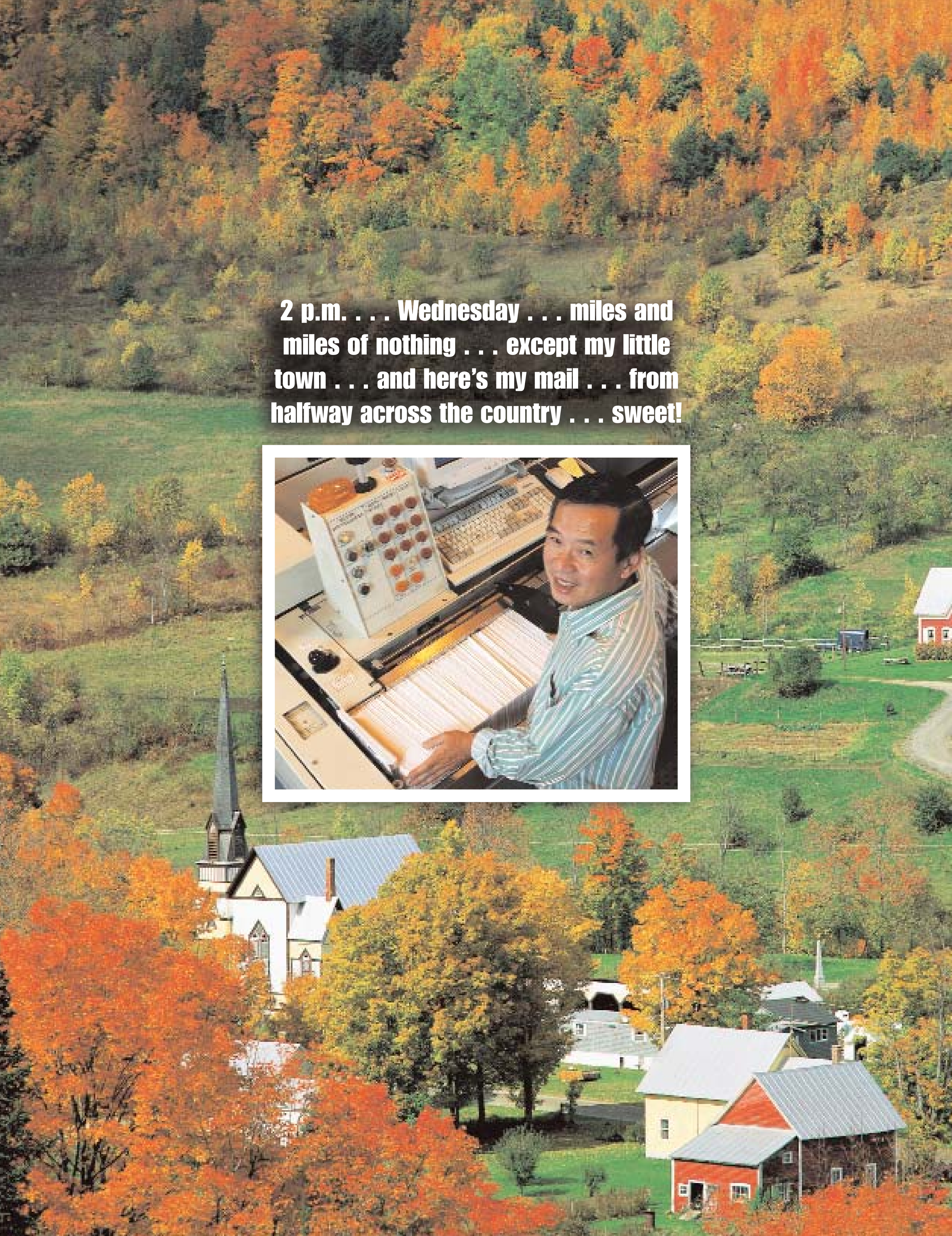
10 a.m. . . . Tuesday . . . there she is . . . my letter carrier . . . smiling . . . delivering my mail . . . in a city of millions, she finds me . . . every day . . . now that's magic!

2003
annual report

UNITED STATES POSTAL SERVICE


2 p.m. . . . Wednesday . . . miles and miles of nothing . . . except my little town . . . and here's my mail . . . from halfway across the country . . . sweet!

financial highlights

($ in millions)	Years ended September 30 2003	2002	2001	Percentage Change From Preceding Year 2003	2002	2001
Operating revenue	**$68,529**	$66,463	$65,834	**3.1%**	1.0%	2.0%
Operating expenses	**$63,902**	$65,234	$65,640	**-2.0%**	-0.6%	4.2%
Income from operations	**$ 4,627**	$ 1,229	$ 194			
Operating margin	**6.8%**	1.8%	0.3%			
Net income (loss)	**$ 3,868**	$ (676)	$ (1,680)			
Capital cash outlays	**$ 1,314**	$ 1,705	$ 2,961	**-22.9%**	-42.4%	-11.3%
Total debt	**$ 7,274**	$11,115	11,315	**-34.6%**	-1.8%	21.5%
Interest expense on borrowings	**$ 334**	$ 340	$ 306	**-1.8%**	11.1%	39.1%
Debt repurchase expense	**$ 360**	–	–			
Capital contributions of U.S. government	**$ 3,034**	$ 3,034	$ 3,034			
Deficit since reorganization	**$ (2,168)**	$ (6,036)	$ (5,360)			
Total net capital (deficiency)	**$ 866**	$ (3,002)	$ (2,326)			
Number of career employees*	**729,035**	752,949	775,903	**-3.2%**	-3.0%	-1.5%
Mail volume (millions of pieces)	**202,185**	202,822	207,463	**-0.3%**	-2.2%	-0.2%
New Delivery Points Served*	**1,908,797**	1,770,172	1,736,256			

