year that *Fortune* has recognized our diversity efforts.

HELPING OTHERS. The Heroes of 2001 semi-postal stamp raises funds for the families of emergency workers killed or injured in the Sept. 11 attacks. It's already raised $3.9 million. Over 500 postal employees joined the National Registry of potential marrow donors, with two life saving matches. And our Breast Cancer Research Stamp, since being issued in 1998, has raised $27.9 billion toward finding a cure.

PRICING FLEXIBLY. A historic series of "Rate Summits" explored all facets of postal ratemaking with the mailing community. We later filed two innovative rate cases with the Postal Rate Commission: our first negotiated service agreement, and experimental workshare discounts for Periodicals mailers. Pursuing pricing flexibility is central to our Transformation Plan.

IMPROVING EFFICIENCY. New automated technology brings the processing efficiency of letter mail to flat-size mail — oversized envelopes, magazines and catalogs. By sorting three times faster than the last generation of flat-sorting equipment, we control costs and help make mail a better value than ever.

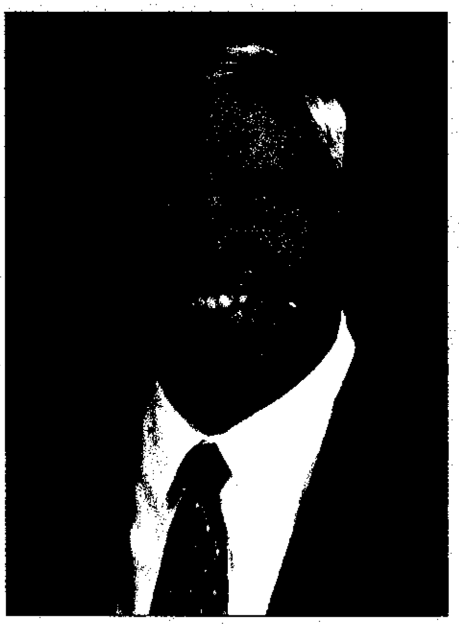
EXPLORING NEW TECHNOLOGY. Building on our experience as a leader in innovation, we tested the revolutionary Segway Human Transporter on delivery routes in seven cities across the country, with more tests to follow.

PROTECTING THE NATION. The Postal Inspection Service took a lead role in protecting America's senior citizens against fraud. At the same time, it's helping to combat identify theft, one of the fastest-growing and most devastating crimes in the country.

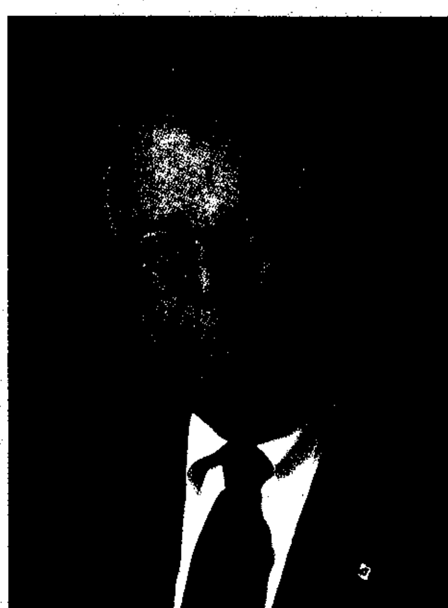
ADDING CUSTOMER VALUE. Our new CONFIRM® service lets customers track their mail as it moves through our system. The information it provides helps them plan and manage inventory and other resources better than ever. And Click-N-Ship™, available at *www.usps.com*, allows customers to print postage and mailing labels from home or office computers.

FINANCIALHIGHLIGHTS

	YEARS ENDED SEPTEMBER 30			PERCENTAGE CHANGE FROM PRECEDING YEAR		
	2002	**2001**	**2000**	**2002**	**2001**	**2000**
OPERATINGREVENUE	**$66,463**	$65,834	$64,540	**1.0%**	2.0%	2.9%
OPERATINGEXPENSES	**65,234**	65,640	62,992	**-0.6%**	4.2%	3.9%
OPERATINGINCOME	**$1,229**	$194	$1,548			
OPERATINGMARGIN	**1.8%**	0.3%	2.4%			
NETLOSS	**$(676)**	$(1,680)	$(199)			
CAPITALCASH OUTLAYS	**$1,705**	$2,961	$3,337	**-42.4%**	-11.3%	-14.8%
TOTALDEBT	**11,115**	11,315	9,316	**-1.8%**	21.5%	34.7%
INTERESTEXPENSE ON BORROWINGS	**$340**	$306	$220	**11.1%**	39.1%	39.2%
CAPITALCONTRIBUTIONS OF U.S. GOVERNMENT	**$3,034**	$3,034	$3,034			
ACCUMULATEDLOSSES AT END OF YEAR	**(6,036)**	(5,360)	(3,680)			
TOTAL NETCAPITAL DEFICIENCY	**$(3,002)**	$(2,326)	$(646)			
NUMBER OFCAREER EMPLOYEES	**752,948**	775,903	787,538	**-3.0%**	-1.5%	-1.3%
MAILVOLUME (MILLIONS OF PIECES)	**202,822**	207,463	207,882	**-2.2%**	-0.2%	3.1%
NEW DELIVERYPOINTS SERVED	**1,770,172**	1,736,256	1,893,377			



John E. Potter



Robert F. Rider

To the President, members of Congress, postal employees and the American people:

For the Postal Service, the year was marked by challenge and defined by change. Employees of this enduring symbol of national unity demonstrated an unequalled capacity to respond to a dramatically changing landscape.

Following the attacks of 9/11, America's air-transportation system was grounded. One month later, bioterrorist attacks challenged our own network while claiming the lives of two of our employees. The men and women of the Postal Service worked quickly — and successfully — to reconfigure a national mail-processing and transportation network capable of protecting service and increasing safety.

The tragic events of that September day also intensified the recessionary effects on the mailing and advertising industry this year, with mail volume declining by 4.6 billion pieces by the end of the year. At the same time, our delivery infrastructure grew to reach 1.8 million new homes and businesses, and we were faced with the extraordinary costs of responding to bioterrorism.

But we responded. We began the year with a focused plan to reduce costs, increase efficiency and improve service. We succeeded in all areas. We cut or otherwise avoided $2.8 billion in costs. More than 23,000 career positions were eliminated — through attrition. New automation contributed to continued, strong productivity growth. And, following a suggestion by the chairman of the Postal Rate Commission, we approached our major stakeholders and took a bold step that enabled us to implement new postage rate in June, 2002, rather than in the fall. This gained us an additional $1 billion in revenue.

As a result, and despite the impacts of the recession and the terror attacks, we were able to close the year with a loss that was almost $700 million below original projections and half of last year's. None of the $762 million the Administration and Congress generously appropriated to the Postal Service to protect the security of the mail was used for operations.

At the same time, our management team and employees achieved record service performance and customer satisfaction during a year in which two major mail processing facilities were out of service — Brentwood in Washington, DC, and the plant in Trenton, NJ. Our service performance levels demonstrate our commitment to maintaining the mail as a fundamental personal and business communications tool.

Through it all, we also accelerated the pace of change in April with the completion of our Transformation Plan. This comprehensive Plan is a blueprint for the future of the Postal Service. It identifies the short- and long-term changes necessary for improving operational efficiency, driving growth by adding value to our products and services, and enhancing a performance-based culture. The Plan will continue to guide all of our activities in the years ahead.

At the same time, we are maintaining our leading role in the critical public policy discussion about the legislative changes necessary to protect the fundamental right of affordable, universal mail service for every American — no matter who, no matter where. We look forward to continuing this important conversation with our customers, our employees and the public officials who represent them.

In the near term, we will seek moderate legislative reform that will support the Postal Service's ability to provide affordable, universal mail service. An example is proposed legislation that would permit the Postal Service to modify its payments to the Civil Service Retirement System. A recent analysis conducted by the Office of Personnel Management found that, at present funding rates, the Postal Service could overfund its liability by $71 billion. Passage of this legislation would permit the Postal Service to substantially reduce its debt and hold postage rates steady until at least 2006, while protecting the benefits of current and future retirees covered by this retirement system.

The men and women of the Postal Service delivered exceptional service during an extraordinary year. Their accomplishments have paved the way for even greater success over the next year.

Sincerely,

John E. Potter

John E. Potter
Postmaster General and CEO

Robert F. Rider

Robert F. Rider
Chairman, Board of Governors

In a world that's gone virtual, it seems that everyone is searching for the authentic. They're looking for roots. Tradition. Values. Real Experience.

They want something they can hold. Something they can touch. Something that's still here tomorrow — and the day after.

Mail — the real kind — has it all. Always has. Always will.

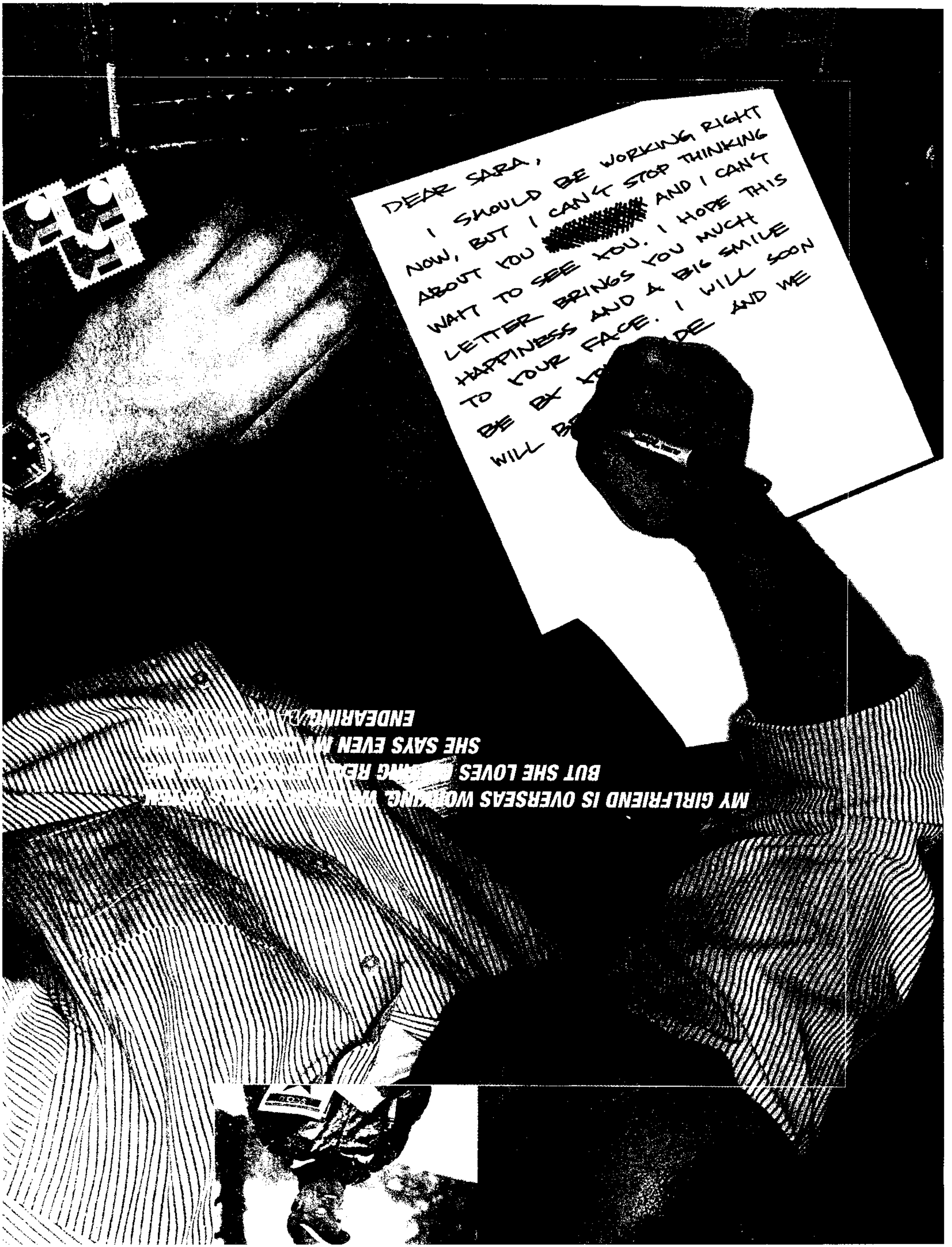
Looking for roots? You can't beat mail. It was there to spread the word when the 13 colonies united to become a single, great nation. And it's been growing with America ever since, using the latest technology for one simple purpose, to keep people in touch, whether it's personal or whether it's business.

How about tradition? Mail has been a part of our daily experience — at home and at work — for more than two centuries. It's still delivered hand to hand, person to person. After all, personal service is a tradition that never grows old. And who else makes house calls to just about every home in America, six days a week?

Looking for values? You don't have to look any further than mail. Americans trust it with their most personal sentiments, their hopes and their dreams. Seal it and put it in the mail, and you know it will be secure — whatever it is — whether you're sending it across town, across the nation or around the world.

Real experience? It doesn't get more real than the mail. You can reach out and touch it. What can beat the experience of opening a package from home? Seeing your name in the handwriting of someone you love? Opening the latest copy of your favorite magazine? Or knowing that when you drop the check in the mail, your house becomes your home — free and clear?

Authentic? That's mail. It's an original. It's as creative as you are, and it's created just for you. It can be a simple envelope or a colorful package. But there's no mistaking the sight or the feel of it. Mail. It's real. There's nothing like it in the world. And it's yours!


DEAR SARA,
I SHOULD BE WORKING RIGHT
NOW, BUT I CAN'T STOP THINKING
ABOUT YOU AND I CAN'T
WAIT TO SEE YOU. I HOPE THIS
LETTER BRINGS YOU MUCH
HAPPINESS AND A BIG SMILE
TO YOUR FACE. I WILL SOON
BE BY
AND WE
WILL
MY GIRLFRIEND IS OVERSEAS
BUT SHE LOVES
SHE SAYS EVEN
ENDEARING

Through a year of tremendous challenges, the Administration and Congress were extremely supportive of the Postal Service. Postmaster General John E. Potter testified at numerous hearings in October and November 2001 about the consequences of bioterrorism and the Postal Service's response. Members of both houses of Congress spoke highly of employees who faced unknown dangers yet continued to serve America.

Due to the need for immediate response to the anthrax incidents, the Administration transferred $175 million to the Postal Service. Congress also appropriated funds for the purchase of biohazard detection and prevention equipment recommended in our Emergency Preparedness Plan. The Postal Service received $500 million through the *Department of Defense Emergency Supplemental Appropriations Act, Public Law No. 107-117*. Another $87 million was received through the *Supplemental Act for Further Recovery From and Response To Terrorist Attacks on the United States, Public Law 107-206*.

Congress also passed and the president signed *Public Law 107-225*, to rename Washington, DC's Brentwood mail processing facility in honor of Joseph Curseen, Jr. and Thomas Morris, Jr., two Brentwood employees who died tragically as a result of bioterrorism.

The Postal Service has neither requested nor received a public service appropriation for operations since 1982. While Congress passed and the President signed the *Treasury, Postal Service and General Government Appropriations Act, Public Law 107-67*, this reimburses the Postal Service for Congressionally mandated services such as free mail for the blind and handicapped and voting materials for Americans overseas.

In April, the Postal Service delivered its Transformation Plan to Congress. It defines the short- and long-term strategies that will enable the Postal Service to successfully carry out its long-standing mission of providing affordable, universal service. At a May hearing of the Senate's Governmental Affairs' Subcommittee on International Security, Proliferation and Federal Services, Postmaster General Potter testified about the Plan. The Postal Service regularly updates Members of Congress and their staffs about the progress made toward transformation and the preservation of our universal service obligation.

In June, the House of Representatives' Committee on Government Reform considered postal reform legislation. While the bill did not move out of Committee, the effort provided many legislators with information on postal issues and the need for reform — a key element of our Transformation Plan. We will continue our efforts to explain to policymakers how the current regulatory model, created in 1970, is outdated and fails to address the realities of today's marketplace, as well as other issues facing the Postal Service.

In August, *Public Law 107-210* was signed by the President. It allows the Customs Service to open outbound international mail weighing more than 16 ounces. A search of letters of domestic origin weighing less than 16 ounces still requires a warrant. We are working closely with the Customs Service, the Transportation Security Administration and other agencies in this new environment to ensure the safety of our employees and the mail — without disrupting service.

Despite a busy legislative year, many members of Congress were able to participate in postage stamp dedication ceremonies. Notable were ceremonies on Capitol Hill for the *United We Stand* flag stamp and in New York City for the *Heroes of 2001* stamp. The *Heroes* stamp generates funds to assist families of emergency workers killed or permanently disabled in the line of duty in connection with the terrorist attacks of September 11, 2001.


I'M THERE.
JAMES MOORE, 26
MAURITIUS
RAMBLING IN
THE INTERIOR
DR JAMES MOORE
4351 WICKER PLACE
BOSTON MA 02117

Change — it's a fact of life. It's something the Postal Service knows a lot about. For more than 225 years, America's postal system has adapted to meet the growing communication needs of an expanding nation.

It's no different today. But the stakes are much higher. The simple fact is that the economic assumptions that created today's Postal Service are no longer valid. Our 30-year-old regulatory structure doesn't provide us with the flexibility — particularly in the areas of pricing and product introduction — needed to fulfill our mission in today's dynamic communications marketplace. To protect the fundamental right of every American to send and receive mail affordably, we need to change. That's the basis for our comprehensive Transformation Plan.

The Plan approaches this goal in three ways. It addresses today's challenges by pushing business effectiveness and operational efficiency to the limits permitted by current postal laws. It seeks moderate, near-term legislative reform. It also examines the need for long-term transformative structural change to our legislative and regulatory framework.

Legislative change for the Postal Service will require a comprehensive debate and consensus on complex public policy issues. But until then, the Postal Service has identified — and is taking — innovative actions to protect universal service for every American.

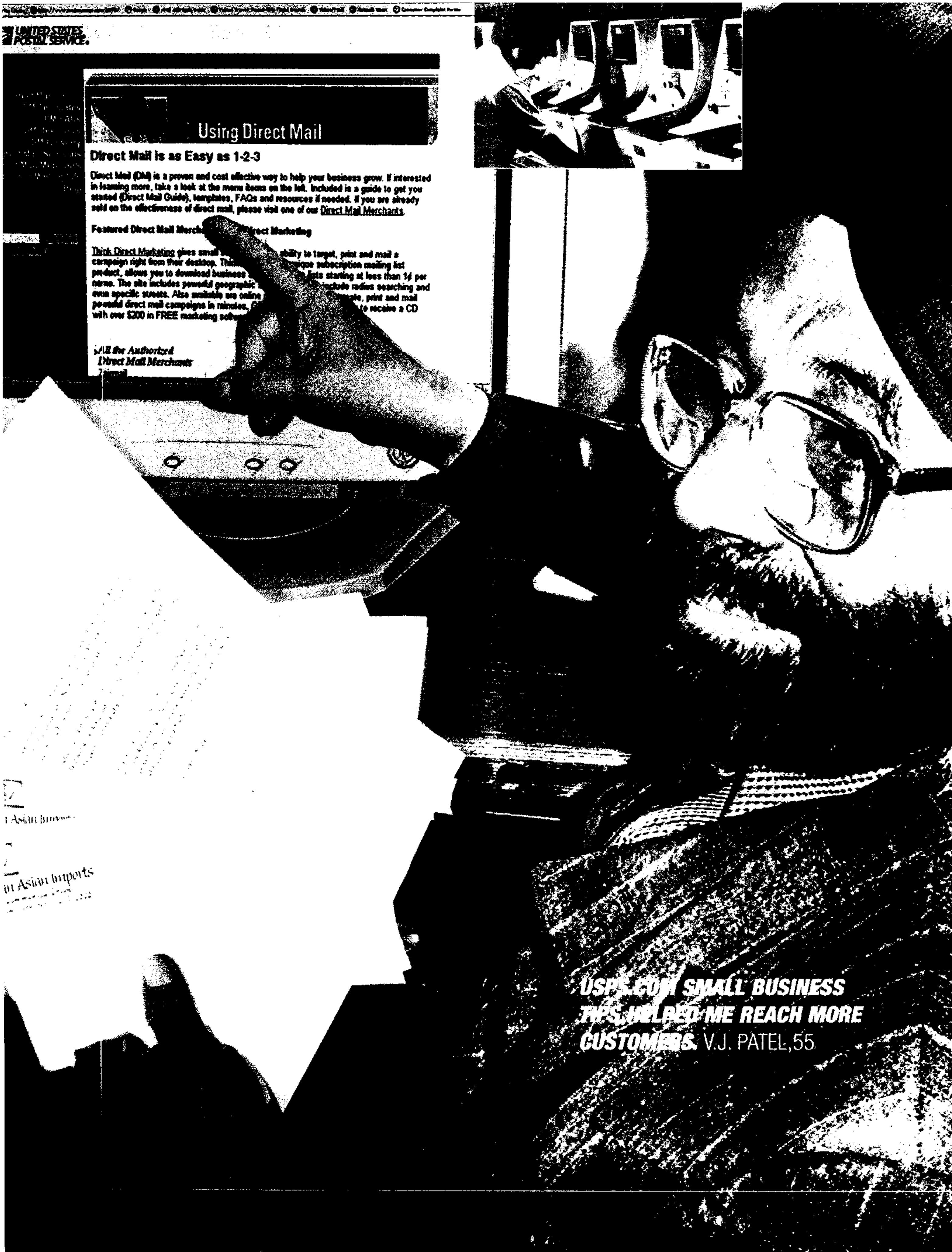
First, we're increasing the value of the mail. After all, that's the key to growth. We'll do that by developing the new products and services our customers need. And we'll make our existing offerings flexible enough to adapt to the technological advances of a new century. This means we'll do everything we can to make sure mail serves our customers better than ever.