* As of end of September for 2003 and early September for 2002 and 2001.

table of contents

year in review

delivering our best

On-time delivery of overnight-committed First-Class Mail achieved a record high — 95% — through one of the harshest winters in years. We held that performance level for the rest of 2003. And it wasn't just First-Class Mail — all measured service categories were at record levels.*

satisfying customers

We delivered for our customers, and they noticed. Independently measured customer satisfaction scores for quarter four showed that 94% of our customers rated their experience with the Postal Service as excellent, very good or good. This was a one-point jump over the 93% recorded during the first three quarters. Research generated by the President's Commission on the Postal Service also found the Postal Service held in the same high regard as our private-sector competitors.

staying productive

We marked a record fourth straight year of positive total-factor productivity. TFP includes all factors of production and measures the growth in the ratio of the resources we use — the inputs — to the products and services they produce — the outputs.

cutting costs

At the Postal Service, we understand that every penny we spend is a penny we have to earn from our customers. So managing costs is important to us. In 2003, we reduced costs by $1.1 billion, increasing customer value with every transaction. Our goal? Removing another $2.3 billion in costs by 2006.

expanding access

No time to visit the Post Office? We bring the Post Office to you — with *usps.com*. Buy stamps. Send packages using Click-N-Ship. Print address labels — with or without postage. Add Delivery Confirmation and other special services. Send cards and letters. Schedule a pickup. Get mailing information. And check on the status of your shipment. All from the convenience of your home or office. You're busier than ever — that's why we've made *usps.com* better than ever.

continuing to transform

Times are changing — customers have more choices than ever. That's why the Postal Service is changing. We're increasing operational efficiency. We're adding value for our customers. And we're enhancing our performance-based culture. It's all in our Transformation Plan, defining the strategies we're following to protect the right of everyone in America — no matter who, no matter where — to affordable, universal mail service.

providing solutions

Consumers are saying "no" to telemarketing. They're blocking spam. But most still welcome direct mail. It's one of the most respected — and effective — sales tools available to marketers. This year, we've made it even better with innovations like Customized MarketMail and Repositionable Notes — two ways for mailers to make sure their messages stand out from the crowd.

helping others

Our Breast Cancer Research stamp — the first semipostal stamp issued by the United States Postal Service — has raised $34.5 million toward finding a cure. And the "Heroes of 2001" semipostal has already raised $8.6 million for the families of emergency workers killed or injured in the 9/11 attacks. Both stamps sell for 45 cents, with the difference between the one-ounce, First-Class letter rate and the price of the stamp earmarked for their special purpose.

celebrating diversity

For the fourth straight year, Fortune magazine recognized the Postal Service as a leader in diversity, naming us one of the "50 Best Companies for Minorities." And we placed ahead of every other delivery company included in the list!

driving performance

We're implementing an innovative new pay-for-performance system. For the first time, compensation for every supervisor, postmaster, manager and executive is directly tied to their achievement of clearly-defined service, financial and employee goals.

protecting employees, customers and the mail

We tested a state-of-the-art Biohazard Detection Systems at 15 locations nationwide in preparation for deployment in 2004. The system will provide a new level of protection through early warning if biohazards such as anthrax are detected in the mail. And an independent Environmental Clearance Committee declared our decontamination of Washington, DC's huge Curseen-Morris mail processing facility a success.

respecting privacy

As we do business with our customers — from the largest mailer to the individual household — we're creating a gold standard of privacy protection. In a survey conducted by the prestigious Ponemon Institute, the Postal Service received the highest privacy trust score of any government organization examined.

safeguarding the mail

The Postal Inspection Service worked to prevent crime involving the mail through an aggressive program of education, prevention and investigation. As a participant in the Attorney General's Corporate Fraud Task Force, the Inspection Service also led a nationwide awareness campaign that showed millions of consumers how to protect themselves against identity theft, whatever its source.

board of governors

In 2003, the Board held regular, monthly meetings in each month except July, for a total of 21 days of regular meetings. Seven of the regular monthly meetings were held in Washington, DC. Four were held in other areas of the country to allow the Board to see postal operations. In addition, the Board held four special meetings.

The Board had three standing committees: Audit and Finance, Capital Projects and Strategic Planning. The committees held regularly scheduled meetings during the year to consider matters within their areas of responsibility and refer items to the full Board for consideration.

Board actions during 2003 included:

- approval of funding for Biohazard Detection Systems.
- approval of the 2002 audited financial statements, *Annual Report*, and *Comprehensive Statement on Postal Operations.*
- approval to implement a Negotiated Service Agreement with Capital One.
- approval of major capital projects.
- appointment of 2nd Inspector General of the Postal Service.