We're also expanding access to postal products and services. In addition to 38,000 post offices, customers can buy stamps at about 60,000 other locations including supermarkets, drug stores and ATMs. And through our website, *www.usps.com*, customers can take advantage of a wide range of features, such as Click-N-Ship, which lets them print out postage and address labels for their packages — and a letter carrier will pick them up.

Second, we'll continue to push the limits on operational efficiency — while improving service. This will help us reach our five-year goal to reduce/avoid costs of $5 billion, beginning in 2002. And it will support the unique value our customers have come to expect from their Postal Service.

We're holding the line on future rate changes until 2004 and possibly longer. And, if legislation is enacted that would change the way we fund our retirement obligations for Postal Service employees and retirees covered by the Civil Service Retirement System, it could allow the Postal Service to maintain current postage rates to 2006. That means stability for mailers and stakeholders. And that's good for customers and the Postal Service.

Finally, we'll keep working to enhance our performance-based culture. That's the key to meeting our customers' expectations. Leadership development, increased accountability and continued workplace improvement will help us to maintain an effective, diverse and highly-motivated workforce. That's the key to customer satisfaction.


UNITED STATES POSTAL SERVICE.
Using Direct Mail
Direct Mail is as Easy as 1-2-3
Direct Mail (DM) is a proven and cost effective way to help your business grow. If interested in learning more, take a look at the menu items on the left. Included is a guide to get you started (Direct Mail Guide), templates, FAQs and resources if needed. If you are already sold on the effectiveness of direct mail, please visit one of our Direct Mail Merchants.
USPS.COM SMALL BUSINESS TIPS HELPED ME REACH MORE CUSTOMERS. V.J. PATEL, 55

The Postal Service's Transformation Plan is based on action. It's about taking the steps necessary to protect affordable, universal mail service for every American. That's the promise of universal service. That's the core of the Postal Service's historic mission. And that's exactly what we're doing.

Our new CONFIRM service uses web-based technology to increase the value of the mail. Using an innovative, subscription-based pricing system, major users of the mail can track their mail as it moves through our system. That helps them manage their businesses better than ever.

An unprecedented, negotiated rate settlement, proposed by the independent Postal Rate Commission made it clear there is flexibility in a lengthy and cumbersome rate-setting process.

And we built on that. We worked with the Commission to convene a historic "rates summit" with mailers. We looked at ratemaking from every angle. How can we streamline the ratemaking process? What are mailers' priorities? How much flexibility do we really have in setting rates?

But we did more than just talk. We moved forward with an experimental rate filing that matches pricing — and our costs — to the unique needs of particular mailers. It's what we call a negotiated service agreement. It's about innovation — and growth — for the Postal Service and the mailing industry. And it's just the first of many new ideas that we'll be pursuing.

We're taking that spirit of innovation to our compensation systems, too. We've started discussions with our management associations on a new performance-based pay system. It will bring more accountability and focus to everything we do. That's what our customers expect. That's what we'll give them.

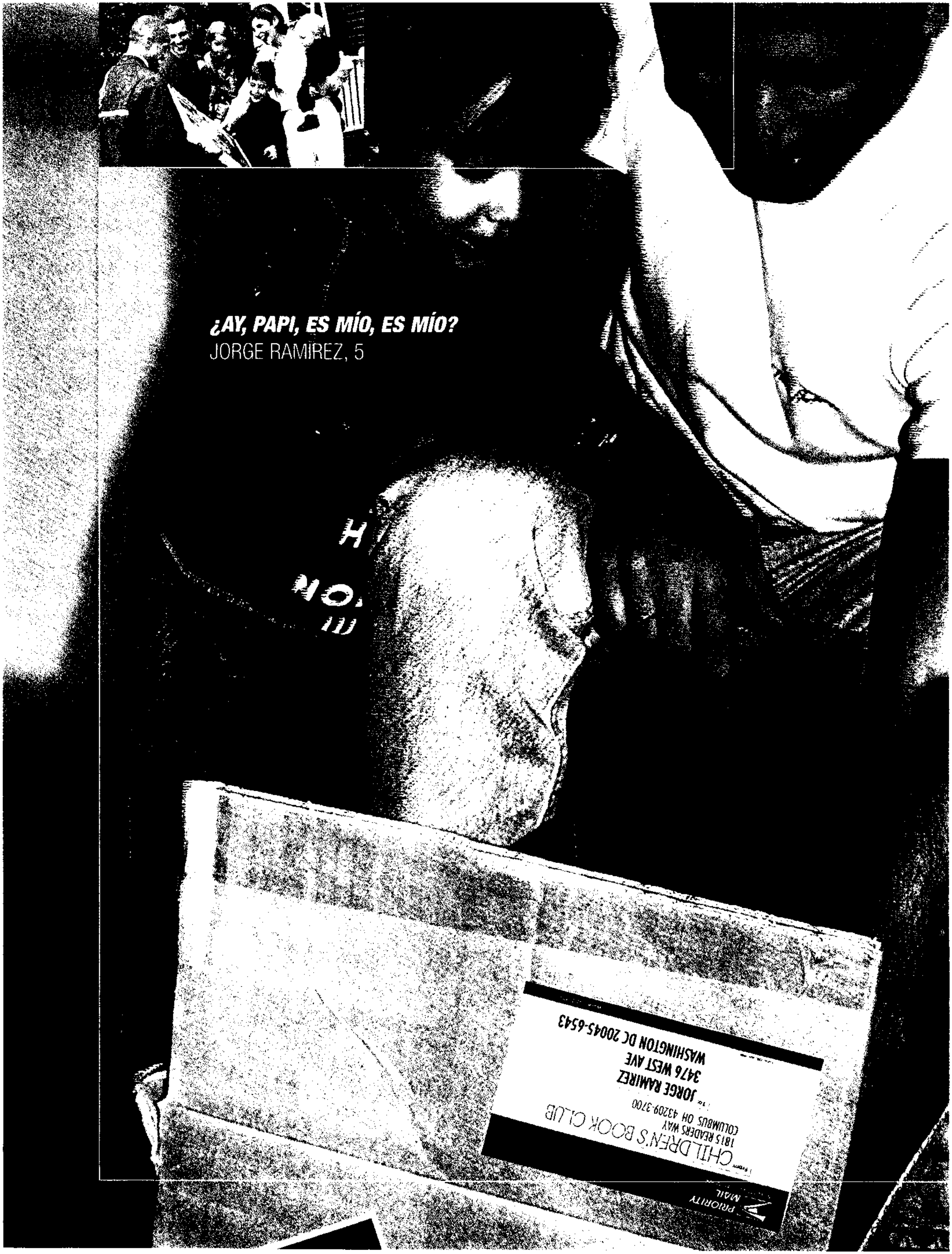
Tomorrow's challenges will call for exceptional leadership. So we're identifying and preparing the next generation of postal leaders today. Our new management intern program draws from the best — in the Postal Service and from other organizations. They'll make sure we're ready to meet the needs of our customers far into the future.

Our Transformation Plan also calls for building a better workplace. We want to be sure our employees have the tools, the opportunity and the incentive to continue providing the best service possible.

Exceptional service is what it's all about. That's why we'll continue to make our operations even more efficient. Expanding our automation program will help us move the mail faster and more accurately than ever. That will help us keep costs down. Combine the two, and mail will continue to offer the best value possible — fast and affordable.

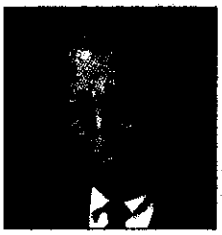
We're looking at our networks, too. Using a complex data-collection model, we'll be able to better align, integrate and optimize our mail-processing and transportation systems. Simplifying our systems means better service and reduced costs. That's a winning proposition no matter how you look at it.

Transformation? Nothing new for the Postal Service. We've been transforming since Ben Franklin was Postmaster General. We've grown with the nation and embraced new technologies and better ways of doing business. We won't stop now.



¿AY, PAPI, ES MÍO, ES MÍO?
JORGE RAMIREZ, 5

Se-cu-ri-ty *n* [from Latin *securus* safe, secure] **1:** the quality or state of being free from danger, fear or anxiety **2:** the care and protection the United States Postal Service provides for every letter and package we deliver.



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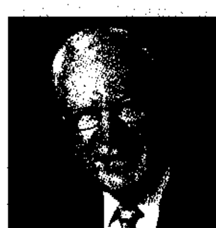
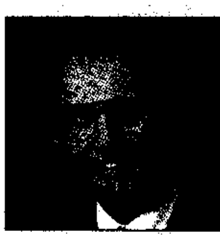


JOHN F. WALSH



EINAR V. DYHRKOPP

JOHN E. POTTER

JOHN NOLAN

Self-supporting *adj* **1:** the ability of an entity to satisfy its own needs **2:** like the operations of the United States Postal Service, which are funded by the sale of postal products and services, not by tax dollars.

JOHN E. POTTER

JOHN M. NOLAN

PATRICK R. DONAHOE

RICHARD J. STRASSER, JR.

SUZANNE MEDVIDOVICH

ANITA J. BIZZOTTO

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PAUL VOGEL
JAMES P. WADE
JOHN R. WARGO

The Audit and Finance Committee assists the full Board of Governors in fulfilling its fiduciary responsibilities. The Chairman of the Board of Governors selects the members of the Committee for each calendar year. This year, the Committee, whose members are Governors Dyhrkopp, McWherter and I, met nine times in conjunction with the regularly scheduled monthly Board meetings.

The Audit and Finance Committee's primary responsibility is oversight of the integrity of Postal Service financial statements. The Committee regularly receives financial reports and reviews the soundness of the internal accounting and control practices and major financial statement accruals. The certified public accounting firm responsible for an independent audit of Postal Service financial statements reports to the Board through the Audit and Finance Committee. Additionally, the Committee oversees postal rate case development, cash management and overall financial performance with particular attention to model performance and variance between forecast and actual results.

During 2002, the Committee continued to focus attention on Postal Service debt. At the Board's direction, capital investments financed with debt have been limited to equipment with high return on investment, employee and customer safety and infrastructure improvements that are absolutely necessary to do business. These policies along with breakthrough productivity improvement by management have resulted in the first overall reduction in outstanding debt in five years.

One of the most significant actions taken by the Board of Governors this year was the award of a new audit contract. In July the Board announced the selection of Ernst & Young LLP as its independent auditor to perform external auditing services. The Audit and Finance Committee conducted a competitive selection process, and the entire Board of Governors participated in final interviews. The external auditor reports to the Board, not management, as would be required for a private sector corporation of our size and complexity. Also, the auditor will perform no consulting work for the Postal Service for the duration of its auditing contract.

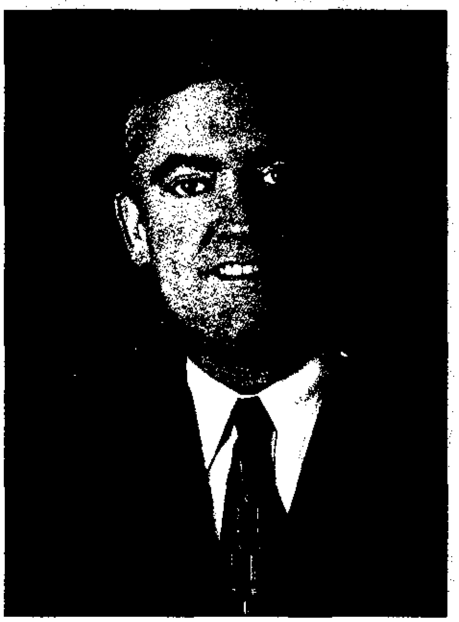
2002 was a year in which accounting irregularities were discovered at a number of well-known companies. Some involved outside auditors. The Audit and Finance Committee conducted an evaluation of its charter and procedures including a review by the former Chairman of the National Association of Corporate Directors. The Committee's charter and procedures are continually refined to ensure they reflect best corporate practice.

Ernst & Young LLP presented their work plan for the financial statement audit, and we concurred with the scope and materiality levels established. We met jointly and independently with Ernst & Young LLP, the Inspector General (OIG), management and the General Counsel to discuss the progress of the audit. We ensured independence and objectivity in the OIG and external audit programs.

Shortly after the end of the year, the Office of Personnel Management (OPM) released the results of a new analysis of Postal Service funding for the Civil Service Retirement System (CSRS). The analysis shows that the Postal Service is much closer to fully funding future CSRS pension obligations than previously estimated. Although this could potentially lead to reduced CSRS pension expenses, legislation will be required to authorize OPM to change the Postal Service's funding schedule. This development is further discussed in the Management Discussion and Analysis and in Note 11 of the Financial Statements.

Accordingly, the Committee recommended, and the Board approved, the financial statements for 2002.

Ernesta Ballard
Chairman, Audit and Finance Committee
December 10, 2002



Richard J. Strasser, Jr.

This year has been the most challenging, and also, the most rewarding in my experience in the Postal Service. By responding more rapidly than ever before, working with our customers and communicating better with our employees, we overcame much adversity in 2002. Were it not for the successful partnership forged with everyone involved in postal matters and the extraordinary cost containment and productivity gains made, we could not have met the challenge of 2002 as successfully as we did.

Despite the economic recession, the contamination of some mail with anthrax and the largest decline in mail volume in our history, we finished the year with a net loss of $676 million, well below the $1.35 billion we had expected at the beginning of the year. This enabled us to reduce debt by $200 million. Our net loss easily could have exceeded $4 billion were it not for the decisive actions taken by postal management and employees to control expenses. For the first time in 31 years, operating expenses in 2002 were reduced below the previous year, and for the first time in five years we reduced debt. We did this while extending delivery to 1.8 million new addresses. The actions we took in 2002 have laid a foundation for savings in 2003 and beyond, setting the stage for achievement of our Transformation Plan goal to take $5 billion in costs out of the system by the end of 2006.

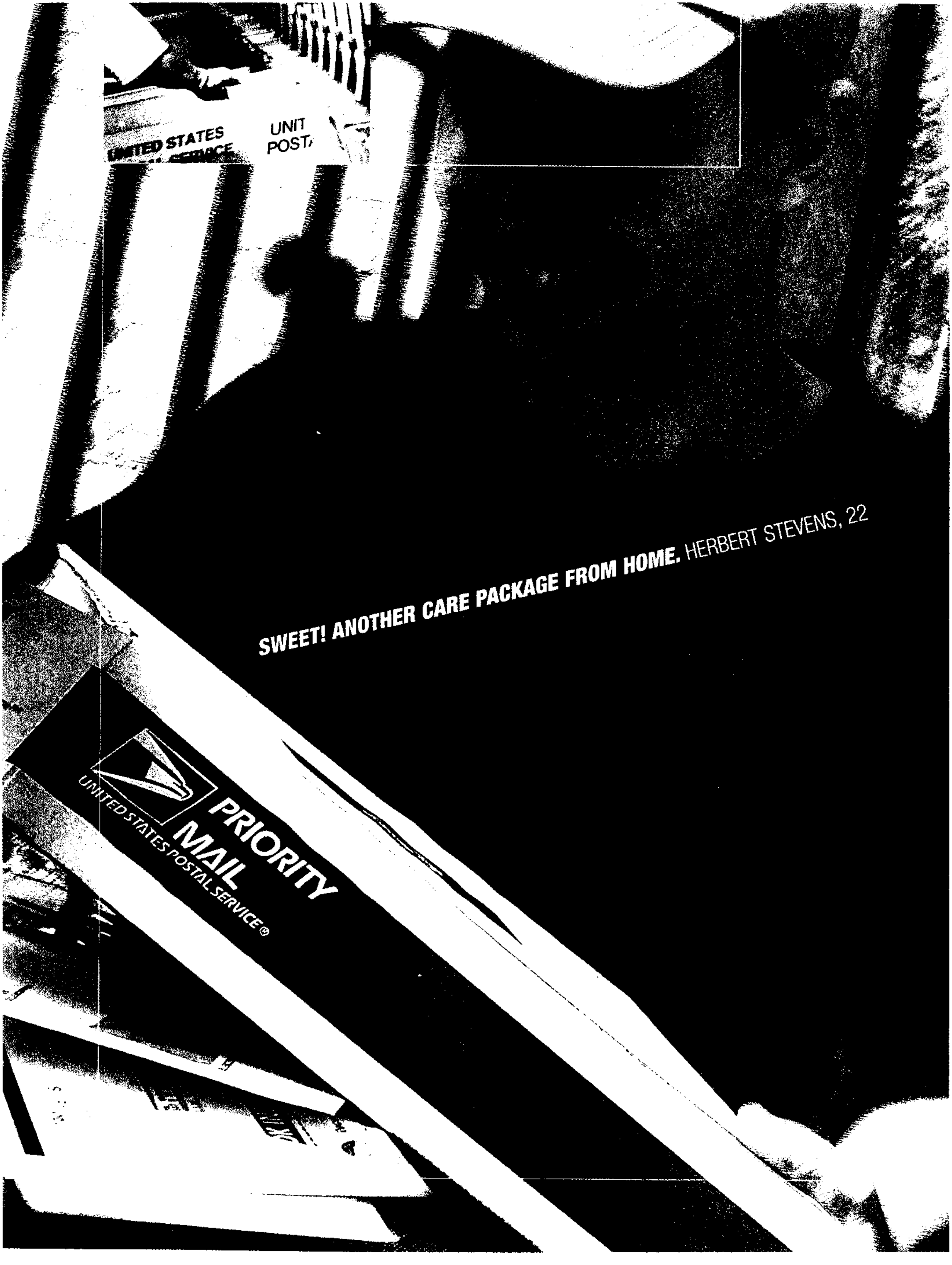
We must continue to control costs and stringently manage our work hours and workforce complement. We expect that labor costs and non-personnel costs will continue to increase. In an environment where our customers expect rate increases to be kept to an absolute minimum and where overall inflation in the economy is expected to be in the range of 2 to 3%, controlling resource usage is a critical strategy for limiting rate increases.

We, in Finance, view the financial operating information we provide for management decision-making as a primary tool in supporting value creation. In addition, we have two financial fiduciary responsibilities. First, we are responsible for maintaining and improving a system of internal controls to ensure that assets are safeguarded against material loss from unauthorized use or disposition and that our financial records are reliable for preparing financial statements. The second responsibility, which rests on the first, is for the preparation of financial statements on which our customers, our employees and our regulators can rely. We always apply generally accepted accounting principles, when we have a choice, and we have chosen to be conservative in our assumptions and assessments to minimize the likelihood of misstating assets, income, expenses or liabilities.

In last year's report I said we faced a future forever changed, with unprecedented uncertainty. I believe we are well prepared for that future because we have had our mettle tested and proven beyond expectations. We will continue to do everything possible to ensure the financial health of the Postal Service and provide outstanding service to our customers, the American People.

Thank You,

Richard J. Strasser, Jr.
Chief Financial Officer and Executive Vice President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Service n [illegible] serves another [illegible] help, use, benefit, contribution to the welfare of others 2: [illegible] Postal Service [illegible] such a part of the United States Postal Service [illegible] name

MANAGEMENT DISCUSSION & ANALYSIS OUTLOOK

Despite unique challenges from the faltering economy and the direct impacts of terrorist attacks that together caused the greatest ever decline in mail volumes, the Postal Service realized a net loss of $676 million in 2002. Although our third consecutive net loss, it was less than the $1.35 billion loss that had been projected in the plan for the year. We achieved this result through a cash infusion from the early implementation of rate changes and through our own stringent controls on expenses and capital spending. We reduced operating expenses $400 million below 2001 levels and $2.8 billion below plan. As a result, Total Factor Productivity (TFP) increased 1.1% despite the fact that workload declined. We were even able to retire $200 million of debt, our first reduction since 1997. Additionally, the federal government provided appropriations to fund health and safety improvements necessitated by the terrorist and anthrax attacks.

The early implementation of new postal rates came about through the unprecedented action of the Postal Rate Commission (PRC). In October 2001, the PRC convened settlement conferences among the 63 participants of the Postal Service's Docket No. R2001-1 Omnibus Rate Filing. Of these participants, 57 signed an agreement advancing new rates implementation by three months to June 30, 2002. The average rate increase was 7.7%, including a 3-cent increase in the price of a First-Class stamp. Early implementation of new rates directly increased 2002 postal revenue by about $1 billion.

We received $762 million in appropriations for securing the mail, and protecting the health and safety of Postal Service employees and customers following the terrorist and anthrax attacks. The President of the United States authorized an initial funding of $175 million for 2002. Congress later appropriated $587 million for health and safety protections and for the repair of facilities damaged in the New York City terrorist attacks. Some of those funds will be expended in 2003 and thereafter, as required safety equipment is placed in service.