* The External First-Class Mail measurement system (EXFC) externally measures collection box to mailbox delivery performance. EXFC continuously tests a panel of 463 ZIP Code areas selected on the basis of geographic and volume density from which 90% of First-Class volume originates and 80% destinates. EXFC is not a system-wide measurement of all First-Class Mail performance.

1:30 a.m. . . . it's soooo cool, I'm printing out my Click-N-Ship labels in the middle of the night . . . in the morning, I just hand the packages to my letter carrier.

S. David Fineman

John E. Potter

a letter from the postmaster general/ceo and the chairman of the board of governors

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

It was a great year for the Postal Service.

We set records in service, productivity and customer and employee satisfaction.

We accomplished transformation breakthroughs by using technology to improve efficiency, increase customer convenience and enhance products and services.

We joined our customers and representatives from the mailing industry in supporting legislation that adjusts our payments to the Civil Service Retirement System.

We worked with the President's Commission on the United States Postal Service to preserve the viability of the nation's postal system well into the new century.

We managed for results. And we achieved them by staying focused on three key strategies: improving operational efficiency, adding value for our customers, and enhancing our performance-based culture.

We identified each of these strategies in our Transformation Plan. The Plan is our response to the challenges of an intensely competitive delivery market, the emergence of new communication technologies, and a business model defined by a statute written for a different time. The Postal Service must continue to change to meet the needs of a changing nation. The Transformation Plan will help us do that.

We appreciate the help of others, as well. An analysis by the Office of Personnel Management found that, without a change in our payment schedule, the Postal Service would overpay its obligation to the Civil Service Retirement System by $105 billion. Quick action by Congress and the Administration resulted in legislation to avoid this overpayment.

The savings available through the new law helped us reduce outstanding debt by more than one third, from $11.1 billion to $7.3 billion, and make it possible for us to continue reducing debt in 2004 and hold postage rates steady until at least 2006.

We closed the year with a net income of $3.9 billion, reflecting both our success in managing costs and improving efficiency and the positive effects of the Civil Service Retirement System funding reform legislation.

We will continue to do everything possible to protect the basic right of affordable, universal mail service for everyone in America. Yet we must face the simple fact that our business model — established by the 1970 Postal Reorganization Act — is no longer valid. We can no longer expect that the costs of serving a continually expanding delivery base will be offset by increasing revenue from continued mail volume growth.

To address these issues, the President appointed a Commission to recommend the legislative and administrative steps necessary to ensure the viability of the nation's postal system. The Commission, acknowledging the important role of our Transformation Plan in helping us meet today's challenges, also offered recommendations for change in four key areas: the Postal Service business model, private-sector partnerships, technology and workforce.

The Commission brought informed proposals to the critical consideration of the future of our nation's mail service. The Postal Service will remain engaged in that discussion. But we will not let it distract us from our mission of providing affordable, universal mail service for all customers and all communities. That is our job. That is what we will continue to do.

Sincerely,

John E. Potter
Postmaster General and CEO

S. David Fineman
Chairman, Board of Governors

5 p.m. . . . every day . . .
like clockwork . . . right in front of my building . . . the Postal Service keeps our appointment and picks up my mail . . . We've got to keep meeting like this!

mail – the real kind: technology at work.

Think about it. Every day, the United States Postal Service delivers more than 650 million letters, cards, magazines, packages and catalogs to more than 141 million American families and businesses.

It's a big job. It's an important job. And it's our goal to do it accurately, on time and on budget — yours and ours.

We start with 729,000 of the most dedicated career employees in the nation. We add a liberal dose of technology to cancel stamps, sort the mail and get it ready for delivery. It sounds simple, but it's not.

With a mail volume that's more than doubled in the last 25 years, technology has never been more important to the Postal Service. It's helped us manage costs, improve productivity and keep prices affordable. In fact, the cost of today's First-Class stamp, adjusted for inflation, is less than the 15-cent stamp of 1979.

It all starts when you drop a letter into any one of over 300,000 street collection boxes, at any of our more than 37,000 Post Offices, or hand it to your letter carrier. From there, your mail begins its incredible journey through the world's most advanced mail-processing environment.

First stop? State-of-the-art automated processing equipment that faces each letter in the same direction and applies your postmark to each stamp. From there, our sortation control system helps move mail to the right equipment or processing location.

For letters, our sorting equipment reads the address, checks it against our master address list and applies a barcode identifying the Post Office that will deliver the letter and the individual carrier route that serves the address. And it does this quicker than the blink of an eye.

And our world-class handwriting recognition program allows equipment to read the addresses on almost 85 percent of the letters we handle. Of course, not everyone earned an "A" in penmanship. So some letters need a little extra work. But we're ready for them. Our remote bar coding system captures a video image of the envelope and transmits it to a centralized, remote encoding site, often hundreds of miles away. There, operators enter address information, and we can apply a bar code to the envelope and keep it moving through our automated processing system.

If your letter is for local delivery, the mail is sorted and transported to the delivery Post Office. But for mail going farther, we've got to prepare it for long-distance transportation. So, before it leaves the local processing facility, mail is put into trays according to its destination. Then it passes through equipment that checks the address and assigns it to the right airline flight or surface transportation so that it gets delivered on time.