Although many of the fundamental challenges of the past year will continue into 2003, we are cautiously optimistic about the coming year when economic growth will be a major driver of our performance.

The Federal Reserve recently retreated from its assessment that the risks of inflation and economic weakness are equally weighted, stating that "weakness in financial markets and heightened uncertainty related to problems in corporate reporting and governance" mean that risks "are weighted mainly toward conditions that may generate economic weakness."

We are particularly concerned about these downside risks because our volumes and revenue are increasingly subject to competition and substitution by alternative media. Historically, our mail volume growth rates have tracked the economy. Therefore, while we expect economic recovery to generate volume growth, we expect growth to be less than 2%, giving us lower volume in 2003 than in our peak year of 2000.

Nevertheless, the outlook is subject to great risk and uncertainty. Risks from terrorism are ever present. The economy is on an uneven growth path. The recovery has been slow and is far from complete. Instability in South Asia and the Middle East could drive up oil prices or threaten consumer and business confidence. The long-term effects of recent corporate governance problems and accounting scandals are unclear. We do not expect a rapid buildup of economic activity in 2003 and remain concerned about the possibility of a "double dip" recession.

Of critical importance to us in this assessment of economic indicators and projections of mail volumes are signs that the advertising recession is abating. A large portion of First-Class Mail volume and essentially all Standard Mail contain advertising material. These two products rank first and second in generating contribution to overhead costs. Standard Mail volume increased in the last quarter of 2002, the first such increase in 18 months. In addition, advertising industry employment has stabilized over the last six months, after steadily declining from its peak in June 2000.

The economic and advertising recovery should boost Standard Mail. Since Standard Mail is often part of a multifaceted advertising campaign, the prospects for Standard Mail volume growth are favorable. Advertisers know they can use Standard Mail to reach a very specific audience, rather than having a message broadcast to many uninterested parties, making it a highly cost efficient advertising medium.

Historically, volume growth has financed the cost of our continuous delivery network expansion. Delivery point growth requires the equivalent of hiring 3,000 new carriers each year as well as purchasing new vehicles and building or leasing new facilities.

Delivery network growth is driven by new household formation. In the 1980's delivery points grew by about 1.8% annually, as the last of the baby boom generation was entering the housing market. Since then, annual delivery point growth has held at 1.4%. From 2000 to 2002, delivery points grew by 1.8 million annually. We expect this level of growth to continue for the indefinite future. According to a report from the Joint Center for Housing Studies of Harvard University, 1.2 million new households are expected to form each year through 2020. Its 2002 report, "The State of the Nation's Housing," states that household formation, together with the demand for vacation and retirement homes and replacing units lost from stock, calls for an average of 1.7 million new homes annually.

Adding to the risk in our financial outlook are the financial and market implications specific to our own business model. Mail and related special services generate virtually all of our revenue. Unlike many telecommunications firms and utilities, we do not charge to access our network. Funds to maintain network operations and to support network expansion can only be generated by mail volume. Unlike competing delivery companies, we cannot dynamically change prices or add surcharges to our products to account for cost increases such as energy prices.

However, mail volume has not grown sufficiently in recent years to provide the revenue that supports extension of our delivery and retail network. Volume growth averaged 4.9% in the 1980's, 2.2% in the 1990's and close to zero in the last three years, due in part to increasing competition and electronic diversion.

Electronic alternatives are gradually diverting First-Class, Periodical and Standard Mail volume, a trend we expect to continue. Internet-based bill payment systems are well established, and consumers will increasingly use these services. As electronic bill payment becomes more popular, the number of bills presented to consumers electronically will also grow. We expect First-Class Mail volume growth to be sluggish due to economic conditions and the increasing market share of alternative bill presentment and payment technologies.

The end result of slowing volume growth and continuing network expansion is a declining number of pieces per delivery and a rising cost per delivery. Since we are constrained to break even over time, we face an even greater challenge in improving service and keeping rate increases reasonable, in both frequency and magnitude. To combat this growing inequality, we must continue to increase productivity, managing our costs and using fewer resources.

The last several years, marked by stagnant mail volumes and continued network expansion, have been notable for continued resource price inflation. Resource price inflation dropped from 5.9% annually during the 1980's to 3.1% annually during the 1990's, contributing to strong financial performance from 1995 through 1999. Inflation in resource prices then increased to an average of 4.1% annually over the last

FORTUNE 500 RANKINGS

Rank	Company	2001 Revenue ($ millions)
1	Wal-Mart Stores	$219,812
2	Exxon Mobil	191,581
3	General Motors	177,260
4	Ford Motor	162,412
5	Enron	138,718
6	General Electric	125,913
7	Citigroup	112,022
8	Chevron Texaco	99,699
9	IBM	85,866
10	Philip Morris	72,944
11	Verizon Communications	67,190
12	**United States Postal Service**	**65,834**
13	American International Group	62,402
14	American Electric Power	61,257
15	Duke Power	59,503

Com·mit·ment *n* [from Latin *committere* to connect, entrust] **1:** the state or instance of being obligated to a specific charge, goal, or trust **2:** the essence of the motto of the United States Postal Service **3:** neither rain nor heat nor gloom of night stays these couriers from the swift completion of their appointed rounds.

MANAGEMENT DISCUSSION & ANALYSIS OUTLOOK

three years. In a low volume and revenue growth environment, inflation in labor costs and other resource prices translates directly into a need for rate increases.

Recognizing these continuing challenges, we nevertheless foresee the opportunity to earn net income in 2003 which would allow us to retire more of our debt. To achieve net income and to generate positive cash flow, we are committed to savings and cost avoidance of nearly $1 billion in 2003. All major field operating functions will have to become more efficient. We will deploy new automation equipment and operating management will be challenged to increase productivity for a fourth consecutive year.

We are benefiting from moderate inflation and low interest rates. For the first time in years we have labor contracts in place for each of the major craft unions, giving next year's expenses a modicum of predictability. We expect that volume growth will resume slowly and generate increased revenue as the economy recovers from the recession. Our bottom line will also benefit from the full-year impact of the rate increase implemented last June.

In addition, our financial results will be positively affected by proposed legislation if passed into law. This legislation would change the way we fund our retirement obligations for Postal Service employees and retirees covered by the Civil Service Retirement System (CSRS). In November 2002, the Office of Personnel Management (OPM) completed a review of Postal Service funding and obligations pertaining to our employees and annuitants covered by the CSRS. This review concluded that without a change in the governing law, we would over-fund our CSRS obligations by $71 billion. This conclusion was arrived at through careful analysis conducted by actuaries and others at OPM, the Department of Treasury and the Office of Management and Budget.

For 2002, the Postal Service deferred retirement liability payment of $3.9 billion is reflected in the Statement of Operations as Compensation and Benefits ($2.3 billion) and Interest Expense on deferred Retirement Liabilities ($1.6 billion). If enacted, the legislation has the potential to reduce Postal Service annual CSRS retirement expenses between $2 and $3 billion. It would also eliminate most of the $32 billion deferred retirement benefit asset and liability carried on the Postal Service's balance sheet. We intend to use the benefits of this legislation to retire debt and stabilize current postage rates until 2006.

We need to produce positive net incomes and reduce debt. At the same time, we will maintain service performance and fund infrastructure replacement and expansion. Retiring debt and funding capital improvement at the same time involves a balancing act. It is appropriate to carry debt that funds capital expenditures necessary to support our infrastructure or to increase our operational efficiency.

To achieve a better balance in this regard, we must look to achieving positive bottom lines. Under the current rate-making practice, however, we can design rates to earn net income only to the extent necessary to recover prior years' losses. We have not been permitted to accumulate retained earnings.

Our challenge is to build our business and improve productivity through control of costs, while ensuring our long-term ability to provide quality services. This may require filing for new rates. It may also require securing legislative change that gives us more flexibility in the marketplace and better control over costs.

Our discussion in the MD&A represents our best estimate of the trends we know about, the trends we anticipate and the trends we think are relevant to future operations. However, actual results may be different from our estimates.


Happy Holidays
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you, our value
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Dil·i·gence *n* [from Latin *diligere* to esteem, love] **1:** perseverance to honor a commitment by steady, earnest, and energetic effort **2:** the care displayed by employees of the United States Postal Service in handling America's mail, each and every day.

MANAGEMENT DISCUSSION & ANALYSIS OPERATIONS

The aftermath of the September 11th terrorist attacks, the economic recession and the anthrax-by-mail contamination resulted in a volume decline of 2.2%, or 4.6 billion pieces of mail, the largest volume decline in Postal Service history. Despite these events, however, we finished the year with a net loss of $676 million, instead of the $1.35 billion loss we had planned last year, before either of the terrorist attacks.

Our revenue increased 1.0% over last year to $66.5 billion. In June, we implemented our rate increase three months early, with an average increase of 7.7%, including a 3-cent increase in the price of a First-Class stamp. Typically, it takes 10 months to litigate an omnibus rate case. Citing the need for "extraordinary acts" in "extraordinary times," the chairman of the Postal Rate Commission, in October 2001, suggested the process that led to a settlement agreed to by 57 of the 63 participants in the postal rate case. Such a settlement of an omnibus case is unprecedented in the history of the Postal Service.

We reduced operating expenses by 0.6% from last year and brought them to $2.8 billion below plan, another first for the Postal Service. We reduced work hours by 78 million and employment by 23,000 career employees, bringing our complement down to 1995 levels. However, higher costs per work hour, increased workers' compensation costs and rising health benefit premiums continued to put pressure on our expenses. Premium increases contributed to retiree health benefits expenses, which rose 15% compared to last year.

Cash flow from operations was $1,431 million, reflecting the impact of the June rate increase. Cash outlays for capital spending were $1,705 million. The margin between internally generated cash and cash outlays allowed us to decrease debt by $200 million, the first reduction in our debt since 1997. The federal government provided three appropriations totaling $762 million to offset the effects of the terrorist attacks and to cover the costs of modifying postal systems for the safety and security of employees, customers and the mail. We used $179 million of the appropriations to offset expenses and hold the remaining for the bio-hazard detection and vacuum equipment to be deployed within the postal system in the coming year.

Despite the operational difficulties we faced this year, we achieved record levels of service. Service levels for Express Mail, Priority Mail and First-Class Mail either matched or set new records since the establishment of independent measures. In addition, overall household satisfaction with the Postal Service is back to or exceeds levels achieved before the past year's crises.

OPERATING REVENUE

An economic recession began in 2001, and its effects have continued into this year. Since mail volume historically has tracked the economy, usually with some lag, our volume declined in 2002. In fact, we suffered our largest volume decline since 1946. The recession in the advertising market was particularly damaging, and it was only at the end of 2002 that the advertising industry began to show signs of recovery. Since advertising mail has been the main source of our volume growth and volatility in recent years, the collapse in this market seriously hurt our 2002 mail volume growth.

The events of September 11th and the anthrax attacks affected all mail categories with the possible exception of Periodicals. Both mailers and consumers became concerned about the security of the mail service, and disruptions resulting from these events caused mailers to delay or cancel mailings or use alternate providers.

The 7.7% average rate increase implemented on June 30 further reduced volume growth, especially in such competitive categories as Priority Mail and

OPERATING REVENUE

Year	Operating Revenue	Increase Over Previous Year	Increase Over Previous Year
2002	**$66.5 billion**	**$0.6 billion**	**1.0%**
2001	$65.8 billion	$1.3 billion	2.0%
2000	$64.5 billion	$1.8 billion	2.9%

Express Mail. The early implementation of the rate increase, however, brought in an additional billion dollars in revenue.

The weak economy hurt letter mail (First-Class and Standard Mail) in 2002. In addition, electronic diversion continues to cut into the market share of letter mail products. Mailers are also continuing to develop methods to sort and deliver mail farther down our processing stream, thus shifting their mailings to categories with deeper worksharing discounts. All this affects the revenues of letter mail products.

First-Class Mail volume fell 1.2% this year. Electronic diversion continues to affect First-Class Mail. Even though many analysts predicted a spike in the adoption of Internet bill paying in the wake of the anthrax attacks, evidence suggests that the rate of adoption has remained basically the same. According to the Household Diary Survey, in 2000, 4.4% of households paid bills through the Internet. In 2001, this figure rose to 7.5%. For 2002, it is 11%. The proportion of bills that consumers pay through the Internet has risen from 3.2% in 2001 to 4.2%, or less than half of one bill per household. Between 2001 and 2002, however, the number of bills paid by mail per household has remained steady at about 8.5. In fact, the main source of growth in electronic payments in 2002 came from automatic deduction, which rose almost 30%. Mail is still vital to the payment processing system. With a slow economic recovery and continued electronic diversion, we expect First-Class volume to be essentially flat in 2003, growing by about 0.3%.

Standard Mail volume fell by 3.0% in 2002 as a result of the weakness of the advertising market. Nonprofit mail was especially hard hit, as organizations whose philanthropy was not directed to the victims and survivors of the September 11th attacks pulled back fundraising efforts. Standard Mail should grow slightly over 4% in 2003, accounting for most of our planned volume increase. This growth represents mailers returning to mail after the anthrax attacks, as well as assuming growth in the economy and a recovering advertising market.

Priority Mail volume fell 10.7% this year, continuing to slide further from the 8.6% decline of 2001. It dropped most sharply early in the year when package prohibitions on commercial airlines disrupted our transportation network. Price increases for Priority Mail further hampered growth. Since January 2001, Priority Mail prices have increased by 35%. Priority Mail is part of the highly competitive expedited package market where the actions of our competitors affect our volume. We anticipate that Priority Mail volume will continue to fall in 2003, responding to the 16% price increase in June 2002.

Package Services declined 1.6%, although Parcel Post grew 5.1%. Most of this growth came in bulk-entry products. Some of this growth represents migration out of Priority Mail, as mailers look for more economical means of shipping their merchandise. In particular, the increasing use of package consolidation services enabled mailers to take advantage of drop-shipping discounts. Additionally, since it moves over the road, Parcel Post avoided the restrictions on airline parcel carriage. In 2003, growth in Package Services should be effectively flat, with Parcel Post growth of less than 1%.

Periodicals were down by 3.8% this year, accelerating the long-term decline in household subscriptions. This reflected the large number of magazine titles that ceased publication during the recession. Remaining publications were hit hard by the shrinkage in the advertising market. Publication weight, advertising pages and per-piece revenue all declined in 2002. We expect volume to continue to decline in 2003 while the economy is sluggish.

International Mail shrank by 16.5% this year, a result of the worldwide recession and restrictions on mail carriage imposed after September 11th. The global economy appears to be lagging that of the United States, and in 2003 we expect the decline in

GROWTH IN REVENUE AND VOLUME

	REVENUE			VOLUME		
	2002	2001	2000	2002	2001	2000
First-Class Mail	**1.7%**	1.0%	1.7%	**-1.2%**	0.1%	1.6%
Standard Mail	**0.7%**	3.4%	5.2%	**-3.0%**	-0.1%	5.1%
Priority Mail	**-3.9%**	1.6%	6.7%	**-10.7%**	-8.6%	2.8%
Package Services	**4.3%**	4.3%	4.6%	**-1.6%**	-3.1%	8.2%
Periodical Mail	**-1.8%**	1.6%	2.6%	**-3.8%**	-2.8%	0.9%
International Mail	**-8.8%**	4.5%	1.8%	**-16.5%**	-1.5%	6.7%
TOTAL MAIL	**0.5%**	1.8%	1.7%	**-2.2%**	-0.2%	1.6%

International Mail volume to continue. Customers will also explore alternative means to deliver international communications, further affecting this sector.

In 2003 we expect volume and revenue to stage a modest recovery from one of the worst volume declines in postal history as we recover from last year's service disruptions. Overall, we expect a sluggish economic recovery to restrain volume growth in 2003. We think volume will expand somewhat less than 2%, leaving us with less mail than we had in 2000. Revenue will rise, however, as the full effect of the June rate increase flows through.

RATE-MAKING ACTIVITY

Until 1971, Congress set postage rates through legislation, and the relationship between the revenue from those rates and the actual costs of operating the postal system varied greatly. Since 1971, however, the Postal Reorganization Act has required the Postal Service to establish postal rates that cover the cost of operating the postal system.

The rate-making process is lengthy and complicated and begins when management determines that current rates will not be adequate to meet our mandate of "covering future costs". The Postal Service, with approval of the Board of Governors, submits a request for a recommended decision on rate and fee changes to the Postal Rate Commission (PRC), an independent establishment of the executive branch of the government. The submission is accompanied by detailed rate proposals supported by extensive documentation and lengthy testimony.

The PRC's proceedings usually take 10 months. It holds public hearings, during which interested parties such as mailers, competitors and consumer representatives are authorized to challenge the Postal Service's proposals and submit their own testimony and proposals. At the conclusion of the hearings, the PRC sends its recommended decision to the Governors. The Governors may approve, reject, allow under protest, or, under certain limited circumstances after more proceedings, modify the PRC's recommendations.

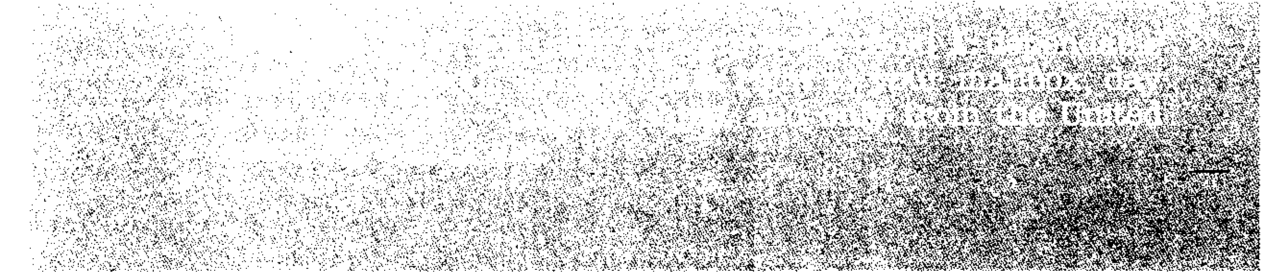
NEW RATES EFFECTIVE JUNE 30, 2002

We filed for new rates on September 24, 2001, and on March 22, 2002 the Postal Rate Commission issued a Recommended Decision accepting the new rates essentially as we proposed them. Citing the need for "extraordinary acts" in "extraordinary times," the Chairman of the Postal Rate Commission on October 25, 2001, began the process that led to a settlement agreed to by 57 of the 63 participants in the postal rate-making process. Such a settlement of an omnibus rate case is unprecedented in the history of the Postal Service.

These rates, which went into effect three months ahead of schedule on June 30, 2002, added approximately $1 billion to our revenue in 2002. Rate increases averaged 7.7%.

When we developed our proposal for a rate increase in the summer of 2001, we did not anticipate an economic recession, terrorist attacks in New York City and Washington D.C. on September 11, 2001, or the use of the mail to transmit anthrax. All of these events have caused a sharp drop in mail volume and revenue. Implementing rates early enabled us to limit our financial losses. Although we have generated significant savings from improved operating efficiencies and our new cost savings programs, our expenses continue to increase due to resource cost inflation and the need to serve an expanding delivery network.

As part of the rate settlement process and the Transformation Plan, the Postmaster General committed to not implementing additional rate increases until calendar year 2004.



EXPENSES

COMPENSATION AND BENEFITS

Our personnel compensation and benefits make up more than 79% of our operating costs. These costs, including interest on deferred retirement, grew only $204 million or 0.4% in 2002. This compares to growth of 3.6% in 2001 and 4.4% in 2000. This year's growth was primarily due to contractual labor payments, health benefits payments for current and retired employees and workers' compensation costs. The growth was mitigated by labor reductions of over 78 million work hours, or approximately 38,000 work years.

GROWTH IN COMPENSATION AND BENEFITS

2002	2001	2000
0.4%	3.6%	4.4%

Although average hourly labor rates increased by about 2.8%, compensation cost declined 2.8% or $1,047 million due to our reduction in work hours. Our health benefits expense for current employees was $342 million greater than last year, driven mainly by premium increases. As health care costs continue to rise, our health benefits expense for current employees continue to grow.

Almost 90% of our career workforce is covered by collective bargaining agreements. We reached agreements through arbitrated settlements with all of our major unions in 2002. These agreements, which have expiration dates ranging from November 20, 2003 to November 20, 2006, call for basic pay increases and cost of living adjustments (COLAs).

Our non-bargaining employees receive pay increases only through annual merit reviews. Unlike the rest of the federal government, these employees do not receive automatic salary increases, nor do they receive COLAs or locality pay.

In 1995, the Board of Governors approved a group incentive program that covered over 80,000 supervisors, managers, postmasters, executives and staff throughout the Postal Service. To spur greater levels of performance in core areas, this incentive program set measurable performance goals for the entire organization and for each organizational unit at the beginning of each year.