From there, it's almost home. Once your mail gets to a processing facility serving the delivery Post Office, it gets sorted again — either to the delivery Post Office or right to the carrier route. This is where those bar codes really come in handy. Delivery-point automation takes over, reads the codes and sorts your mail into the order your letter carrier will deliver it. Quickly. Easily. Accurately.

Similar technology does many of the same tasks for packages, larger envelopes, catalogs and magazines.

And that's not all. We're bringing advanced technology to our mail-forwarding system, too. Even if your college roommate doesn't know you moved, we'll make sure your birthday card finds you — before it becomes a belated "Best Wishes!" So, if you've filed a change-of-address notice, we'll program that into our address database. And in many areas, when your card gets processed, our equipment will know you moved and get it to the right address. No muss. No fuss. And no delay. That's because we won't have to send your card to your old Post Office to correct the address and then forward it.

Your mail is important to you. It's important to us. That's why the men and women of the United States Postal Service — supported by the latest and best technology — will continue to provide you with an unparalleled tradition of service. It's what we do.


1:30 p.m. . . . Venice . . .
oceans away from home
. . . an assignment with
an impossible deadline
. . . then I get my mail . . .
and things get just a little
bit easier . . . grazie!

how easy can it get?

It's about access. Making it easier than ever for customers to do business with the Postal Service.

We start with almost 300,000 letter carriers serving just about every city, town and neighborhood in America. They not only deliver your mail, but they'll pick it up, too, right from your home, your office or your mailbox.

If you miss your letter carrier, well, no problem. We've got you covered. Just down the street or around the next corner you'll find one of more than 300,000 street collection boxes. Drop in your letter, go on your way and you can be sure your letter will go on its way, too.

Don't forget your local Post Office. With more than 37,000 locations, there's one close to you, offering everything you need to keep in touch. Mail your letters and packages. Buy stamps. Take advantage of value-added services like Registered Mail, Certified Mail, Insurance, Delivery Confirmation, Signature Confirmation and so much more. In many locations, you can even find great stamp-related gifts.

Rural carriers take it one step further. That's why we call them Post Offices on wheels. Need stamps? Postal Money Orders? Other postal services? They're no farther than your rural carrier.

If you can't get to the Post Office, we try our best to bring the Post Office to you.

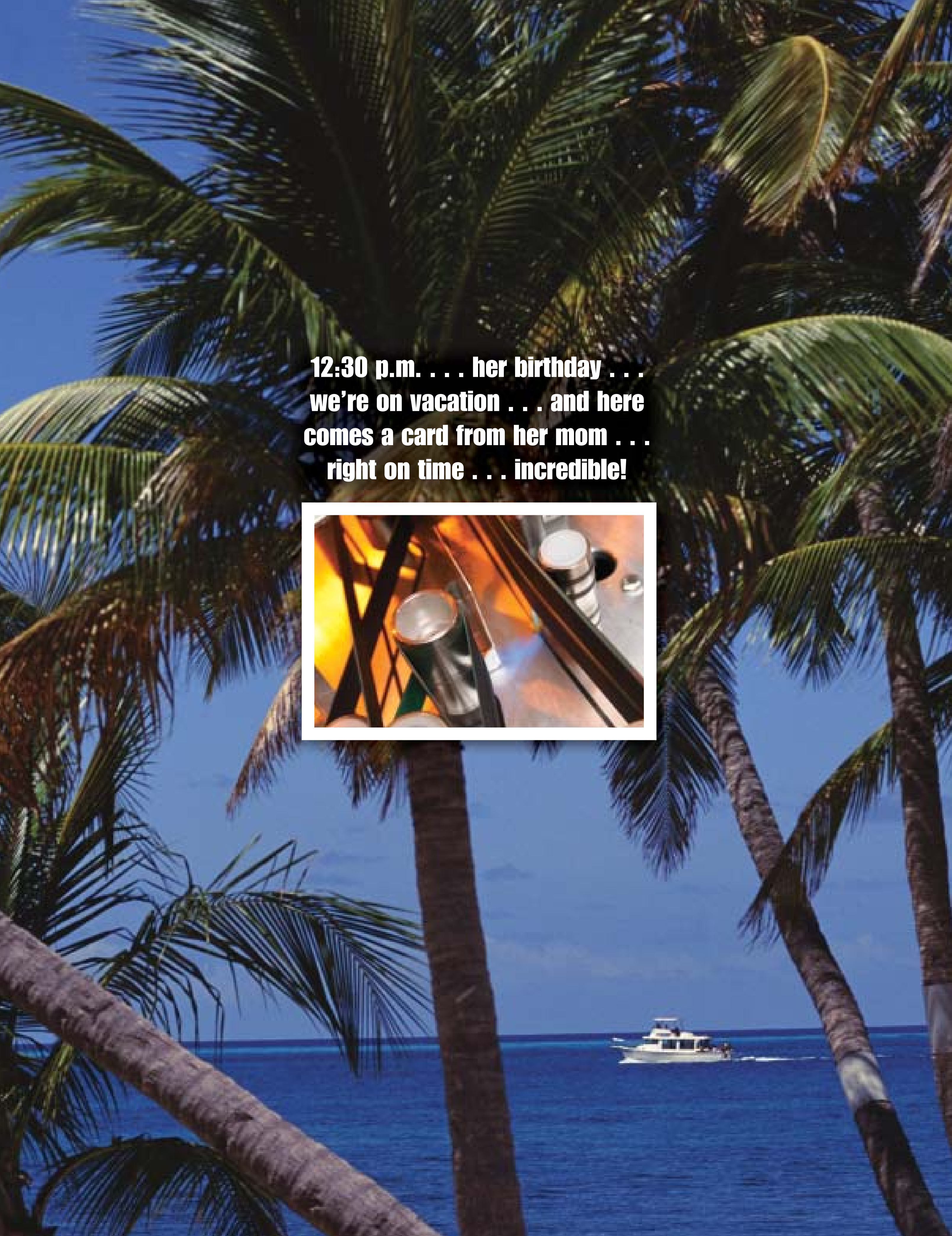
That's what our website, *usps.com*, is all about. It's a hectic world. You're busier than ever. You just want to get home, kick off your shoes and relax. And *usps.com* can help you do that. It's there when you need it, where you need it, whatever your schedule. Right on your own computer.

Use *usps.com* to get all the information you need about our products and services. Need a ZIP Code? It's right there. Check the status of your Express Mail or Priority Mail shipment. Visit The Postal Store to buy stamps. Moving? You can change your address. Going on vacation? You can have your mail held at your local Post Office. And don't forget Click-N-Ship. Use it to print out address labels for Express Mail and Priority Mail — with or without postage. Of course, your letter carrier will be happy to pick those packages up with the next delivery.

Okay, so you have to go out anyway for those weekend chores — dry cleaner, bank, groceries, library, gas station, Post Office. Your time is valuable. So we've made it easy to save some. Thousands of supermarkets and ATMs offer stamp booklets at the Post Office price. Easy. Quick. Convenient. And one less trip.

We're also as close as your telephone. Just dial 1-800-ASK USPS. Get mailing information and ZIP Codes. Track and trace your Express Mail and Priority Mail shipments. Hold mail. Change your address. And if you have a question about the mail, we can answer it.

Your Postal Service offers one of the most extensive service networks in the world. And we'll keep working to make it even easier and more convenient. We're transforming for you.



12:30 p.m. . . . her birthday . . .
we're on vacation . . . and here
comes a card from her mom . . .
right on time . . . incredible!

the mail ... and more

Is the mail important? No doubt about it. It's the center of a huge part of the American economy. The Postal Service is the heart of a $900 billion industry that employs 9 million of your friends and neighbors.

But numbers only tell part of the story. For more than 225 years, the mail has been a:

Messenger of sympathy and love,

Servant of parted friends,

Consoler of the lonely,

Bond of the scattered family,

Enlarger of the common life,

Carrier of news and knowledge,

Instrument of trade and industry,

Promoter of mutual acquaintance,

Of peace and of goodwill among men and nations.

Stirring words. In fact, they're carved into the cornice of the former Washington, DC, City Post Office, now the site of the Smithsonian Institution's National Postal Museum. They describe the power of the mail. They just as accurately describe the caring men and women of the Postal Service.

These are the men and women who this year collected almost 62 million pounds of food to help "Stamp Out Hunger" as part of the eleventh annual National Association of Letter Carriers Food Drive. Since 1993, they collected an incredible 587 million pounds of food from caring customers along their routes.