Participants in the program earned incentive credits through performance to the goals and financial performance measures, which indicated that economic value had been added to the organization. From 1996 to 2001, employees earned incentive credits that were placed in a reserve account. Each year, approximately one-third of the total reserve amount was paid, and the remainder was held in the reserve and placed "at risk," pending future performance. This approach was designed to promote continuous improvement and create long-term value. While considerable service improvements and productivity gains resulted from this pay-for-performance system, there is still room for improvement. In 2002 management, with the Board of

COMPENSATION AND BENEFITS DETAILS ($ MILLIONS)

	2002	2001	Change	Percentage Change
Compensation	**$36,877**	$37,924	($1,047)	-2.8%
Retirement	**9,105**	8,885	220	2.5%
Health Benefits	**3,678**	3,336	342	10.3%
Retirement Health Benefits	**987**	858	129	15.0%
Workers Compensation*	**1,511**	970	541	55.8%
Other	**1,000**	981	19	2.0%
TOTAL COMPENSATION AND BENEFITS**	**$53,158**	$52,954	$ 204	0.4%

* *Does not include POD workers' compensation cost.*

** *Equals compensation and benefits plus interest on deferred retirement on the Financial Statements.*

Choice n: [illegible] to taste, [illegible] 1: the opportunity or privilege of choosing freely from a variety of alternatives. The United States Postal Service offers more mailing and shipping choices than anyone in the business.

Governor's approval, decided to end the established pay-for-performance system. The majority of the remaining reserve will be paid out in October 2002. The reserve was recognized as expense in the years earned.

Management is meeting with representatives from employee groups to redesign the performance-based pay systems to enhance accountability for individual contributions to organizational success. The new system will provide clear expectations and feedback on progress toward established goals. It will also be designed to reward and recognize exceptional individual performance for achieving challenging objectives.

RETIREE HEALTH BENEFITS

The Postal Reorganization Act of 1970, which created the Postal Service, required that the Postal Service either participate in the Federal Employees Health Benefits Program (FEHB), or adopt a plan that would provide equivalent benefits to our employees. The Postal Service continued to participate in FEHB. Eligible postal employees with at least five consecutive years' participation in the FEHB immediately preceding retirement are entitled to continue this healthcare coverage after retirement.

Until 1987, the cost of postal retirees' health benefits under the FEHB was paid from funds appropriated (tax dollars) directly to the federal Office of Personnel Management (or its predecessor). The Omnibus Budget Reconciliation Act (OBRA) of 1985 made us responsible for paying the government's share of health insurance benefits under the FEHB for those postal employees who retired after September 30, 1986. The OBRAs of 1989 and 1990 retroactively extended our responsibility for paying health insurance benefits for all postal retirees and their survivors to July 1, 1971, the date of Postal Reorganization. The retroactive payments for this extended liability were assessed in those years and paid as required by law.

FEHB, which provides health benefits to federal and postal employees and retirees, treats participants as a single group. In addition, OPM and the various providers control the benefits offered in FEHB. Benefits are equally available to participants.

Each federal employing agency (via appropriations), and the Postal Service (from postal revenues), are allocated and billed the cost of the program based upon their respective number of participants and the weighted average participant medical cost. OPM negotiates rates with the insurance carriers, and the premiums charged by insurance carriers are based on the risk characteristics of the entire population of FEHB participants.

In 1990, the Financial Accounting Standards Board (FASB) issued its Statement on Financial Accounting Standards (FAS) No.106, *Employers' Accounting for Postemployment Benefits Other Than Pensions.* This standard required employers who participate in either single or multiple employer programs to accrue the future post-retirement costs of its current employees. Participants in a multi-employer plan were to continue to account for these costs as expenses in the period the payment is due.

Based on analysis of FAS No.106 when the standard was issued, management determined that our participation in the FEHB for retirees most closely matched the characteristics of a multi-employer plan.

We, based on a suggestion from the General Accounting Office (GAO) in May 2002, reviewed the accounting treatment of postretirement health benefits. There have been no changes in accounting pronouncements relating to this issue, nor have there been any modifications to the structure of FEHB that would alter the original determination that recognition of these costs should follow that of a multi-employer plan.

We will be paying a portion of the health benefits of currently retired postal employees, or their survivors, for the remainder of their lives. The funds to make future payments will come from future revenue. We have planned for these payments, and our practice has been and continues to be to include them as a part of our revenue requirement in the rate-making process.

If we were not considered to be a participant of a multi-employer plan, we would be required to record and disclose our obligation for the present value of future costs under the program. Because there are several areas of judgment involved in calculating this obligation, estimates can vary widely based upon the assumptions used. An actuarial consultant we enlisted calculated the present value of future premium payments to be between $40 and $50 billion, based on Postal Service employment since 1971. The range in the estimate exists only because long-term medical inflation assumptions differed by 1%. All other assumptions for health plan utilization, benefits and actuarial estimates were identical.

Under the FEHB, OPM bills us for our cost for participating in the plan related to retirees, and we record this cost as a current expense as part of our compensation and benefits expense. Our financial statements reflect expenses related to retiree health benefits of $987 million in 2002, $858 million in 2001 and $744 million in 2000. In 2002, the increase in these costs represented 0.2% of total costs.

These retiree health benefit costs are currently included in our rate base. Retiree health benefits costs represent 1.5% of our total operating expenses.

We will continue to fulfill our obligation to fund retiree health benefits according to the requirements established by OPM and Congress. Postal revenue will be used to cover these costs in the future as they have in the past.

RETIREMENTEXPENSES

Based on their date of employment, our career employees participate in one of the three retirement programs sponsored by the United States government's Office of Personnel Management (OPM). Employees hired before January 1, 1984, are covered by the Civil Service Retirement System (CSRS). Participating employees contribute 7% of their basic pay to this fund. We match the 7% contribution.

Employees with prior government experience hired after December 31, 1983, and before January 1, 1987, are covered by the Dual CSRS/Social Security System ("Dual"). We contribute 7% of the employee's basic pay; the employee contributes 0.8% of basic pay; and we and the employee contribute to Social Security at rates prescribed by law.

Employees hired after December 31, 1983, with the exception of Dual employees, are covered by the Federal Employees Retirement System (FERS), a retirement program that provides benefits from three different sources: Social Security, a basic FERS annuity and a voluntary thrift savings plan.

While all career employees may participate in the Thrift Savings Plan (TSP) as administered by the Federal Retirement Thrift Investment Board, the rules for participation are different for each group of employees. We do not match contributions by CSRS or Dual-covered employees to the TSP, and CSRS employee contributions are currently limited to 7% of basic pay. The contribution rate increases 1% per year for the next three years reaching a maximum contribution of 10%, subject to annual dollar limitations imposed by the Internal Revenue Code. We are required to make a contribution of 1% of basic pay to the TSP for FERS employees. In addition, we fully match FERS employee contributions up to 3%, and half of employee contributions between 3% and 5%. Employee contributions are currently limited to 12% for FERS employees. This rate increases 1% per year for the next three years reaching a maximum contribution of 15%, subject to annual dollar limitations imposed by the Internal Revenue Code. The table below outlines our contributions to the three retirement plans as required by law.

RETIREMENTCONTRIBUTIONS

	FERS	CSRS	Dual
Basic Annuity	10.7%	7.0%	7.0%
Social Security	6.2%	0.0%	6.2%
TSP	≤ 5.0%	0.0%	0.0%

The CSRS combined 14% normal cost contribution (7% Postal Service, 7% employee) is based on "static" economic assumptions of 5% return on investments, no future salary increases and no cost of living adjustments (COLAs) for retirees. Notably, by law, our retirees' COLAs are the same as all federal employees.

We are the only federal agency to provide full funding (principal and interest) for the retirement costs associated with general pay increases to CSRS employees and COLAs to CSRS retirees. As part of a multi-employer plan, the payments we make are not segregated for application to postal costs only. They are applied to total plan costs for all participants. We fund these deferred retirement liabilities over 30 years at 5% interest for active employees and 15 years at

5% interest for retirees. Our 2002 year-end payment to OPM, including interest, was $3.9 billion for our CSRS deferred retirement liability. We have no deferred retirement expense for FERS employees because FERS is funded so that all future costs, including retiree COLAs, are provided for from present contributions related to active employees. This is referred to as "dynamic funding."

In accordance with FAS Statement No. 87, *Employers' Accounting for Pension Costs*, an employer participating in a multi-employer plan recognizes as net pension cost the required contribution of the period. Any contributions due and unpaid are recognized as a liability. By law, we are responsible to fund the additional estimated increased liability cost to the Civil Service Retiree Disability Fund (CSRDF) created from our employee raises and retiree COLAs. This additional cost is set by OPM at the effective date of the raises or COLAs. OPM notifies us of the amount and bills us for the fixed and determinable amount. This creates a liability layer.

At the time the liability is fixed by OPM, we recognize the obligation as a liability. We defer recognition of the liability as an expense until the period in which the obligation is payable to OPM. The deferred liability, and the related deferred asset, recorded on our balance sheets was $32 billion as of September 30, 2002 and 2001. These balances will moderate and decrease over the next several years as the number of CSRS employees decreases and old liability layers are liquidated.

From postal reorganization in 1971 through the end of 2002, we have made cash payments totaling $55 billion on CSRS retirement liabilities associated with pay increases and retiree COLAs. Current postage rates include approximately $4 billion per year for payment of these costs, providing adequate funds on an ongoing basis to fully liquidate the current and future CSRS deferred retirement liabilities..

Our total retirement expense in 2002 was $9.1 billion, an increase of $220 million or 2.5% compared to 2001. This follows increases of $356 million in 2001 and $428 million in 2000. Over $112 million of this year's increase is related to a combination of an increase in the number of FERS employees and an increase in basic pay. Approximately $66 million of this year's increase was due to the COLAs for retirees, reflecting both an increase in their benefits based on increases in the Consumer Price Index and in the number of retirees eligible for the COLAs.

(See Note 6 of the Notes to Financial Statements for additional details.)

WORKERS'COMPENSATION

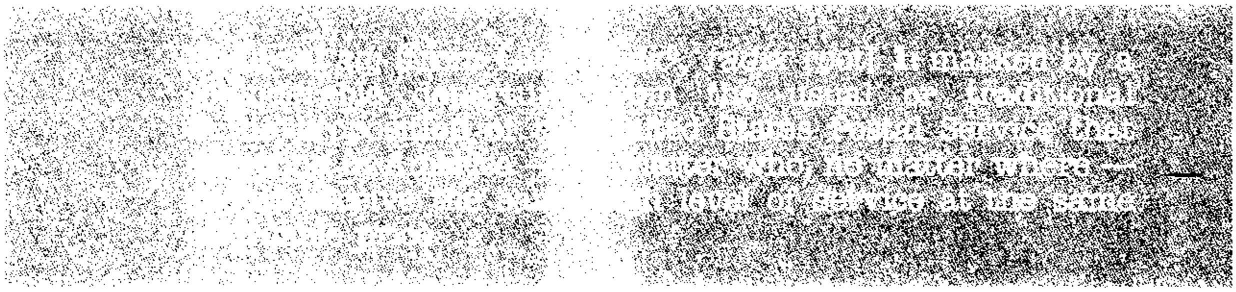
Our employees are covered by the Federal Employees' Compensation Act, administered by the Department of Labor's Office of Workers' Compensation Programs (OWCP) which makes all decisions regarding injured workers' eligibility for benefits. We pay all postal workers' compensation claims out of postal funds. Thus, our bottom line is directly affected every time an employee is injured.

We record as a liability the present value of all future payments we expect to make to those employees receiving workers' compensation. At the end of 2002, we estimate our total liability for future workers' compensation costs at $6,525 million, an increase of $721 million or 12.4% over 2001. For 2002, we had anticipated workers' compensation costs of $1,026 million. We based our budget on then-recent trends that we expected to continue. However, in 2002, we recorded $1,511 million in workers' compensation expense, compared to the $970 million we recorded in 2001.

A number of factors contributed to the unexpected increase in workers' compensation expense. In addition to an increase in the number of medical claims paid, the average cost per medical claim increased 8.5% from $2,150 in 2001 to $2,332 in 2002, an increase of $298 million. There was a record increase in the number of compensation claims in 2002. These changes resulted in a $381 million increase in the liability. We expect these trends to stabilize in 2003.

In addition to the cost of workers' compensation claims, OWCP charges us an administrative fee for processing claims. In 2002, the administrative fee was $37 million compared to $31 million in 2001.

(See Notes 2 and 3 of the Notes to Financial Statements for additional details.)

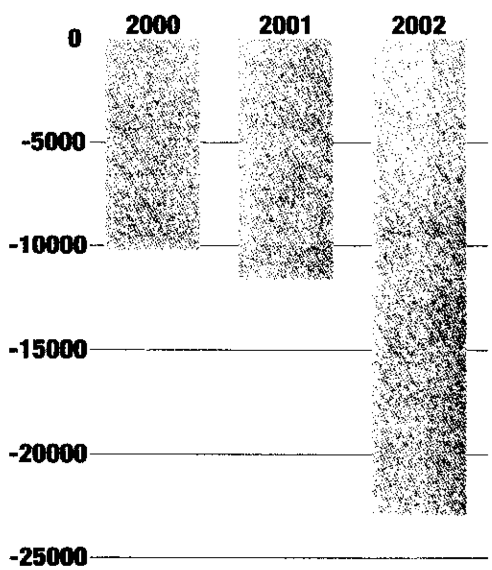


PRODUCTIVITY

We use two indicators to measure our efficiency. First, we use Output per Workhour which measures the change in the relationship between workload (mail volume and deliveries) and the labor resources used to do the work. Second, we use Total Factor Productivity (TFP), which measures the change in the relationship between workload, and all the resources used in producing these outputs. Our main output is delivering mail and service to an expanding delivery network. Resources measured in the TFP calculations include labor for processing and delivery, transportation, capital investments, materials and other non-personnel costs.

During 2002, our Output per Workhour grew by 2.2%, and our TFP improved by 1.1%. This TFP growth is equivalent to $700 million in expense reductions. 2002 marks our third consecutive year of positive TFP growth, with equivalent expense reductions totaling over $3 billion over this time. Our productivity growth continues to be fueled by substantial restraints on resource usage. In 2002 we were able to achieve positive TFP growth as the volume of our workload declined while deliveries grew, in contrast to the years before 2001 when our strong TFP growth was fueled largely by absorbing an ever-increasing total workload.

REDUCTION IN CAREER EMPLOYEES



IN THE LAST THREE YEARS, WE REDUCED OUR WORKFORCE EVEN AS WE ADDED 5.4 MILLION DELIVERY POINTS

TRANSPORTATION

Transportation expenses increased by $76 million in 2002. On August 27, 2001, we entered into a contract with FedEx to transport a portion of expedited mail through their existing air network. After the terrorist attacks on September 11, the Federal Aviation Administration placed restrictions on mail pieces weighing more than 16 ounces, which prohibited the Postal Service from using commercial air carriers to carry packages. We were forced to move virtually all Priority Mail to either the FedEx network or our surface network, with a small volume of mail on air taxis, which is costly. Although the FedEx network is less expensive than our old dedicated network, it is more expensive than commercial air carriers. The increased use of the FedEx network has increased air transportation costs. We are currently moving 51% of Priority Mail on our surface network, 48% on FedEx and 1% on contracted off-shore air taxis to service routes not served by FedEx.

GROWTH IN TRANSPORTATION EXPENSES

2002	2001	2000
1.5%	7.4%	10.4%

Even with the additional increase in volume to the FedEx network, we were able to keep the growth in transportation costs to a minimum. We moved more Priority Mail to surface transportation, reducing those network costs. We renegotiated our existing contract with FedEX to lower rates as volume on that network increased. A decrease in mail volume and a decline in fuel prices also helped us control our transportation costs.

We think that our transportation costs for 2003 will remain in line with our costs for 2002. We continue to work with the Transportation Security Administration with the expectation that we will again be able to use passenger air transportation for Priority Mail. We are also working to integrate and realign our distribution and transportation infrastructure.

Ac·cess n [from Latin *accessus* to approach] **1:** freedom or ability to obtain or make use of **2:** and the United States Postal Service offers more access than any other retailer in America — or the world

MD&A CAPITAL INVESTMENT AND FINANCING

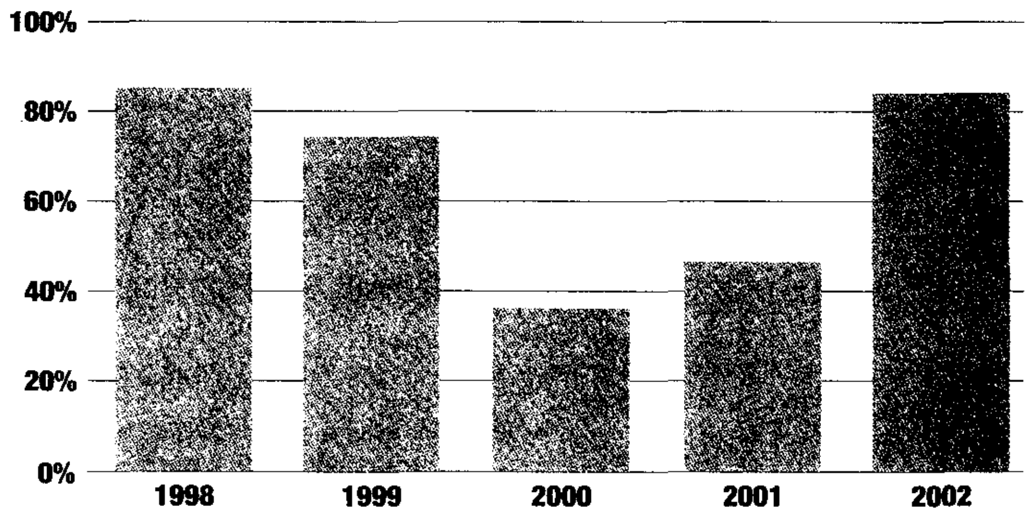
CAPITAL

Capital cash outlays are the payments we make for such capital improvements as facilities, automation equipment and information technology. During the year, when we realized that cash flow from operations was going to be significantly less than we had expected, we reduced our capital commitments, and we continued the freeze on new facility commitments to avoid a major increase in borrowing.

The Cash Flow/Capital Expenditure (CAPEX) ratio shows the relationship between these main drivers of our debt balance. CAPEX is computed by dividing cash flow from operations by capital cash outlays. In 2000 and 2001, the CAPEX ratio was close to 40%, and debt was increased substantially to cover the gap. In 2002, a $176 million increase in cash flow from operations and a $1.3 billion reduction in planned capital expenditures raised the CAPEX ratio to 84%. The remaining gap was covered by reducing non-appropriated cash

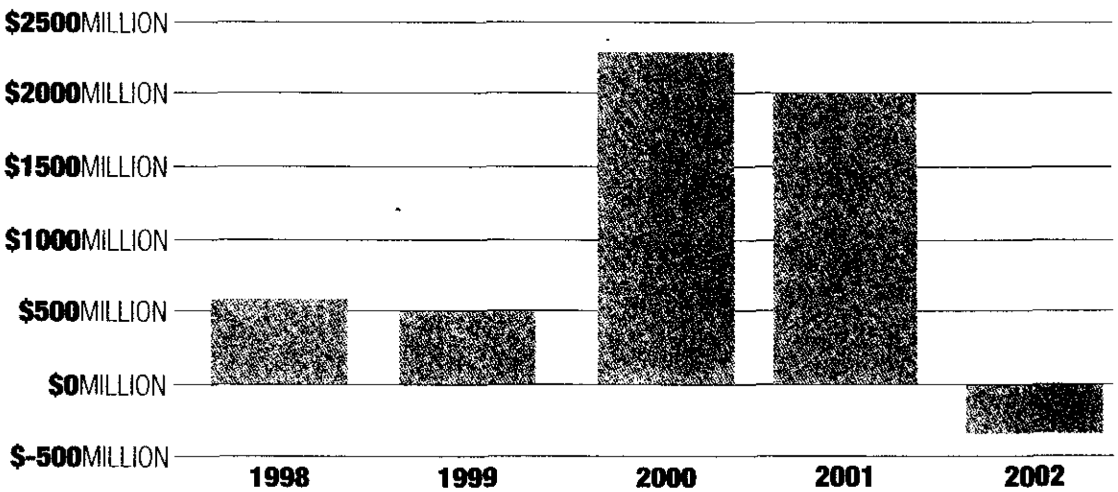
WHEN THE CASH FLOW/ CAPEX RATIO FALLS BELOW 100%, WE CANNOT PAY FOR ALL CAPITAL WITH INTERNALLY GENERATED FUNDS

CASH FLOW/CAPITAL EXPENDITURE (CAPEX) RATIO



BUT MUST INCREASE DEBT (1998 – 2001) OR USE AVAILABLE CASH ON HAND TO REDUCE DEBT (2002)

ADDITIONAL(REDUCED) DEBT



Di·verse *adj* [from Latin *divertere* to turn in opposite directions] **1:** composed of distinct or various elements **2:** because they're part of every community we serve, the men and women of the United States Postal Service reflect the communities we serve.

on hand. This reduction in available cash not only covered the difference between cash flow from operations and capital expenditures, but it also permitted a $200 million reduction in debt as shown in the graph. In other words, our beginning cash balance of $1.0 billion allowed for reduction in debt without the use of appropriated funds.

CAPITAL INVESTMENTS

All major capital projects, generally defined as projects greater than $10 million, require authorization by the Board of Governors. At the beginning of the year, there were 56 Board-approved projects in progress. During the year, 10 additional projects, totaling $1,261 million, were authorized. The following table shows the project authorization history and the commitment and capital cash outlays for the 50 Board-approved projects active at the end of the year. While the funding for a project may be authorized in one year, the commitment, or contract to purchase or build the project, may occur over several years. In addition, the actual payment, or capital cash outlays, for the project may occur over several years. In the following table, the $1,030 million in capital outlays for board approved projects for 2002 represents outlays for commitments made in previous years as well as some commitments made in 2002.

ACTIVE BOARD-APPROVED CAPITAL PROJECTS AT END OF 2002 ($ MILLIONS)

	[illegible]	Commitments*	Outlays*
2002	$1,789	$823	$1,030
2001	1,375	517	896
2000	436	1,037	379
1999 and earlier	2,092	1,570	578
TOTAL	**$5,692**	**$3,947**	**$2,883**

** This table summarizes the Cash Outlays and Commitments made that year for each of the active, Board-approved projects, regardless of the year in which the Board authorized the project.*

CAPITAL FREEZE

We prioritize all proposed capital projects, giving the highest priority to investments related to the safety of our employees and customers, legal requirements, emergencies and investments that produce labor efficiencies. We placed a freeze on all other new facilities. Our total capital commitments for 2002 were $1.3 billion with cash outlays of $1.7 billion.

FUTURE

Our capital plan for the future calls for aggressive cost management by developing and deploying new automation and mechanization equipment that will increase our operating efficiency. We estimate our total capital commitment plan for 2003 at $2.5 billion. We will continue to concentrate on maintaining such infrastructure as facilities, vehicles and systems, as well as return on investment projects. Under this plan, we will make investments in programs that reduce work hours in our distribution, processing and delivery operations. A prime example of this type of investment is Postal Automated Redirection System (PARS) approved by the Board of Governors in 2002. PARS will identify and intercept letters that should be forwarded during the initial handling and automatically redirect them to the new address. Each year we process more than 43 million change-of-address orders and over 5 billion pieces of mail that must be either forwarded, returned to sender or handled alternatively. The total cost attributed to this activity exceeds $1.5 billion annually. PARS technology will help us capture cost savings by reducing labor and the time required for delivery.

With the exception of mail forwarding, there are no new major automated equipment initiatives left for letter mail. We will focus on flat mail processing, including the Flats Optical Character Reader, Flats Identification Code Sorter and the Flats Feeder Enhancement Program. We expect this focus will be as successful as our efforts in reducing costs for letter mail processing.

In 2001, our facility-related investments were limited to those that addressed emergency, safety and legal issues; modifications to ongoing construction; planning funds for a small number of major projects and opportunities for revenue generation or significant savings. In 2002, we expanded these criteria to

Uni·ver·sal adj [from universum the universe] 1: comprehensively broad and versatile without limit or exception 2: combine that with service and you're talking about the mission of the United States Postal Service — affordable, universal service for every American.

address high-growth areas, facility obsolescence and necessary maintenance of our real property assets. We review projects meeting these criteria on a case-by-case basis.

DEBT

From 1997 through 2001, our capital cash outlays exceeded cash flow from operations by $5.3 billion, so we covered the difference with borrowed funds. Our debt outstanding with the Department of the Treasury's Federal Financing Bank increased by $5.4 billion during that period. This year, however, we were able to reverse the trend of increasing debt each year. Debt outstanding at the end of the year was $11.1 billion, a decrease of $200 million compared to 2001.

Our debt balance at the end of the year represents our highest level of debt for the year because, while we accrue our expenses for workers' compensation and deferred retirement benefits throughout the year, we make the actual payments in late September. This year we paid $4.7 billion, including $787 million for workers' compensation and $3.9 billion for the Civil Service Retirement System (CSRS) deferred retirement costs and cost of living adjustments (COLAs) for retirees. Our cash flow throughout the year was sufficiently strong to reduce debt from the prior year-end level. We have debt financing flexibility and can manage the fluctuations in our debt during the year by actively managing our credit lines. However, just as our debt balance at year-end has increased in recent years, so has our average debt level. The graph of our debt during the year illustrates this point well, showing that the peaks were getting higher each year.

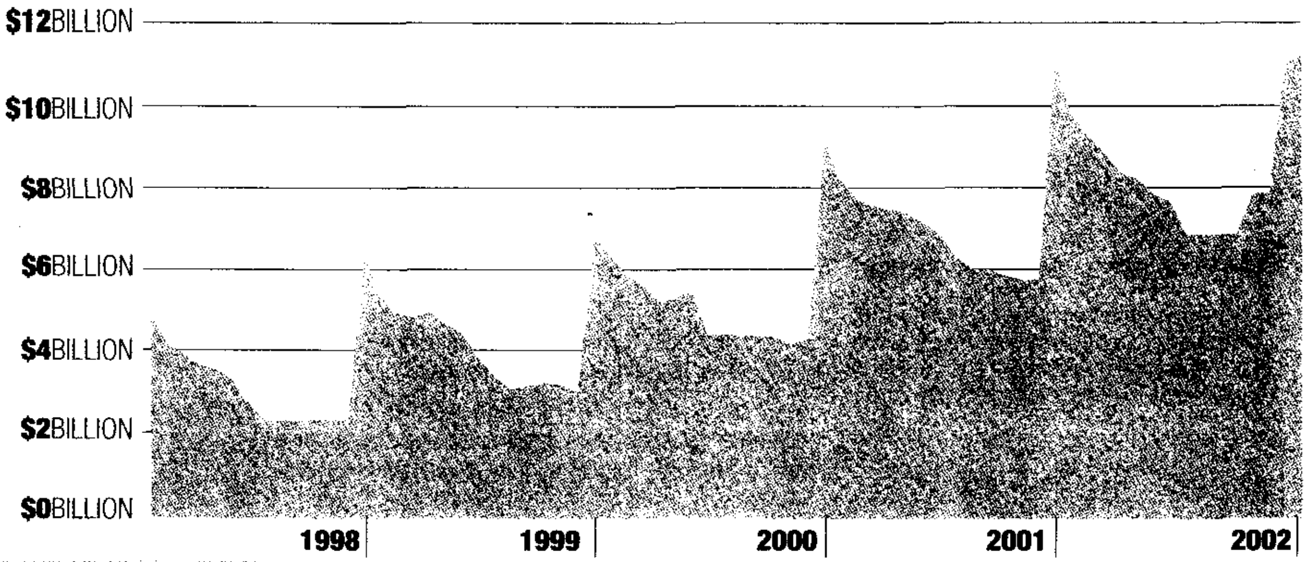
DEBT/AVERAGE DEBT/INTEREST EXPENSE

	Year-End Debt $billions	Average Debt $billions	Interest Expense $millions
2002	**$11.1**	**7.7**	**$340**
2001	11.3	6.4	306
2000	9.3	4.7	220
1999	6.9	3.9	158
1998	6.4	3.2	167

For 2002, our average outstanding debt during the year was less than the prior year-end balance but increased 20.3%, or $1.3 billion, to $7.7 billion. Our interest expense totaled $340 million in 2002, compared to $306 million in 2001. Managing cash and debt on a daily basis is one of the means we use to minimize annual interest expense.

DEBT BALANCE DURING THE YEAR

OUR DEBT PEAKS EACH YEAR ON SEPTEMBER 30



MANAGING NET INTEREST EXPENSE AND RISK

Our interest expense is determined by the interaction of a number of variables including day-to-day cash flows, the behavior of interest rates and our debt management activities.

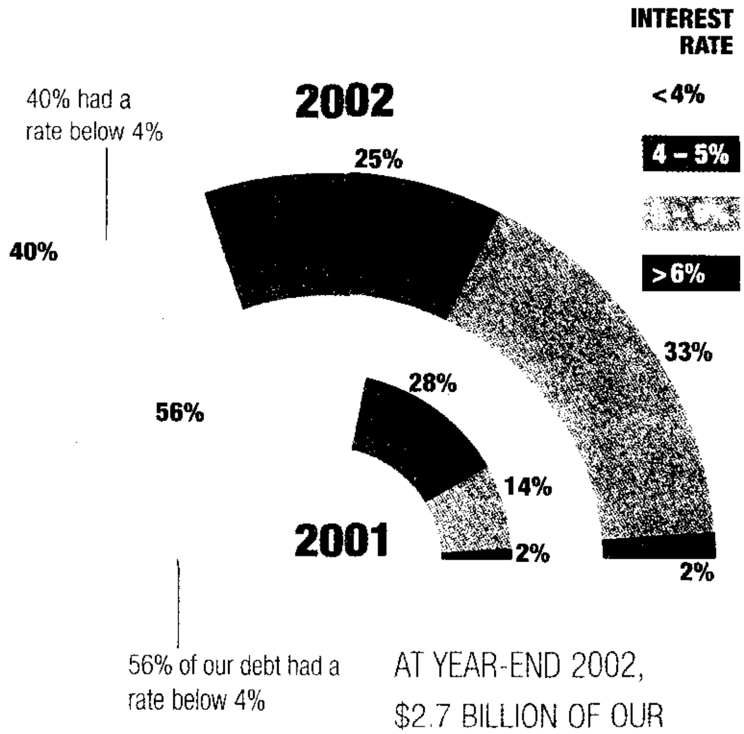
We prefer to maintain a mix of fixed- and floating-rate debt because we believe that, over the long term, variable- or floating-rate debt may provide more cost-effective financing than 100% fixed-rate debt. However, we strive for a favorable balance, and we borrow fixed-rate debt when market opportunities arise, or when we believe doing so reduces risk. Such was the case this year with long-term interest rates declining to historically low levels not seen in 40 years. We shifted the balance of our debt portfolio toward more fixed-rate long-term debt, reducing our exposure to any increase in interest rates.

We entered 2002 knowing that $1.15 billion of our long-term debt would become reclassified as short-term debt by the end of the year. We also believed that long-term rates had become very attractive for borrowers.

Rather than execute all of our transactions at one time, we prefer to assess market conditions continuously and then make measured increments in our borrowing. Beginning in February, and then again in July and September, we added $2.7 billion in long-term debt in eleven separate transactions. The weighted average rate on this year's financings was 4.36%, and the weighted average maturity was 10.49 years. We benefited from declining rates by stabilizing future interest expense volatility.

At year-end, our long-term debt was $7.3 billion, with a weighted average interest rate of 5.01%, in comparison with $5.75 billion and a weighted average rate of 5.17% at the end of 2001. Our 2002 borrowing transactions ranged from a high of 5.522% for a twenty-nine-year maturity to a low of 3.449% for a five-year maturity. As we enter 2003, our debt portfolio puts us in a good position to manage interest expense and risk for next year and beyond.

AT THE END OF 2002, ONLY $250 MILLION OR 2% OF OUR DEBT HAD A RATE ABOVE 6%.



AT YEAR-END 2002, $2.7 BILLION OF OUR DEBT HAD AN INTEREST RATE BELOW 2%.

Pride *n* [from Latin *prodesse* to be advantageous] **1:** a reasonable or justifiable self-respect **2:** the special quality that unites the 750,000 men and women of the United States Postal Service.

MD&A CAPITAL INVESTMENT AND FINANCING

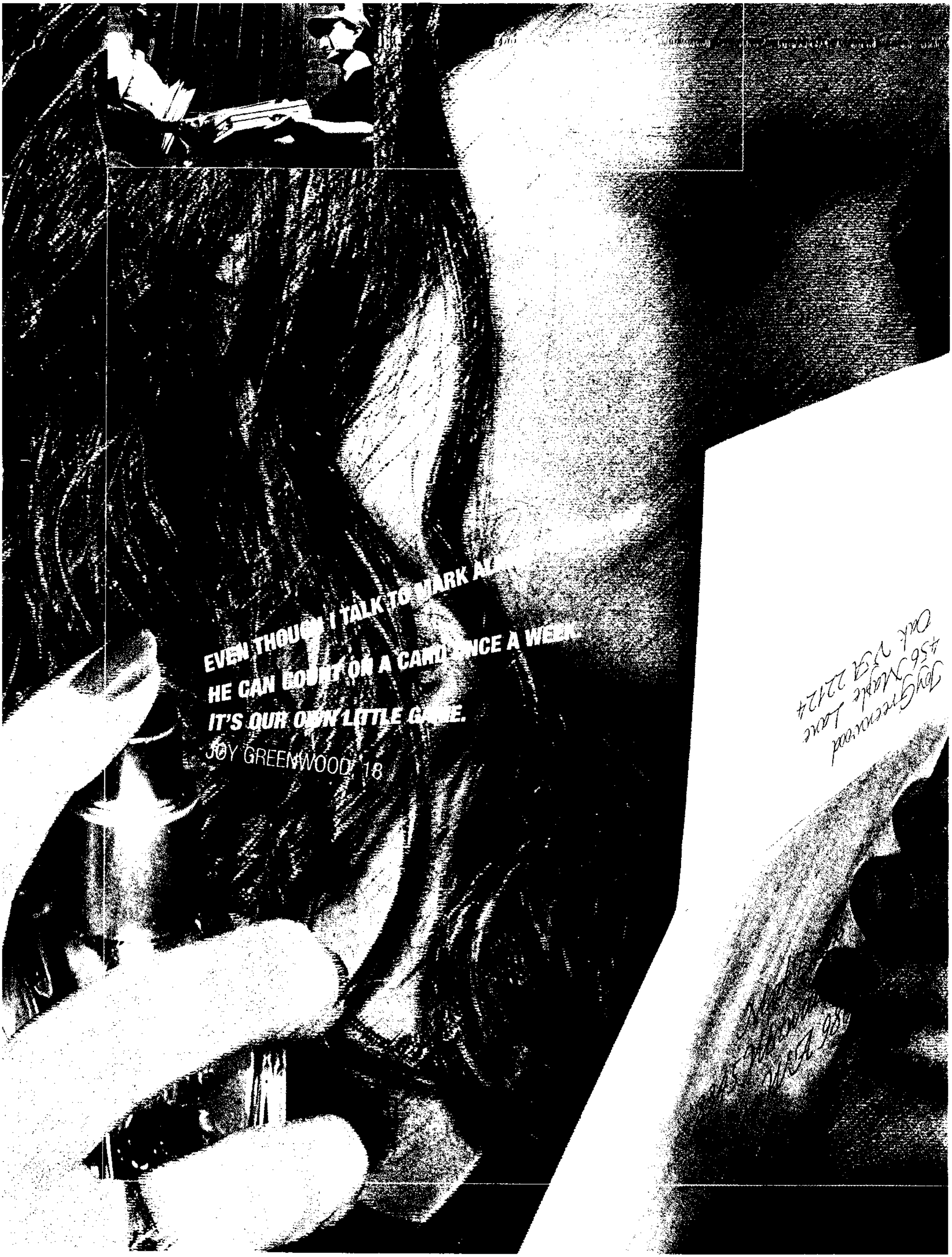
LIQUIDITY

Liquidity is the cash that we have in the bank (the Postal Service Fund) and the amount of money we can borrow immediately if needed. In recent years we have relied less on the cash we have on hand and more on the readily available cash we can borrow as needed. Our Note Purchase Agreement with the Federal Financing Bank, renewed this year, provides for revolving credit lines of $4 billion. These credit lines enable us to draw up to $3.4 billion with two days' notice and up to $600 million on the same business day. Under this agreement we can also use a series of other notes with varying provisions to draw upon with two days' notice.

We are limited in the amount of funds we can borrow by the amount of debt authorized by the Board of Governors and by certain statutory limits on our borrowing. First, our total debt outstanding cannot exceed $15 billion. Second, the net increase in debt for any year cannot exceed $2 billion for capital purposes and $1 billion for operating purposes.

The economic slowdown had a negative impact on our cash flow. In addition, we were the target of multiple acts of terrorism. Both management and the Governors moved immediately to counteract the effects of these actions on our cash flow and liquidity. To increase cash flow on the revenue side, we implemented new postage rates on June 30, three months ahead of schedule. On the disbursement side, we reduced expenses and, therefore, increased our cash flows from operations. By increasing revenue and reducing expenses, we limited our net loss to $676 million. We also continued our freeze on capital facility projects and reduced planned cash outlays for capital by $500 million. In addition, we received $762 million in emergency appropriations, most of which we had not disbursed by the end of the year.

We are currently projecting net income of $600 million and capital expenditures, funded by operations, of $2 billion in 2003. If we achieve these targets, we should generate excess net cash flow that can be applied to debt reduction. Debt reduction beyond 2003 will depend on our ability to operate at close to a break-even net income combined with capital expenditures that approximate our depreciation expense. The requirement that customers pay for postage before mail can be processed reduces our need for external financing. Any change to this policy would adversely affect our level of debt outstanding. Payment of retirement expenses is not problematic since these expenses are provided for on an ongoing basis in the cost structure of postage rates.


EVEN THOUG I TALK TO MARK AL
HE CAN COUNT ON A CARD ONCE A WEEK.
IT'S OUR OWN LITTLE GAME.
JOY GREENWOOD, 18

Board of Governors
United States Postal Service

We have audited the accompanying balance sheets of the United States Postal Service as of September 30, 2002 and 2001, and the related statements of operations, changes in net capital deficiency and cash flows for each of the three years in the period ended September 30, 2002. These financial statements are the responsibility of the United States Postal Service's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards for financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the United States Postal Service at September 30, 2002 and 2001, and the results of its operations and its cash flows for each of the three years in the period ended September 30, 2002, in conformity with accounting principles generally accepted in the United States.

In accordance with *Government Auditing Standards*, we have issued our report dated November 8, 2002, on our consideration of the United States Postal Service's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report when considering the results of our audit.

Ernst + Young LLP

McLean, VA
November 8, 2002

STATEMENTS OF OPERATIONS

[illegible]	Year ended September 30, 2002	2001	2000
Operating revenue — Note 7	**$66,463**	$65,834	$64,540
Operating expenses:			
Compensation and benefits — Notes 2, 3, 4 and 6	**51,557**	51,351	49,532
Transportation	**5,132**	5,056	4,709
Other	**8,545**	9,233	8,751
Total operating expenses	**65,234**	65,640	62,992
Income from operations	**1,229**	194	1,548
Interest and investment income	**46**	35	41
Interest expense on deferred retirement liabilities — Note 6	**(1,601)**	(1,603)	(1,568)
Interest expense on borrowings	**(340)**	(306)	(220)
Emergency preparedness appropriations — Note 10	**179**	-	-
Emergency preparedness expenses — Note 10	**(189)**	-	-
Net Loss	**$ (676)**	$ (1,680)	$ (199)

See accompanying notes to financial statements.

BALANCE SHEETS

(DOLLARS IN MILLIONS)	September 30, 2002	2001
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents — Note 2	**$ 1,156**	$ 1,005
Receivables:		
Foreign countries	**592**	379
U.S. government	**125**	133
Consignment	**55**	55
Other	**137**	151
	909	718
Less allowances	**112**	110
Total receivables, net	**797**	608
Supplies, advances and prepayments	**327**	320
TOTAL CURRENT ASSETS	**2,280**	1,933
OTHER ASSETS, PRINCIPALLY REVENUE FORGONE APPROPRIATIONS RECEIVABLE — NOTE 7	**368**	372
PROPERTY AND EQUIPMENT, AT COST:		
Buildings	**19,513**	18,808
Equipment	**16,421**	15,456
Land	**2,776**	2,684
Leasehold improvements	**1,098**	1,163
	39,808	38,111
Less allowances for depreciation and amortization	**16,895**	15,317
	22,913	22,794
Construction in progress	**1,223**	1,969
TOTAL PROPERTY AND EQUIPMENT, NET	**24,136**	24,763
DEFERRED RETIREMENT COSTS — NOTE 6	**32,231**	32,023
TOTAL ASSETS	**$59,015**	$59,091

See accompanying notes to financial statements.

[illegible]	September 30, 2002	2001
LIABILITIES AND NET CAPITAL DEFICIENCY		
CURRENT LIABILITIES:		
Compensation and benefits	**$ 5,113**	$ 5,810
Estimated prepaid postage	**1,500**	1,623
Payables and accrued expenses:		
Foreign countries	**748**	499
U.S. government	**246**	151
Emergency preparedness appropriations — Note 10	**583**	-
Other	**584**	956
Total payables and accrued expenses	**2,161**	1,606
Prepaid box rentals, permit and metered mail	**2,011**	1,866
Outstanding postal money orders	**986**	988
Current portion of long-term debt	**3,815**	5,564
TOTAL CURRENT LIABILITIES	**15,586**	17,457
LONG-TERM DEBT, LESS CURRENT PORTION — NOTE 5	**7,300**	5,751
OTHER LIABILITIES:		
Amounts payable for deferred retirement benefits — Note 6	**30,046**	29,932
Workers' compensation costs — Notes 2 and 3	**5,815**	5,167
Employees' accumulated leave	**2,088**	2,124
Other	**1,182**	986
TOTAL OTHER LIABILITIES	**39,131**	38,209
COMMITMENTS AND CONTINGENCIES — NOTES 8 AND 9		
TOTAL LIABILITIES	**62,017**	61,417
NET CAPITAL DEFICIENCY:		
Capital contributions of the U.S. government	**3,034**	3,034
Deficit since reorganization	**(6,036)**	(5,360)
TOTAL NET CAPITAL DEFICIENCY	**(3,002)**	(2,326)
TOTAL LIABILITIES AND NET CAPITAL DEFICIENCY	**$59,015**	$59,091

See accompanying notes to financial statements.