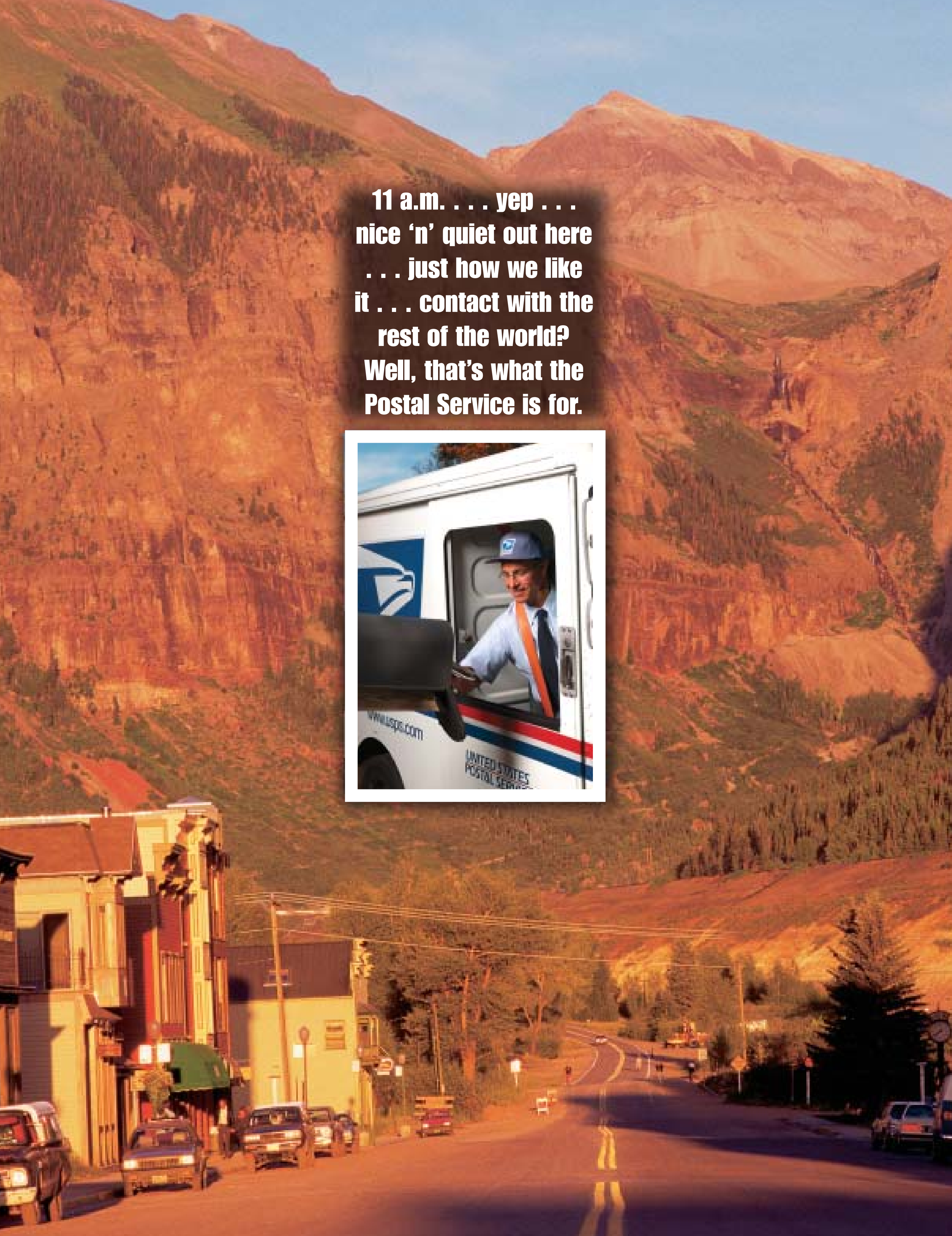
These are the men and women who deliver the gift of life through their participation in the National Marrow Donor Program. Since 1997, some 18,000 postal employees have volunteered as marrow donors. And more than 40 have delivered the gift of life to someone in need.

These are the men and women who, in cities large and small, take the time each holiday season to help Santa with his mail. They work to bring the magic of the season to thousands of children and families whose dreams might otherwise be unfulfilled.

These are the men and women who are the caring and watchful eyes for the elderly and disabled in their communities. On some days, they're the only point of human contact for home-bound customers. Through the Carrier Alert program, postal employees work with local agencies, such as the United Way, the Red Cross or the Agency on Aging, when they notice changes in routines that could mean a customer is in distress.

These are the men and women who rode with or supported the Tour of Hope, whose one-week, cross-country cycling journey inspired thousands to learn more about cancer research and the importance of clinical trials. The Team's journey took them through 14 states, beginning in Los Angeles and ending with a triumphant entry into Washington, DC, led by Lance Armstrong, cancer survivor, leader of the U.S. Postal Service Pro Cycling Team and five-time winner of the Tour de France.

We're serious about the mail. We're just as serious about helping to make the communities we serve — the same communities where we live — as good as they can be. That's why we care so much about our role as "enlargers of the common life". It's what we do.


11 a.m. . . . yep . . . nice 'n' quiet out here . . . just how we like it . . . contact with the rest of the world? Well, that's what the Postal Service is for.
www.usps.com
UNITED STATES

2003 legislation: important public policy decisions for America's postal system.

In the drastically changed security environment growing from the terrorist attacks of 2001, aviation security has been an issue high on Congress' agenda. Several bills, including H.R. 2144, the Aviation Security Technical Corrections and Improvements Act of 2003, were introduced in both the Senate and the House of Representatives that called for screening of aircraft cargo. Most bills included mail within the definition of cargo. S. 824, passed by the Senate, would require the Department of Homeland Security to study air cargo security.

H.R. 2555, introduced in the House of Representatives, contained an amendment that would not have permitted the transport of unscreened cargo, including mail, on passenger planes. While this bill was enacted and became Public Law 108-90, this amendment was stricken and funds were appropriated for research on this issue.

Legislation was introduced to encourage employers to make up the difference between the civilian and military compensation of employees who are called to duty as reservists or as members of the National Guard. These include S. 442, S. 593, H.R. 217 and H.R. 1345.

The issue of postal reform remained prominent with the introduction of S. 1285, the Postal Accountability and Enhancement Act of 2003, building on the postal reform legislation introduced by the House of Representatives in the last Congress. The bill would preserve universal service and the Postal Service's exclusive access to the mailbox. It also would create a Postal Regulatory Commission which would develop a new pricing system for postal market-dominant products. A number of the bill's provisions were reflected in the recommendations of the President's Commission on the United States Postal Service.