STATEMENTS OF CHANGES IN NET CAPITAL DEFICIENCY

Year ended September 30, 2002, 2001 and 2000

(DOLLARS IN MILLIONS)	Capital Contributions of U.S. Government	Deficit Since Reorganization	Total Net Capital Deficiency
Balance, September 30, 1999	$3,034	$ (3,481)	$ (447)
Net Loss	—	(199)	(199)
Balance, September 30, 2000	3,034	(3,680)	(646)
Net Loss	—	(1,680)	(1,680)
Balance, September 30, 2001	3,034	(5,360)	(2,326)
Net Loss	—	**(676)**	**(676)**
BALANCE SEPTEMBER 30, 2002	**$3,034**	**$(6,036)**	**$(3,002)**

See accompanying notes to financial statements.

	Year ended September 30, 2002	2001	2000
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net loss	**$ (676)**	$(1,680)	$ (199)
Adjustments to reconcile net (loss) to net cash provided by operating activities:			
Depreciation and amortization	**2,296**	2,223	2,029
(Gain) loss on disposals of property and equipment, net	**(6)**	16	(5)
Decrease in other assets, principally revenue forgone appropriations receivable	**4**	3	1
Increase in USPS workers' compensation	**721**	244	254
Increase (decrease) in Post Office Department workers' compensation	**13**	(21)	(17)
(Decrease) increase in employees' accumulated leave	**(36)**	34	49
Increase (decrease) in other liabilities	**196**	167	(20)
Changes in current assets and liabilities:			
Increase in receivables, net	**(189)**	(19)	(11)
(Increase) decrease in supplies, advances and prepayments	**(7)**	63	4
(Decrease) increase in compensation and benefits	**(877)**	310	(892)
(Decrease) increase in estimated prepaid postage	**(123)**	29	(34)
(Decrease) increase in payables and accrued expenses	**(28)**	(283)	225
Increase (decrease) in prepaid box rentals, permit and metered mail	**145**	(103)	(80)
(Decrease) increase in outstanding postal money orders	**(2)**	272	(97)
Net cash provided by operating activities	**1,431**	1,255	1,207
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of property and equipment	**(1,705)***	(2,961)	(3,337)
Proceeds from sale of property and equipment	**42**	29	83
Net cash used in investing activities	**(1,663)**	(2,932)	(3,254)
CASH FLOWS FROM FINANCING ACTIVITIES:			
U.S. government emergency preparedness appropriations	**762**	-	-
Less portion used to offset expenses	**(179)**	-	-
Appropriation balance	**583**	-	-
Issuance of debt	**2,700**	5,651	5,550
Payments on debt	**(2,900)**	(3,652)	(3,151)
Net cash provided by financing activities	**383**	1,999	2,399
Net increase in cash and cash equivalents	**151**	322	352
Cash and cash equivalents at beginning of year	**1,005**	683	331
CASH AND CASH EQUIVALENTS AT END OF YEAR	**$ 1,156****	$ 1,005	$ 683

See accompanying notes to financial statements.

* *Includes $38 million for purchase of emergency preparedness equipment not yet placed in service. See Note 10.*

** *Includes cash of $545 million to be used for emergency preparedness. See Note 10.*

1 DESCRIPTION OF BUSINESS

Nature of Operations

The United States Postal Service (Postal Service) provides mail service to the public, offering a variety of classes of mail services without discrimination among its many customers. This means that within each class of mail our price does not vary by customer for the levels of service we provide. This fulfills our legal mandate to offer universal services at a fair price. Our primary lines of business are First-Class Mail, Standard Mail and Priority Mail. The principal markets for these services are the communications, distribution and delivery, advertising and retail markets. Our products are distributed through our 38,000 post offices and a large network of consignees. As in the past, we continue to conduct our significant operations primarily in the domestic market, with international operations representing less than 3% of total revenue.

Our labor force is primarily represented by the American Postal Workers Union, National Association of Letter Carriers, National Postal Mail Handlers Union and National Rural Letter Carriers Association. Almost 90% of our career employees are covered by collective bargaining agreements. Agreements with the unions representing all of these employees were finalized during 2002. The agreements with the major unions expire between November 20, 2003 and November 20, 2006.

Postal Reorganization

The Postal Service commenced operations on July 1, 1971, in accordance with the provisions of the Postal Reorganization Act (the Act). The equity that the U.S. government held in the former Post Office Department became the initial capital of the Postal Service. The Postal Service valued the assets of the former Post Office Department (POD) at original cost less accumulated depreciation. The initial transfer of assets, including property, equipment and cash, totaled $1.7 billion. Subsequent cash contributions between 1973 and 1982 totaled approximately $1.3 billion, resulting in total government contributions of approximately $3 billion. The U.S. government remained responsible for all the liabilities attributable to operations of the former POD. However, under the Balanced Budget Act of 1997, the remaining liability for certain POD costs was transferred to the Postal Service. See Note 3 for additional information on costs transferred to the Postal Service.

Although the Postal Service is excluded from the U.S. government budgetary process, the Postal Service enters into significant transactions with other government agencies, as disclosed throughout these financial statements.

Price Setting Process

Since 1971, the Act has required the Postal Service to establish prices that cover the costs of operating the postal system. The Act established the independent Postal Rate Commission with oversight responsibility for mail prices, subject to approval by the Governors of the Postal Service. The Act provides for the recovery of financial losses through future rate increases.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting and Use of Estimates

We maintain our accounting records and prepare our financial statements on the accrual basis of accounting. This basis conforms to accounting principles generally accepted in the United States. Following these principles, we made estimates and assumptions that affect the amounts we report in the financial statements and notes. Actual results may differ from our estimates.

Cash Equivalents

Cash equivalents are securities that mature within 90 days or less from the date we buy them. We recognize checks outstanding as a current liability until presented for payment.

Current Values of Financial Instruments

The current value of our debt is what it would cost to pay off the debt if we used the current yield on equivalent U.S. Treasury debt.

Supplies, Advances and Prepayments

Supplies, advances and prepayments are primarily composed of our inventories of supplies, motor vehicle parts, repairable parts for mail processing equipment and advances to employees for annual leave. We value our inventories at the lower of average cost or current market price. Total inventories amounted to $136 million at the end of 2002 and $152 million at the end of 2001.

Property and Equipment

We record property and equipment at what it costs us to acquire the assets, including the interest we pay on the money we borrow to pay for the construction of major capital additions. This interest amounted to $23 million in 2002, $50 million in 2001 and $49 million in 2000.

We depreciate buildings and equipment over their estimated useful lives, which range from 3 to 75 years, using the straight-line method. We amortize leasehold improvements over the period of the lease or the useful life of the improvement, whichever time is shorter.

Impaired Assets

We record losses on long-lived assets when events and circumstances indicate it is probable that the assets are impaired. In accordance with FAS Statement No. 121, *Accounting for the Impairment of Long-lived Assets and for Long-lived Assets to be Disposed Of*, we have written down our impaired assets to the lower of cost or fair value. No material impairments were recorded in 2002, 2001 or 2000.

Revenue Recognition/Estimated Prepaid Postage

We recognize revenue when service is rendered. Estimated prepaid postage is the amount of cash we estimate that we collected by the end of the year for services that we will perform in the following year. In 2002 after extensive analysis, we changed our estimate of the sampling period for meter customers from 92 days to 30 days to more closely reflect the meter resetting practices of our customers. The impact of this change in estimate is a $113 million reduction of the liability in 2002.

Compensation and Benefits Payable

This is the salaries and benefits we owe to current and retired employees, including the amounts employees have earned but have not yet been paid, current workers' compensation, unemployment costs, health benefits and the current portion of the amounts payable for retirement benefits.

Deferred Retirement Benefits and Costs

This is the present value of our estimated legal obligation to the Civil Service Retirement and Disability Fund (CSRDF) for the amount of retirement benefits payable in the future for our current Civil Service Retirement System (CSRS) employees' retirement and our present retirees and their survivors. The present value of our benefits payable for our current CSRS employees increases when management increases basic pay.

The present value of our benefits payable also increases when cost of living adjustments (COLAs) are granted by Congress to our CSRS retirees or their survivors. We capitalize as deferred retirement costs the amounts due and payable in future years. We expense and pay these costs over periods of 30 years for amounts attributable to current employees and 15 years for amounts attributable to retirees, at 5% interest. We account for our participation in the U.S. government sponsored retirement plans as a participant in a multi-employer plan arrangement in accordance with FAS Statement No. 87, *Employer's Accounting For Pension Costs*. See Note 6 for additional information.

Post-Retirement Health Benefits

Retiree health benefits costs are our obligation to pay a portion of the health insurance premiums of those retirees and their survivors who participate in the Federal Employees Health Benefits Program (FEHBP). We account for our participation in FEHBP as a participant in a multi-employer plan arrangement. Therefore, the costs of retiree health benefits are expensed as we incur them. See Note 4 for additional information.

Workers' Compensation Costs

We are self-insured for workers' compensation costs under a program administered by the Department of Labor (DOL). We record these costs, which include the employees' medical expenses and payment for continuation of wages, as an operating expense.

At the end of the year, our liability represents the estimated present value of the total amounts we expect to pay in the future for postal workers injured through the end of 2002. In our calculation of present value, a net discount rate of 1.4% for medical expenses and 3.0% for compensation claims is used.

The estimate of the total costs of a claim is based upon the severity of the injury, the age of the injured employee, the assumed life expectancy of the employee, the trend of our experience with such an injury, and other factors. See Note 3 for additional information.

Emergency Preparedness Appropriations

Emergency preparedness appropriations are the funds received from the federal government to help fund costs to keep the mail, postal employees and postal customers safe. Upon receipt of the funds, we establish a liability. Upon use of the funds, we recognize non-operating revenue to the extent of the expenditure. For capital equipment, we recognize non-operating revenue over the estimated useful life of the equipment when placed into service. See Note 10 for additional information.

New Accounting Pronouncements

In August 2001, the Financial Accounting Standards Board issued FAS Statement No.144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. FAS 144 supercedes FAS 121 referred to above and requires that one accounting model be used for long-lived assets to be disposed of by sale, whether previously held and used or newly acquired, and broadens the presentation of discontinued operations to include more disposal transactions. FAS 144 is effective for years beginning after December 15, 2001. We are currently assessing the impact of this statement on the Postal Service. However, we do not anticipate this statement will have a material impact on the financial position or results of our operations.

3 WORKERS' COMPENSATION

At the end of 2002, we estimate our total liability for future workers' compensation costs, excluding Post Office Department (POD) liability, at $6,525 million. At the end of 2001, this liability was $5,804 million.

In 2002, we recorded $1,511 million in workers' compensation expense, compared to the $970 million we recorded in 2001 and the $911 million we recorded in 2000. Our liability for future workers' compensation costs for POD claims was $185 million in 2002 and $172 million in 2001. In 2002, we recorded an expense of $13 million for POD, compared to the $9 million we recorded in 2001 and $14 million in 2000.

In 2000, we refined our methodology used to estimate the present value of the total amounts we expect to pay for current Postal Service workers' compensation claims. The major refinement is the use of a life table that reflects long-term experience with a disabled population to estimate mortality rates of our permanently disabled population. Previously, we had used a life table that reflected experience with the general United States population. In management's opinion, the refinements result in a better estimation of our liability for future outlays on behalf of Postal Service workers' compensation claimants. The effect of the refinements was a reduction of $423 million in the 2000 compensation and benefits expense.

4 POST-RETIREMENT HEALTH BENEFIT PROGRAMS

Career employees of the Postal Service are covered by the U.S. government health plan, the Federal Employees Health Benefits Program (FEHBP). The Office of Personnel Management administers the program and allocates the cost of the program to the various participating employers. Our portion of the cost is based upon the average premium cost of the various employee coverage choices and the specific coverage choices made by our employees. The employees of the Postal Service pay for 16.5% of the cost, and we pay the remainder.

Employees of the Postal Service who participate in the FEHBP for at least the five years immediately before their retirement may participate in the FEHBP during their retirement. The Omnibus Budget Reconciliation Act of 1990 requires us to pay the employer's share of health insurance premiums for all employees, and their survivors, who participate in the FEHBP and who retire on or after July 1, 1971. However, we do not include the costs attributable to Federal civilian service before that date.

We account for post-retirement health benefits as a participant in a multi-employer plan arrangement in accordance with FAS Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions.* Our FEHBP costs amounted to $987 million in 2002, $858 million in 2001 and $744 million in 2000. We include these costs in our compensation and benefits expense.

5 DEBT AND RELATED INTEREST COSTS

Under the Postal Reorganization Act, as amended by Public Law 101-227, we can issue debt obligations. However, we are limited to net annual increases of $2 billion in our debt for capital improvements and to $1 billion for operating expenses. Our total debt cannot exceed $15 billion.

Debt is due as follows (dollars in millions):

Year	Amount
2003	$3,815
2004	-
2005	300
2006	950
2007	1,250
After 2007	4,800

Cash outlays for interest were $339 million in 2002, $339 million in 2001 and $263 million in 2000.

At year-end, the current estimated market value of our debt is $11,991 million in 2002 and $11,650 million in 2001 (Note 2). All notes payable to the Federal Financing Bank (FFB) may be repurchased at current value at any time with five days' notice of intent to do so.

OUR DEBT CONSISTS OF THE FOLLOWING:

Interest Rate %	Terms *	September 30, 2002	2001
	NOTES PAYABLE TO THE FEDERAL FINANCING BANK (FFB):		
1.729**	Overnight revolving credit facility; final maturity date May 10, 2003	$ 214	$ 363
2.489	Payable March 28, 2002	-	800
2.501	Floating rate; payable December 28, 2001, March 28, 2002 and June 28, 2002	-	1,000
5.568	Payable December 31, 2002	200	200
4.543	Payable February 28, 2003	200	200
1.790***	Short-term, floating rate, revolving credit facility; final maturity date May 9, 2004	2,450	3,400
3.858	Payable July 31, 2003	750	750
3.636	Payable February 15, 2005	300	-
4.780	Payable November 15, 2005	200	200
5.412	Payable November 15, 2005	500	500
4.437	Payable May 15, 2006	250	250
4.325	Payable November 15, 2006	200	-
3.449	Payable May 15, 2007	250	-
3.714	Payable May 15, 2007	250	-
5.688	Payable August 15, 2007	400	400
5.546	Payable August 15, 2007	150	150
5.426	Payable May 15, 2008	200	200
4.981	Payable May 15, 2008	200	200
4.910	Payable May 15, 2008	200	200
4.806	Payable November 17, 2008	300	-
5.355	Payable August 16, 2010	500	500
4.999	Payable February 15, 2011	200	200
4.925	Payable August 15, 2011	200	200
4.414	Payable February 15, 2012	250	-
4.594	Payable February 15, 2012	250	-
5.012	Payable February 15, 2012	200	-
3.903	Payable August 15, 2012	250	-
5.959	Payable November 15, 2027	400	400
5.726	Payable November 15, 2027	100	100
5.606	Payable November 15, 2027	300	300
4.836	Payable November 15, 2027	100	100
6.299	Payable May 15, 2030	250	250
5.591	Payable May 15, 2030	250	250
5.417	Payable February 18, 2031	200	200
4.976	Payable February 18, 2031	250	-
5.522	Payable February 18, 2031	200	-
		11,114	11,313
	MORTGAGE NOTES PAYABLE:		
5.00 to 9.25	Maturing from fiscal years 2003 through 2039 secured by land, buildings and equipment with a carrying amount of $16 million.	1	2
		11,115	11,315
	Less current portion of debt	3,815	5,564
		$ 7,300	$ 5,751

* *All debt is repurchasable at any time at a price determined by then current FFB rates.*

** *Prior year rate was 2.521%.*

*** *Prior year rate was 2.501%.*

6 RETIREMENT PROGRAMS

We account for retirement benefits as a participant in a multi-employer plan arrangement, in accordance with FAS Statement No. 87, *Employers' Accounting for Pensions.*

With certain exceptions, employees participate in one of the following three retirement programs based upon the starting date of their employment with the Postal Service. Employee and employer contributions are made to the Civil Service Retirement System, the Dual System or the Federal Employees Retirement System, which are administered by the Office of Personnel Management. Employees may also participate in the Thrift Savings Plan, which is a defined contribution retirement savings and investment plan. Postal Service employees are authorized to participate in the Thrift Savings Plan by the Federal Employees Retirement System Act of 1986. The Plan is administered by the Federal Retirement Thrift Investment Board. We and all employees also contribute to Medicare at the rate prescribed by law.

Civil Service Retirement System (CSRS)

Under the Postal Reorganization Act, officers and career employees are covered by the Civil Service Retirement System, which provides a basic annuity. The CSRS fund covers substantially all employees hired prior to January 1, 1984. We do not match contributions to the Thrift Savings Plan for employees who participate in the CSRS.

Dual Civil Service Retirement System (Dual CSRS)/Social Security System

Employees with prior U.S. government service who were hired between January 1, 1984, and January 1, 1987, are covered by the Dual Civil Service Retirement System/Social Security System. We and the employee contribute to Social Security at the rate prescribed by law. We do not match contributions to the Thrift Savings Plan for employees who participate in the Dual System.

Federal Employees Retirement System (FERS)

Effective January 1, 1987, officers and career employees hired since December 31, 1983, except for those covered by the Dual System, are covered by the Federal Employees Retirement System Act of 1986. In addition, employees hired before January 1, 1984, could choose during certain periods in 1987, 1988 and 1998 to participate in the FERS. This system consists of Social Security, a basic annuity plan, and a Thrift Savings Plan.

We and the employee contribute to Social Security and the basic annuity plan at the rate prescribed by law. In addition, we are required to contribute to the Thrift Savings Plan a minimum of 1% per year of the basic pay of employees covered by this system. We also match a voluntary employee contribution up to 3% of the employee's basic pay, and 50% of a contribution between 3 and 5% of basic pay.

Percentages of employer and employee contributions are as follows for each of the three plans for 2002, 2001 and 2000:

	2002	2001	2000
CSRS			
Employer	7.0	7.0	7.0
Employee	7.0	7.0	7.4
DUAL CSRS			
Employer	7.0	7.0	7.0
Employee	0.8	0.8	1.2
FERS			
Employer	10.7	10.7	10.7
Employee	0.8	0.8	1.2

The number of employees enrolled in each of the retirement plans at the end of 2002, 2001 and 2000 is as follows:

	2002	2001	2000
CSRS	230,632	248,347	263,383
Dual CSRS	10,828	11,440	12,021
FERS	510,237	514,870	510,509

Deferred Retirement Costs

Deferred retirement costs consist of the following (dollars in millions):

	2002	2001
CSRS basic pay increases	$24,602	$24,843
CSRS retirees' and survivors' cost of living adjustments	7,629	7,180
TOTAL	$32,231	$32,023

There are no deferred retirement costs associated with FERS.

Deferred Retirement Liability — Civil Service Retirement System

When we increase CSRS employees' current basic pay, we are, by law, liable for the estimated additional deferred retirement liability. The Office of Personnel Management determines the estimated increase in the deferred liability of the Civil Service Retirement and Disability Fund (CSRDF) resulting from basic pay increases. We amortize and pay this amount in 30 equal annual installments, which includes interest computed at a rate of 5% per year. We make the first payment at the end of the year in which employees receive their pay increase.

The increase in our deferred liability for retirement benefits under the CSRS as a result of basic pay increases was $1,153 million in 2002, $313 million in 2001 and $1,635 million in 2000.

Deferred Retirement Liability — Retirees' and Their Survivors' Cost of Living Adjustments (COLAs)

Congress determines the COLAs granted to our retirees. Under the Omnibus Budget Reconciliation Act of 1990, we are liable, by law, for our share of the COLAs granted to those retirees, and their survivors, retiring on or after July 1, 1971. We are not responsible for any costs due to federal civilian service before that date.

Each year the Office of Personnel Management determines the estimated increase in our share of the liability of the CSRDF under this law for the current year. We amortize and pay each year's amount in 15 equal annual installments, which include interest computed at a rate of 5% per year.

The increase in our deferred liability for our retirees' COLAs was $1,329 million in 2002, $1,668 million in 2001 and $1,056 million in 2000.

Future Minimum Payments

The future minimum payments we have to make in order to fund CSRS benefits and retirees' COLAs as of September 30, 2002, are as follows (dollars in millions):

Year	Amount
2003	$ 3,796
2004	3,675
2005	3,585
2006	3,280
2007	3,162
After 2007	30,421
	47,919
Less amount representing interest	15,688
Total future minimum payments	32,231
Less: Portion classified as a current liability in compensation and benefits	2,185
Long-term portion of future minimum payments	$30,046

Expense Components

The following table lists the components of our total retirement expenses that are included in our compensation and benefits expense and related interest expense in the Statements of Operations for 2002, 2001 and 2000 (dollars in millions):

	2002	2001	2000
CSRS	$ 740	$ 769	$ 795
FERS	2,121	2,046	1,944
FERS — Thrift Savings Plan	827	789	750
Dual CSRS	33	33	35
Social Security	1,511	1,498	1,427
AMORTIZATION OF DEFERRED COST:			
CSRS	1,393	1,333	1,327
Annuitant COLAs	879	814	683
Interest expense on deferred liabilities	1,601	1,603	1,568
TOTAL RETIREMENT EXPENSE	$9,105	$8,885	$8,529

Employer cash contributions to retirement plans were $6,013 million in 2002, $5,799 million in 2001 and $5,516 million in 2000. These amounts do not include Social Security contributions and interest expense on deferred retirement liabilities.

7 REVENUE FORGONE

Our operating revenue includes accruals for revenue forgone. Revenue is forgone when Congress mandates that we provide free mail for certain mailers. Congress appropriates money to reimburse us for the revenue that we have forgone in providing these services. In our operating revenue, we have included as revenue the amounts appropriated by Congress for revenue forgone of $48 million for 2002, $67 million for 2001, and $64 million for 2000. Legislation enacted in 2002 and 2001 delayed payment of the amount authorized for 2002 and 2001 until the first day of the subsequent year, respectively. Accordingly, the Postal Service has recorded these amounts as a receivable at year end.

Under the Revenue Forgone Reform Act of 1993, Congress is required to reimburse us $29 million annually through 2035 (42 years). This reimbursement is for two purposes: services we performed in 1991, 1992 and 1993 for which we have not yet been paid; and for shortfalls in the reimbursement for the costs we incurred for processing and delivering certain nonprofit mail from 1994 through 1998.

The Revenue Forgone Reform Act of 1993 authorized a total of $1.218 billion in payments. We calculated the present value of these future reimbursements to be approximately $390 million at 7% interest. We recognized the $390 million as revenue during 1991 through 1998. The amounts receivable as of September 30, 2002 and 2001 were $370 million and $373 million, respectively.

8 COMMITMENTS

At September 30, 2002, we estimate our financial commitment for approved capital projects in progress to be approximately $1,536 million.

Our total rental expense for the years ended September 30 is summarized as follows (dollars in millions):

	2002	2001	2000
Non cancelable real estate leases including related taxes	$ 894	$ 863	$806
Facilities leased from General Services Administration subject to 120-day notice of cancellation	45	41	39
Equipment and other short-term rentals	214	312	254
TOTAL	$1,153	$1,216	$1,099

At September 30, 2002, our future minimum lease payments for all non cancelable leases are as follows (dollars in millions):

Year	Operating	Capital
2003	$ 805	$ 97
2004	786	97
2005	742	97
2006	683	97
2007	625	97
After 2007	5,963	605
	$9,604	$1,090
Less: Interest at 5.25%		268
Total capital lease obligations		822
Less: Short-term portion of capital lease obligations		55
Long-term portion of capital lease obligations		$ 767

Most of these leases contain renewal options for periods ranging from 3 to 20 years. Certain non cancelable real estate leases give us the option to purchase the facilities at prices specified in the leases.

Capital leases included in buildings were $1,038 million in 2002 and $909 million in 2001. Total accumulated amortization is $264 million in 2002 and $211 million in 2001. Amortization expense for assets recorded under capital leases is included in depreciation expense.

9 CONTINGENT LIABILITIES

Each quarter we review litigation pending against us. As a result of this review, we classify and adjust our contingencies for claims that we think it is probable that we will lose and for which we can reasonably estimate the amount of the unfavorable outcome.

These claims cover labor, equal employment opportunity, environmental issues, traffic accidents, injuries on postal properties, personal claims and property damages, and suits and claims arising from postal contracts. We also recognize the settlements of claims and lawsuits and revisions of other estimates. Additionally, we evaluate the materiality of cases determined to have a reasonably possible chance of adverse outcome. Such cases are immaterial to our financial statements taken as a whole.

As a part of our continuing evaluation of estimates required in the preparation of management's financial statements, we recorded a $128 million increase in liabilities in 2002, $35 million in 2001 and $63 million in 2000, to recognize changes in the estimated cost of litigation and claims asserted in prior years. We recognized settlements of claims and lawsuits and revised other estimates in our changes in contingent liabilities. Management and General Counsel believe that we have made adequate provision for the amounts that may become due under the suits, claims and proceedings we have discussed here.

10 EMERGENCY PREPAREDNESS FUNDING

In October 2001, the United States became the target of biological terrorism. These activities affected us because infectious biological agents were sent by mail, resulting in the death of two employees, the curtailment of mail services in some areas, long-term closing of two processing facilities and a decline in mail volume. Our viability and our value to the American people, is dependent upon an open and accessible system. It was critical to put in place process changes and technology applications that can reduce risks for both employees and customers.

The President of the United States authorized an initial funding of $175 million for 2002 to assist in paying for these safety measures. In November 2001, Congress appropriated an additional $500 million to "protect postal employees and postal customers from exposure to biohazardous material, to sanitize and screen the mail and to replace or repair postal facilities destroyed or damaged in New York City as a result of the September 11, 2001, terrorist attacks." Our use of the funds provided by this appropriation was contingent on the submission of an emergency preparedness plan to combat the threat of biohazards in the mail. We submitted the required Emergency Preparedness Plan in March, 2002.

In August 2002, as set forth in our Emergency Preparedness Plan, Congress appropriated an additional $87 million to us for emergency expenses to further protect postal employees and customers from exposure to biohazardous material and to sanitize and screen the mail.

All three appropriations are to remain available until expended for purposes approved by Congress. We are required to submit quarterly expenditure plans on the obligation of all 2002 supplemental appropriations, as well as annual updates of the Emergency Preparedness Plan. Unspent funds that are not reallocated with Congressional approval are required to be returned to the United States Treasury. As a result, the funds that have not been spent or reallocated as of September 30, 2002 of $583 million are reflected in our 2002 Balance Sheet as a non-interest bearing liability and have been reflected in the 2002 Statement of Cash Flows as a financing activity.

The appropriations during the fiscal year 2002 which have been expended are as follows (dollars in millions):

Appropriations	$175	$587
Operating expenses	16	-
Non-operating expenses	121	42
Capital equipment	38	-
Balance at September 30, 2002	$ -	$545

We recorded the balance of $545 million as a current liability. Detection and filtration systems are being tested and evaluated and will then be deployed in 2003. The amounts to be spent are as follows (dollars in millions):

Protection and health risk reduction	$312
Detection and identification	200
Facility Repairs	10
Miscellaneous (R&D, etc.)	23
	$545

The liability will be reduced as expenditures occur. Appropriations received for capital equipment will be offset against depreciation expense over the life of the equipment.

The Emergency Preparedness Expenses for the year ended September 30, 2002, are as follows (dollars in millions):

Safety measures (gloves, medical treatment, etc)	$128
Research and development	5
Decontamination	54
Miscellaneous	2
	$189

The Emergency Preparedness Appropriations revenue recognized for the year ended September 30, 2002, are as follows (dollars in millions):

Safety measures	$137
Research and development	5
Decontamination	35
Miscellaneous	2
	$179

$73 million for personnel cost was incurred for emergency preparedness and service disruptions and is reported in operating expenses under compensation and benefits, of which $16 million was reimbursed by the appropriation. An additional amount of $38 million has been spent on equipment that has not yet been deployed.

11 SUBSEQUENT EVENT

On November 1, 2002, the Office of Personnel Management advised us that it had completed a review of estimates and our current scheduled funding to the Civil Service Retirement System. OPM determined that at our current rate of funding, we will pay substantially more than will be needed to fund the future benefits expected to be paid to our employees and retirees participating in the Civil Service Retirement System.

As discussed in Note 6, we participate in retirement programs administered by OPM. As required by law, each year OPM determines the estimated liability of the CSRDF for both management-granted increases in CSRS employees' current basic pay and for COLAs the government grants retirees. We amortize and pay this liability amount in 30 equal annual installments for management-granted increases and 15 years for government granted COLAs, both of which include interest computed at a rate of 5% per year. The liability is calculated as part of a multi-employer plan of the U.S. government. Nothing in current legislation permits determining our liability separately.

Office of Personnel Management analysis shows that the net accumulated value of our payments already received is currently approaching the value of the future CSRS benefits applicable to our participants. If current funding provisions remain in place, we will pay substantially more than our equitable share of the CSRS retirement obligations. The projected over-funding is due to the excess interest earned by the fund; that is, interest earnings in excess of the 5% that was assumed under the statutory funding method. Office of Personnel Management has proposed a reduction in future postal payments to the plan. The related estimated reduction of our deferred retirement benefit liability would be in excess of $20 billion.

Any change in funding would require legislation since we have made payments according to the statute. If legislation to change the funding requirements is enacted, we would reduce the deferred retirement asset and liability balances in the period such legislation becomes effective.

	2002	2001	2000	1999	1998
HEADQUARTERS CAREER EMPLOYEES*					
Headquarters	1,712	1,836	2,279	2,372	2,231
Headquarters-Field Support Units	3,848	5,653	5,566	4,357	4,307
Inspection Service (field)	3,875	4,047	4,190	4,334	4,280
Inspector General	722	713	664	387	223
TOTAL HQ AND RELATED EMPLOYEES*	**10,157**	**12,249**	**12,699**	**11,450**	**11,041**
FIELD CAREER EMPLOYEES*					
Area Offices	2,107	1,377	1,597	1,875	1,703
Postmasters/Installation Heads	25,771	26,113	26,121	26,108	26,156
Supervisors/Managers	37,829	38,754	38,797	38,835	36,508
Prof. Admin. Tech. Personnel	9,661	9,764	9,959	11,097	11,703
Clerks	256,656	269,792	281,956	292,400	293,829
Nurses	173	180	191	188	189
Mail Handlers	59,259	60,102	60,851	62,237	62,247
City Delivery Carriers	233,639	240,295	241,079	242,300	240,813
Motor Vehicle Operators	9,092	9,325	9,347	9,270	9,026
Rural Delivery Carriers-Full Time	60,817	59,790	57,111	54,588	52,241
Special Delivery Messengers					7
Bldg. and Equip. Maintenance Personnel	42,275	42,604	42,284	41,873	41,054
Vehicle Maintenance Personnel	5,513	5,558	5,546	5,574	5,524
TOTAL FIELD CAREER EMPLOYEES*	**742,792**	**763,654**	**774,839**	**786,345**	**781,000**
TOTAL CAREER EMPLOYEES	**752,949**	**775,903**	**787,538**	**797,795**	**792,041**
NON-CAREER EMPLOYEES*					
Casuals	19,065	30,317	29,572	25,067	25,711
Non-Bargaining Temporary	807	761	712	707	784
Rural Subs/RCA/RCR/AUX	56,474	58,134	57,532	57,357	56,265
PM Relief/Leave Replacements	12,234	12,313	12,423	12,485	12,613
Transitional Employees	12,847	13,577	13,461	12,355	17,222
TOTAL NON-CAREER EMPLOYEES*	**101,427**	**115,102**	**113,700**	**107,971**	**112,595**
TOTAL EMPLOYEES	**854,376**	**891,005**	**901,238**	**905,766**	**904,636**
OFFICES, STATIONS AND BRANCHES					
Post Offices	27,791	27,876	27,876	27,893	27,952
Classified stations and branches	5,900	5,835	5,802	5,788	5,661
Contract stations and branches	2,500	2,876	2,833	2,903	2,974
Community Post Offices	1,492	1,536	1,549	1,585	1,572
TOTAL OFFICES, STATIONS AND BRANCHES	**37,683**	**38,123**	**38,060**	**38,169**	**38,159**
RESIDENTIAL DELIVERY POINTS					
City	77,014,294	76,578,169	76,131,249	75,575,844	75,088,866
Rural	32,141,581	31,004,518	29,915,385	28,753,812	27,683,441
PO Box	15,772,964	15,818,625	15,904,400	16,048,325	16,575,127
Highway Contract	2,073,145	2,004,837	1,938,395	1,857,689	1,784,522
TOTAL RESIDENTIAL	**127,001,984**	**125,406,149**	**123,889,429**	**122,235,670**	**121,131,956**
BUSINESS DELIVERY POINTS					
City	7,197,207	7,183,431	7,197,776	7,175,729	7,164,995
Rural	1,132,049	1,071,201	1,013,269	956,301	901,124
PO Box	4,065,877	3,969,279	3,796,343	3,638,737	3,351,603
Highway Contract	55,362	52,247	49,234	46,237	43,735
TOTAL BUSINESS	**12,450,495**	**12,276,158**	**12,056,622**	**11,817,004**	**11,461,457**
TOTAL DELIVERY POINTS	**139,452,479**	**137,682,307**	**135,946,051**	**134,052,674**	**132,593,413**
Change in Delivery Points	1,770,172	1,736,256	1,893,377	1,459,261	1,561,961

**Complement data from On-Rolls and Paid Employees Statistics database.*

OPERATINGSTATISTICS

	2002	2001	2000	1999*	1998
FIRST-CLASS MAIL					
Pieces, number	**102,378.6**	103,655.6	103,525.7	101,936.5	100,434.2
Weight, pounds	**4,283.6**	4,362.8	4,392.0	4,299.9	4,151.3
Revenue	**$36,483.2**	$35,876.0	$35,515.9	$34,933.2	$33,861.2
PRIORITY MAIL					
Pieces, number	**998.2**	1,117.8	1,222.5	1,189.5	1,174.4
Weight, pounds	**1,875.1**	2,149.7	2,352.3	2,142.6	1,980.0
Revenue	**$ 4,722.5**	$ 4,916.4	$ 4,837.1	$ 4,533.3	$ 4,187.4
EXPRESS MAIL					
Pieces, number	**61.3**	69.4	70.9	68.7	66.2
Weight, pounds	**59.1**	72.1	80.0	78.3	77.7
Revenue	**$ 910.5**	$ 995.7	$ 996.1	$ 942.0	$ 854.5
MAIL GRAMS					
Pieces, number	**2.8**	3.3	3.7	4.1	4.3
Revenue	**$ 1.4**	$ 1.4	$ 1.5	$ 1.6	$ 1.7
PERIODICALS					
Pieces, number	**9,689.8**	10,077.4	10,364.8	10,273.8	10,316.8
Weight, pounds	**4,006.1**	4,408.3	4,720.3	4,482.6	4,451.1
Revenue	**$ 2,164.9**	$ 2,205.2	$ 2,170.7	$ 2,115.3	$ 2,072.3
STANDARD MAIL					
Pieces, number	**87,230.6**	89,938.4	90,057.1	85,661.7	82,508.1
Weight, pounds	**10,315.5**	10,822.2	11,142.6	10,648.3	10,376.8
Revenue	**$15,818.8**	$15,704.9	$15,193.3	$14,435.8	$13,701.7
PACKAGE SERVICES					
Pieces, number	**1,075.1**	1,093.0	1,128.4	1,043.1	1,023.4
Weight, pounds	**3,690.6**	3,801.7	3,773.8	3,533.2	3,407.3
Revenue	**$ 2,080.1**	$ 1,993.9	$ 1,912.3	$ 1,828.5	$ 1,754.3
INTERNATIONAL ECONOMY MAIL					
Pieces, number	**38.6**	60.4	78.7	103.2	95.6
Weight, pounds	**65.3**	80.3	89.4	96.1	95.6
Revenue	**$ 150.4**	$ 177.7	$ 180.3	$ 193.9	$ 183.7
INTERNATIONAL AIRMAIL					
Pieces, number	**865.2**	1,022.1	1,020.7	927.5	848.4
Weight, pounds	**151.8**	171.6	169.7	152.2	149.0
Revenue**	**$ 1,429.4**	$ 1,554.0	$ 1,477.2	$ 1,434.2	$ 1,416.1
U.S. POSTAL SERVICE					
Pieces, number	**424.9**	380.6	362.9	382.3	380.1
Weight, pounds	**87.5**	82.3	95.3	102.6	96.2
FREE MAIL FOR THE BLIND AND HANDICAPPED					
Pieces, number	**56.8**	44.6	46.6	53.2	53.2
Weight, pounds	**28.1**	24.9	25.1	26.6	27.2
TOTALS* **					
Pieces, number	**202,821.9**	207,462.6	207,882.2	201,643.5	196,904.7
Weight, pounds	**24,562.7**	25,975.9	26,840.6	25,562.2	24,812.3
Revenue	**$63,761.1**	$63,425.2	$62,284.3	$60,417.8	$58,032.9

* *Certain reclassifications have been made to previously reported international amounts.*
** *Includes foreign postal transaction revenue.*
*** *Agency and franked mail are included in their classes of mail, when using official mail. Some totals may not add exactly due to rounding.*

(IN MILLIONS OF UNITS INDICATED)

Class of Mail	2002	2001	2000	1999	1998
REGISTERED*					
Number of articles	**9.1**	11.4	13.3	13.7	15.3
Revenue	**$ 86.6**	$ 98.4	$ 98.4	$ 95.2	$ 89.2
CERTIFIED*					
Number of articles	**283.5**	269.0	270.5	268.1	278.3
Revenue	**$ 605.9**	$ 494.8	$ 385.4	$ 377.3	$ 385.7
INSURANCE*					
Number of articles	**59.8**	60.0	58.0	48.6	40.8
Revenue	**$ 135.2**	$ 123.1	$ 108.9	$ 91.5	$ 72.5
DELIVERY RECEIPT SERVICES**					
Number of articles	**535.5**	421.1	356.9	249.3	237.3
Revenue	**$ 460.4**	$ 370.8	$ 316.8	$ 284.7	$ 262.1
COLLECT ON DELIVERY					
Number of articles	**2.3**	2.7	4.1	4.0	3.8
Revenue	**$ 13.8**	$ 15.3	$ 21.5	$ 19.8	$ 17.8
MONEY ORDERS					
Number issued	**218.0**	227.2	232.8	220.9	208.6
Revenue	**$ 239.4**	$ 225.4	$ 234.7	$ 228.3	$ 210.1
Face value of issues (non-add)***	**$29,721.2**	$30,770.3	$29,945.2	$28,491.4	$26,724.6
OTHER					
Box rent revenue	**$ 750.6**	$ 699.0	$ 684.2	$ 667.2	$ 617.4
Stamped envelope and card revenue	**$ 29.3**	$ 27.1	$ 15.4	$ 30.7	$ 17.4
Other revenue, net	**$ 333.3**	$ 287.5	$ 326.0	$ 442.0	$ 299.8
TOTALS					
Special Services revenue	**$ 2,654.5**	$ 2,341.4	$ 2,191.2	$ 2,236.7	$ 1,972.1
Mail revenue	**$63,761.1**	$63,425.2	$62,284.3	$60,417.8	$58,032.9
Revenue forgone	**$ 47.6**	$ 67.1	$ 64.4	$ 71.2	$ 67.3
Operating revenue	**$66,463.2**	$65,833.7	$64,539.9	$62,725.7	$60,072.3

* *Return receipts have been broken out from registered, certified and insurance special service categories.*

** *Delivery Receipt Services contains Return Receipts, Return Receipts for Merchandise and Delivery Confirmation. Delivery Confirmation Service began during 1999.*

*** *Certain reclassifications have been made to previously reported amounts.*

FINANCIAL HISTORY SUMMARY

	2002	2001*	2000*
STATEMENTS OF OPERATIONS			
(DOLLARS IN BILLIONS)			
Total revenue	**$ 66.5**	$ 65.9	$ 64.6
Total expense	**67.2**	67.6	64.8
Net (loss) income	**$ (0.7)**	$ (1.7)	$ (0.2)
(DOLLARS IN MILLIONS)			
Operating revenue	**$66,415**	$65,767	$64,476
Revenue forgone appropriation	**48**	67	64
Total operating revenue	**66,463**	65,834	64,540
Compensation and benefits	**51,557**	51,351	49,532
Restructuring costs	**—**	—	—
Other expenses	**13,677**	14,289	13,460
Total operating expenses	**65,234**	65,640	62,992
Income from operations	**1,229**	194	1,548
Interest and investment income	**46**	35	41
Interest expense on deferred retirement liabilities	**(1,601)**	(1,603)	(1,568)
Interest expense on borrowings	**(340)**	(306)	(220)
Emergency preparedness, net	**(10)**	—	—
Income (loss) before retroactive assessments and extraordinary items	**(676)**	(1,680)	(199)
Retroactive assessments for employee benefits**	**—**	—	—
Income (loss) before extraordinary item	**(676)**	(1,680)	(199)
Extraordinary item — debt refinancing premium	**—**	—	—
NET (LOSS) INCOME	**$ (676)**	$ (1,680)	$ (199)
BALANCE SHEETS			
ASSETS			
Current assets	**$ 2,280**	$ 1,933	$ 1,655
Property and equipment, deferred retirement costs and other assets	**56,735**	57,158	56,628
TOTAL ASSETS	**$59,015**	$59,091	$58,283
LIABILITIES AND NET CAPITAL DEFICIENCY			
Current liabilities	**$15,586**	$17,457	$18,277
Other liabilities	**39,131**	38,209	38,150
Long-term debt	**7,300**	5,751	2,502
Net capital deficiency	**(3,002)**	(2,326)	(646)
TOTAL LIABILITIES AND NET CAPITAL DEFICIENCY	**$59,015**	$59,091	$58,283
CHANGES IN NET CAPITAL DEFICIENCY			
BEGINNING BALANCES			
Capital contributions of the U.S. government	**$ 3,034**	$ 3,034	$ 3,034
Deficit since reorganization	**(5,360)**	(3,680)	(3,481)
Total beginning balance net capital deficiency	**(2,326)**	(646)	(447)
Net (loss) income	**(676)**	(1,680)	(199)
ENDING BALANCE***	**$ (3,002)**	$ (2,326)	$ (646)