Two bills affecting postmasters' compensation and benefits, S. 678, the Postmaster Equity Act of 2003, and H.R. 2249, the similarly-named Postmasters Equity Act of 2003, were enacted as Public Law 108-86. The law amends Title 39, U.S. Code, to permit postmasters and postmasters' organizations to have access to fact-finding in compensation discussions. It also gives postmasters the right to convene nonbinding fact-finding to resolve differences between their representatives and Postal Service management.

Perhaps the most significant postal legislation enacted was Public Law 108-18, the Postal Civil Service Retirement System Funding Reform Act of 2003. The law helps the Postal Service to avoid an overpayment of $105 billion to the Civil Service Retirement System. An analysis by the Office of Personnel Management found that the net accumulated value of our payments to the Treasury approached the value of future CSRS benefits attributed to our participants. The potential overfunding was due to the excess interest earned by the fund. With the savings from the change in the funding schedule, the Postal Service is reducing debt and holding postage rates steady until 2006.

H.R. 2673, the Omnibus Appropriations Act for 2004, would extend the sales period for the Breast Cancer Research Semipostal stamp, first issued in 1998, and due to expire at the end of calendar year 2003, for an additional two years. The Conference Report is pending before the House and Senate for a final vote.

The Postal Service testified at a number of oversight and other hearings in both the Senate and House of Representatives. This included the Postmaster General's appearance before the Senate Governmental Affairs Committee to testify regarding the recommendations of the President's Commission on the United States Postal Service.

Subjects of other hearings included the reclamation of Washington, DC's Curseen-Morris Processing and Distribution Center, the effects of the 2001 anthrax mailings on the Wallingford, CT Processing and Distribution Center, the screening for radioactive materials in incoming international mail and the Uniformed Services Employment and Reemployment and Rights Act.


10:30 a.m. . . . Saturday . . . hi,
Betty! Got my gift? Cool! I just
ordered it yesterday . . . online.
Now, that's service!

As the governing body of the Postal Service, the 11-member Board of Governors has responsibilities comparable to a board of directors of a publicly held corporation. The Board is composed of nine Governors appointed by the President of the United States with the advice and consent of the Senate. The other two members of the Board are the Postmaster General and the Deputy Postmaster General. The Governors appoint the Postmaster General, who serves at their pleasure without a specific term of office. The Governors, together with the Postmaster General, appoint the Deputy Postmaster General.

The Board meets on a regular basis and, at the annual meeting in January, the chairman is elected by the Governors from among all members of the Board. The vice chairman is elected by the full Board.

The Board directs the exercise of the power of the Postal Service. It establishes policies, basic objectives, and long-range goals for the Postal Service in accordance with Title 39 of the U.S. Code. Except for those powers specifically vested in the Governors, the Board may delegate the authority vested in it by statute to the Postmaster General under such terms, conditions, and limitations, including the power of redelegation, as it deems desirable. The Governors are authorized to establish reasonable and equitable classes of mail and reasonable and equitable rates of postage and fees for postal service. A specific power reserved by statute for the Governors alone is to approve, allow under protest, reject or, by unanimous written decision, modify recommended decisions of the Postal Rate Commission on postal rate and mail classification changes.

board of governors

S. David Fineman, Chairman Appointed May 1995, term expires December 2003. Elected Chairman, January 2003. Served as Vice Chairman, January 2001 through December 2002. Member, Strategic Planning Committee. Managing partner, Fineman Krekstein & Harris, P.C; Former member, Industry Policy Advisory Committee to the U.S. Secretary of Commerce and U.S. Trade Representative.

Alan C. Kessler Appointed November 2000, term expires December 2008. Chairman, Strategic Planning Committee. Attorney and entrepreneur; Partner, Wolf, Block, Schorr and Solis-Cohen, LLP; Member, Board of Directors, Philadelphia Industrial Development Corporation; Chairman, Pennsylvania Supreme Court Continuing Legal Education Board.

John F. Walsh, Vice Chairman Appointed November 1999, term expires December 2006. Elected Vice Chairman January 2003. Chairman, Capital Projects Committee. Former President, Ninth Square Association and Deputy Controller and Purchasing Agent, City of New Haven, Connecticut; Member, Board of Directors, Greater New Haven Chamber of Commerce.

Ned R. McWherter Appointed October 1995, term expires December 2003. Member, Audit and Finance Committee. Former Governor of the State of Tennessee and Speaker, Tennessee House of Representatives; Officer and director of numerous companies in the transportation, financial, distribution, energy and health care industries.

Albert V. Casey Appointed August 2002 through a recess appointment expiring in late 2003. With Senate confirmation, term expires December 2009. Chairman, Audit and Finance Committee. Distinguished Executive in Residence, Southern Methodist University; former Postmaster General; former President and CEO, Resolution Trust Corporation; and former Chairman, AMR Corp. and American Airlines.

James C. Miller III Appointed April 2003 through a recess appointment expiring in late 2004. With Senate confirmation, term expires December 2010. Member, Capital Projects Committee. Chairman, The CapAnalysis Group; Senior Fellow, Hoover Institution at Stanford University; Former Director, U.S. Office of Management and Budget; Former Chairman, U.S. Federal Trade Commission.