* *Certain reclassifications have been made to previously reported amounts.*

** *Relates to OBRA 1990 and 1993.*

*** *Some totals may not add exactly due to rounding.*

1999*	1998*	1997*	1996*	1995*	1994*	1993*	1992*
$ 62.7	$ 60.1	$ 58.3	$ 56.6	$ 54.5	$ 49.6	$ 48.0	$ 47.1
62.4	59.5	57.0	55.0	52.7	50.5	49.8	47.6
$ 0.4	$ 0.6	$ 1.3	$ 1.6	$ 1.8	$ (0.9)	$ (1.8)	$ (0.5)
$62,655	$60,005	$58,133	$56,309	$54,176	$49,252	$47,418	$46,151
71	67	83	93	117	131	164	545
62,726	60,072	58,216	56,402	54,293	49,383	47,582	46,696
47,333	45,596	44,093	42,676	41,931	39,609	38,448	37,122
—	—	—	—	—	—	129	1,010
13,309	12,190	11,038	10,437	8,799	8,846	7,745	7,521
60,642	57,786	55,131	53,113	50,730	48,455	46,322	45,653
2,084	2,286	3,085	3,289	3,563	928	1,260	1,043
29	44	115	142	216	193	404	409
(1,592)	(1,613)	(1,629)	(1,496)	(1,443)	(1,433)	(1,416)	(1,350)
(158)	(167)	(307)	(368)	(566)	(601)	(620)	(638)
—	—	—	—	—	—	—	—
363	550	1,264	1,567	1,770	(913)	(372)	(536)
—	—	—	—	—	—	(857)	—
363	550	1,264	1,567	1,770	(913)	(1,229)	(536)
—	—	—	—	—	—	(536)	—
$ 363	$ 550	$ 1,264	$ 1,567	$ 1,770	$ (913)	$ (1,765)	$ (536)
$ 1,296	$ 1,893	$ 1,736	$ 1,670	$ 2,975	$ 2,683	$ 4,478	$ 6,027
54,713	53,015	51,675	50,157	46,146	43,733	42,803	41,638
$56,009	$54,908	$53,411	$51,827	$49,121	$46,416	$47,281	$47,665
$15,436	$15,278	$14,107	$12,796	$11,499	$11,665	$10,140	$ 9,484
37,466	37,652	37,439	37,746	34,794	32,985	33,503	32,291
3,554	2,788	3,225	3,909	7,019	7,727	8,686	9,173
(447)	(810)	(1,360)	(2,624)	(4,191)	(5,961)	(5,048)	(3,283)
$56,009	$54,908	$53,411	$51,827	$49,121	$46,416	$47,281	$47,665
$ 3,034	$ 3,034	$ 3,034	$ 3,034	$ 3,034	$ 3,034	$ 3,034	$ 3,035
(3,844)	(4,394)	(5,658)	(7,225)	(8,995)	(8,082)	(6,318)	(5,781)
(810)	(1,360)	(2,624)	(4,191)	(5,961)	(5,048)	(3,283)	(2,747)
363	550	1,264	1,567	1,770	(913)	(1,765)	(536)
$ (447)	$ (810)	$ (1,360)	$ (2,624)	$ (4,191)	$ (5,961)	$ (5,048)	$ (3,283)

* *Certain reclassifications have been made to previously reported amounts.*

** *Relates to OBRA 1990 and 1993.*

*** *Some totals may not add exactly due to rounding.*


I TURNED INTO MY MOTHER
Dear Dad,
MY LITTLE GIRL'S NOT SO LITTLE ANYMORE. NOW SHE SENDS ME POSTCARDS FROM HER ADVENTURES AROUND THE WORLD. BUT I'VE STILL GOT HER FIRST ONE, FROM SLEEP-AWAY CAMP. CHARLES DAVIDSON, 68

[from Old Norse *traust*, confidence]
that which can be relied upon without fear or misgiving
that's the United States Postal Service, delivering the things
value, quickly, safely and securely.

GLOSSARY

ACCRUALS: Revenue and expenses that are recorded as they occur, even though they may not have actually been paid.

ANTHRAX: An infectious disease caused by *Bacillus anthracis*. Human anthrax has three major clinical forms: cutaneous, inhalation and gastrointestinal.

AMORTIZE: To reduce the value of an asset through regular charges to income over time; or to write off expenses by prorating them over a period of time.

APPROPRIATION: Public funds set aside by Congress for a specific purpose.

BAR CODE: A series of vertical full bars and half bars representing the ZIP Code information printed on a mailpiece to facilitate automated processing by bar code reader equipment.

BIOHAZARD: A biological material especially if infectious, that poses a threat to humans or their environment.

CAPITALIZE: To treat an expenditure as an asset; or to compute the present value of a future payment that will be paid over a period of time.

CONFIRM: A service that allows mailers to identify and track their mailpieces by placing a bar code or PLANET (Postal Alpha Numeric Encoding Technique) Code on the front of their letter or flat.

CONTRIBUTION: The difference between the revenue from a class of mail and that class's volume-variable costs. For example, if a class of mail has revenue of $1.5 billion and volume-variable costs of $1 billion, its contribution is $500 million, which means that this class of mail covers its costs and contributes $500 million to the common costs of all mail services.

DELIVERY CONFIRMATION: Delivery Confirmation™ is a special service designed to provide the date of delivery or attempted delivery for Priority Mail and Standard Mail parcels, bound printed matter and library mail.

DEPRECIATE: To periodically reduce the estimated value of an asset over the course of its useful life.

DEPUTY POSTMASTER GENERAL (DPMG): A member of the Board of Governors, jointly appointed by the Postmaster General and Governors.

DIRECT MAIL: A form of advertising often employed by businesses to reach targeted groups of potential customers by mail.

EMPLOYMENT COST INDEX (ECI): A national indicator of overall employee labor cost and one of the principal economic indicators used by the Federal Reserve Bank.

EQUITY: The difference between the value of all assets less all liabilities.

EXPRESS MAIL: The Postal Service's premium delivery service, providing guaranteed overnight delivery for documents and packages weighing up to 70 pounds. Both domestic and international services are offered.

FIRST-CLASS MAIL: A class of mail including letters, postcards, and postal cards, all matter wholly or partially in writing or typewriting, and all matter sealed or otherwise closed against inspection.

FIXED ASSET: Any tangible property such as buildings, machinery and equipment, furniture, and leasehold improvements.

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP): The rules and procedures of accepted accounting practice as defined by the Financial Accounting Standards Board.

GROSS DOMESTIC PRODUCT (GDP): The total market value of all the goods and services produced in one year in the United States.

INSPECTOR GENERAL: Appointed by and reports directly to the Governors of the Postal Service, is independent of postal management and is responsible for investigating and evaluating programs and operations of the Postal Service to ensure the efficiency and integrity of the postal system.

IRRADIATION: Treatment or therapy by exposure to radiation.

LEASEHOLD: An asset that gives the Postal Service the right to use property under a lease.

LETTERSHOP: A company that personalizes, labels, sorts and stuffs envelopes in preparation for Standard Mail.

LIABILITY: Any debt or obligation the Postal Service is bound to pay.

Per·for·mance *n* [from Latin *per-* thoroughly + *fournir* to complete] **1:** the efficient fulfillment of a claim, promise, or request **2:** what you can count on, every day, from the United States Postal Service.

GLOSSARY

NITRILE GLOVES: Industrial strength protective hand coverings that are highly resistant to a wide range of chemicals, abrasions and punctures.

PERIODICALS: A class of mail, formerly called second-class mail, that consists of magazines, newspapers, and other publications.

POINT-OF-SERVICE ONE (POS ONE): An electronic retail sales device that assists employees with retail transactions and provides product inventory and sales information.

POSTAL INSPECTION SERVICE: The investigative arm of the Postal Service responsible for investigating criminal acts involving the mails and misuse of the postal system.

POSTAL RATE COMMISSION (PRC): An independent federal agency that makes recommendations concerning Postal Service requests for changes in postal rates and mail classifications.

POSTMASTER GENERAL (PMG): The chief executive officer of the Postal Service, appointed by and serving at the pleasure of the Governors.

PRESENT VALUE: The value today of a future payment that is discounted at a stated rate of compound interest. For example, the present value of $100 that will be paid to the Postal Service 10 years from now is about $38.55, if we discount that $100 at a rate equal to 10 percent interest compounded annually.

PRIORITY MAIL: Priority Mail provides two- to three-day delivery service.

PRIORITY MAIL GLOBAL GUARANTEED®: An alliance with DHL Worldwide Express, Inc. providing day-certain delivery guaranteed service to 65 countries around the world.

PROCESSING AND DISTRIBUTION CENTER (P&DC): A large mail-sorting and dispatching plant that serves as a hub for mail originating from post offices, collection boxes and customer mailboxes, and large-volume mailers in a designated service area.

RECEIVABLE: Money that is owed to the Postal Service.

RECOGNIZE: To record in Postal Service accounts as income or expense.

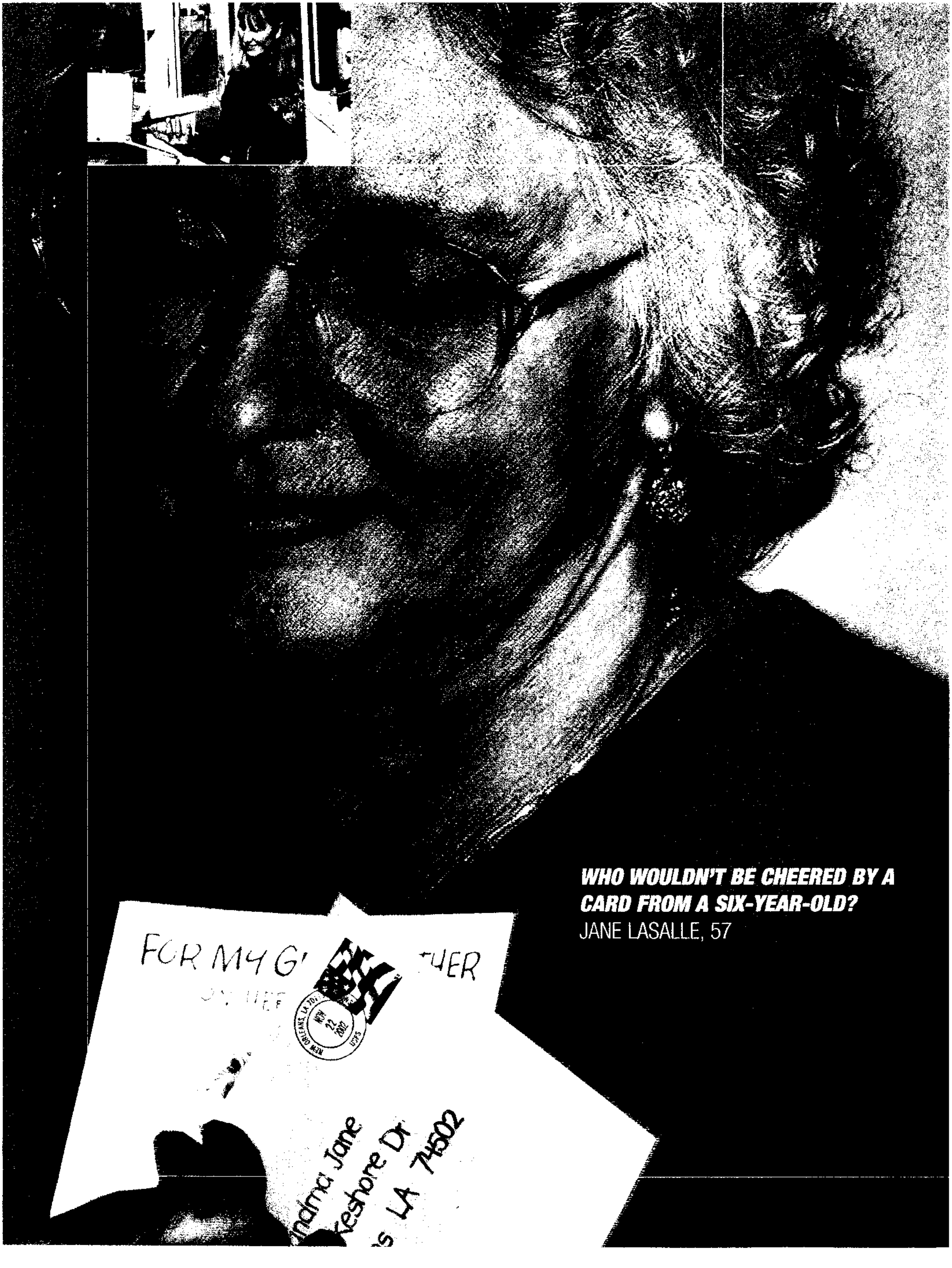
STANDARD MAIL: Name for the bulk advertising mail formerly known as Third-Class Mail.

U.S. MAIL: Any mailable matter that is accepted for mail processing and delivery by the Postal Service.

UNITED STATES POSTAL SERVICE (USPS): The successor to the Post Office Department, the USPS was established by the Postal Reorganization Act of 1970 and began operations on July 1,1971, as an independent establishment of the executive branch.

UNIVERSAL SERVICE: The Postal Service's mandate and commitment to the nation to provide mail delivery service at uniform and reasonable rates to everyone, everywhere.

YEAR: As used in the financial section of this report, it means the Postal Service fiscal year, which is the 12-month period during which the Postal Service keeps accounts, beginning October 1 and closing September 30.



WHO WOULDN'T BE CHEERED BY A CARD FROM A SIX-YEAR-OLD?
JANE LASALLE, 57
FOR MY G
HER
ndma Jane
keshore Dr
s LA 74502

Postmaster General John E. Potter is joined by the leaders of postal unions and management associations for a special broadcast to all Postal Service employees during the anthrax crisis of the fall of 2001.

Left to right: Vincent R. Sombrotto, former president, National Association of Letter Carriers; Gus Baffa, president, National Rural Letter Carriers' Association; Charles E. Moser, former president, National Association of Postmasters of the United States; Dick Collins, assistant to the president, National Postal Mail Handlers Union; Potter; William Burrus, president, American Postal Workers Union; Joseph W. Cinadr, former president, National League of Postmasters of the United States; and Vincent Palladino, president, National Association of Postal Supervisors.

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a Neale Hurston • American Filmmaking: Behind the Scenes • Ohio State
Chavez • First Flight • Louisiana Purchase • Audrey Hepburn • Southea
l • American Treasures: Mary Cassatt • Early Football Heroes • Roy Acu

AMERICAN FILMMAKING BEHIND THE SCENES
ISSUE DATE: FEBRUARY
FORMAT: SOUVENIR SHEET OF 10

EARLY FOOTBALL HEROES
ISSUE DATE: AUGUST
FORMAT: PANE OF 20

HOLIDAY MUSIC MAKERS
ISSUE DATE: OCTOBER
FORMAT: PANE OF 20

CESAR E. CHAVEZ
ISSUE DATE: APRIL
FORMAT: PANE OF 20

LOUISIANA PURCHASE
ISSUE DATE: APRIL
FORMAT: PANE OF 20

OHIO STATEHOOD
ISSUE DATE: MAR
FORMAT: PANE O

ARCTIC TUNDRA
ISSUE DATE: JULY
FORMAT: SOUVENIR SHEET OF 10

PELICAN ISLAND
NATIONAL WILDLIFE REFUGE
ISSUE DATE: MARCH
FORMAT: PANE OF 20

UNITED S
POSTAL S

Lunar New Year: Year he Ram • Thurgood Marshall •
Pelican Island National dlife Refuge • Old Glory • Cesa
Lighthouses • Arctic T a • Korean War Veterans Mem
Reptiles and Amphibia Holiday Music Makers

LUNAR NEW YEAR: RAM
ISSUE DATE: JANUARY
FORMAT: PANE OF 20

ZORA NEALE HURSTON
ISSUE DATE: FEBRUARY
FORMAT: PANE OF 20

ROY ACUFF
ISSUE DATE: SEP
FORMAT: PANE O

AMERICAN TREASURES: MARY CASSATT
ISSUE DATE: AUGUST
FORMAT: DOUBLE SIDED BOOKLET OF 20

FIRST FLIGHT
ISSUE DATE: AUGUST
FORMAT: SOUVENIR SHEET OF 10

KOREAN WAR VETERANS MEMORIAL
ISSUE DATE: JULY
FORMAT: TBD

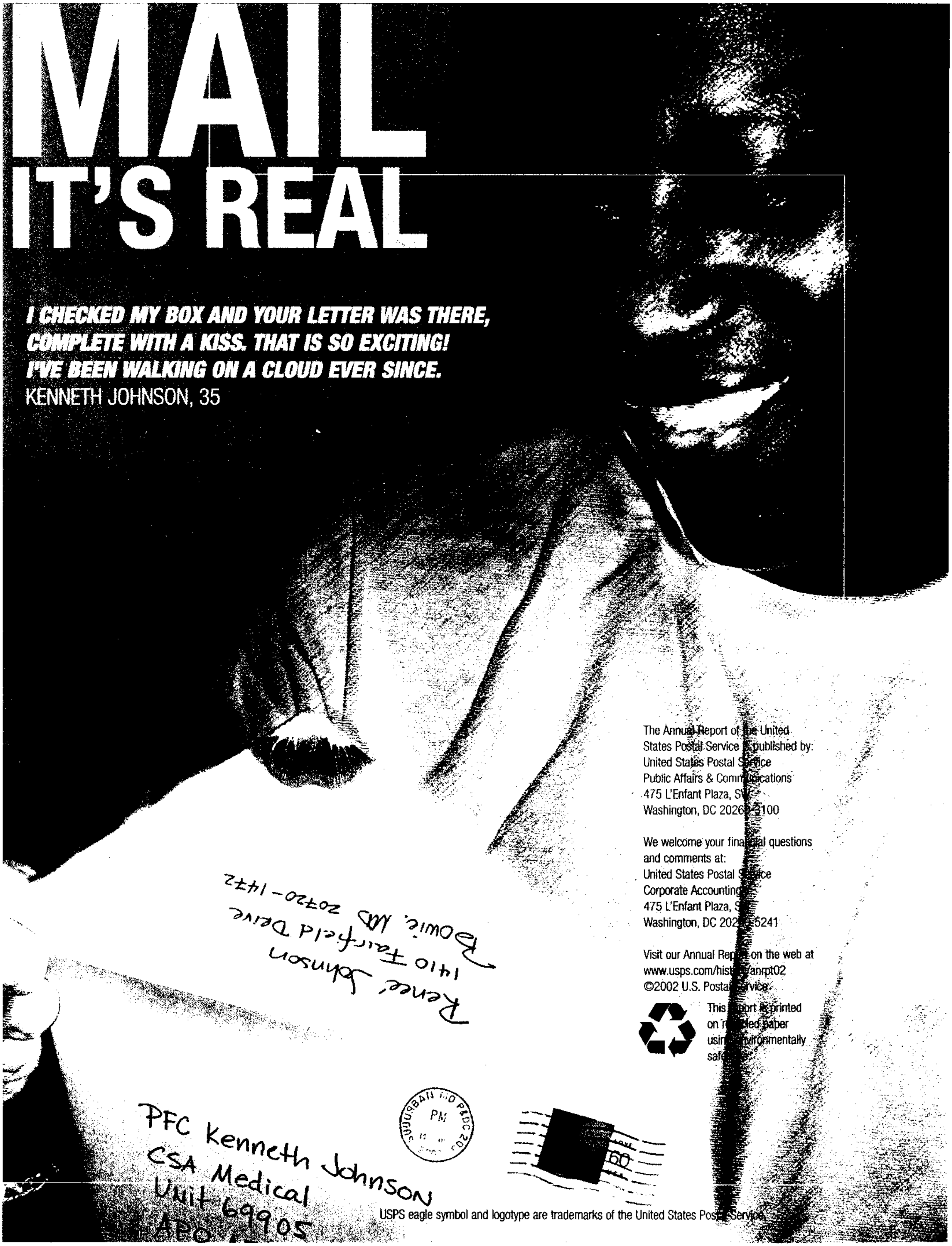
THURGOOD MAR
ISSUE DATE: JAN
FORMAT: PANE O

OLD GLORY
ISSUE DATE: APRIL
FORMAT: BOOKLETS WITH 2 PANES OF 10

AUDREY HEPBURN
ISSUE DATE: MAY
FORMAT: PANE
OF 20 WITH SELVAGE

SOUTHEASTERN LIGHTHOUSES
ISSUE DATE: JUNE
FORMAT: PANE OF 20 WITH HEADER

REPTILES AND AMPHIBIANS
ISSUE DATE: OCTOBER
FORMAT: PANE OF 20 WITH HEADER



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