LeGree S. Daniels Appointed August 1990 and reappointed November 1999, term expires December 2007. Member, Capital Projects Committee. Former Assistant Secretary for Civil Rights, U.S. Department of Education; former member, U.S. Civil Rights Commission; former member, Board of Directors, Center for International Private Enterprise; member, Board of Directors, Heinz Center.

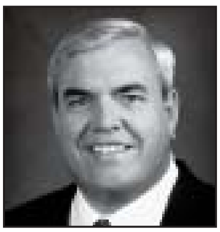
Robert F. Rider Appointed May 1995, term expires December 2004. Served as Chairman, January 2001 through December 2002. Served as Vice Chairman, January 1999 through December 2000. Member, Audit and Finance Committee. Chairman and CEO, O.A. Newton & Son Co.; Trustee, University of Delaware and Wilmington Medical Center; Director of numerous companies and institutions.

John E. Potter Appointed 72nd Postmaster General and Chief Executive Officer of the United States Postal Service in June 2001. Potter has served as Chief Operating Officer and Executive Vice President; Senior Vice President, Operations; Senior Vice President, Labor Relations; and Manager, Capital Metro Operations.

John Nolan Appointed 17th Deputy Postmaster General in February 2000. Nolan has served as General Manager and Postmaster for New York City; Director of Operations for Merrill Lynch Production Technologies; Executive Board member, National Postal Policy Council and the Mailers Council; Co-chairman of the Mailing Industry Task Force.

The Executive Committee of the United States Postal Service consists of the Postmaster General, the Deputy Postmaster General, the Chief Operating Officer, the Chief Financial Officer, the Senior Vice Presidents of Human Resources, Marketing and Government Relations, and the General Counsel. The Executive Committee is a decision-making body and its members serve as senior advisors to the Postmaster General. It meets frequently, and as necessary, to consider topics of importance to the Postal Service.

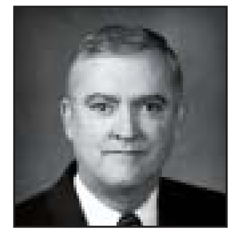
the executive committee



John E. Potter
Postmaster General and CEO

John M. Nolan
Deputy Postmaster General

Patrick R. Donahoe
Chief Operating Officer and Executive Vice President



Richard J. Strasser, Jr.
Chief Financial Officer and Executive Vice President

Suzanne Medvidovich
Senior Vice President, Human Resources

Anita J. Bizzotto
Chief Marketing Officer and Senior Vice President

Ralph J. Moden
Senior Vice President, Government Relations

Mary Anne Gibbons
Vice President and General Counsel

officers of the U.S. Postal Service

Nicholas F. Barranca Vice President, Product Development

Sylvester Black Vice President, Area Operations (Western)

Charles E. Bravo Senior Vice President, Intelligent Mail and Address Quality

William J. Brown Vice President, Area Operations (Southeast)

James A. Cohen Judicial Officer

Thomas G. Day Vice President, Engineering

JoAnn Feindt Vice President, Area Operations (Great Lakes)

William P. Galligan Vice President, Delivery and Retail (Acting)

DeWitt Harris Vice President, Employee Resource Management

Lee Heath Chief Postal Inspector

Al Iniguez Vice President, Area Operations (Pacific)

Azeezaly S. Jaffer Vice President, Public Affairs and Communications

Stephen M. Kearney Vice President, Pricing and Classification

Linda A. Kingsley Vice President, Strategic Planning

George L. Lopez Vice President, Area Operations (Southwest)

Alexander Lazaroff Vice President, Area Operations (Eastern)

Robert L. Otto Vice President, Chief Technology Officer

Henry A. Pankey Vice President, Emergency Preparedness

Donna M. Peak Vice President, Finance, Controller

Robert J. Pedersen Vice President, Treasurer

John A. Rapp Senior Vice President, Operations

Francia G. Smith Vice President and Consumer Advocate

David L. Solomon Vice President, Area Operations (New York Metro)

Jon M. Steele Vice President, Area Operations (Northeast)

A. Keith Strange Vice President, Supply Management

Rudolph K. Umscheid Vice President, Facilities

Anthony J. Vegliante Vice President, Labor Relations

Paul Vogel Vice President, Network Operations Management

James P. Wade Vice President, International Business

John R. Wargo Vice President, Service and Market Development

Murry Weatherall Vice President, Diversity Development

Jerry W. Whalen Vice President, Sales

a message from the audit and finance committee

The Audit and Finance Committee assists the Board of Governors in fulfilling its fiduciary responsibilities. The Chairman of the Board selects the members of the Committee for each calendar year. The Committee met six times in conjunction with regularly scheduled monthly Board meetings.

The Committee's primary responsibility is oversight of the integrity of Postal Service financial statements. The Committee reviews the soundness of internal accounting and control practices and major financial statement accruals. The certified public accounting firm responsible for the independent audit of Postal Service financial statements, Ernst & Young LLP, reports to the Board through the Committee.

The Committee monitors financial performance, debt levels and cash management. The Committee reviewed and endorsed a management proposal to refinance Postal Service debt, which will substantially reduce interest expense. The Committee has also been monitoring the Postal Service's continuing multi-year program to modernize its accounting systems.

Each year the Committee reviews analyses of cost and contribution by major category of mail and special service. When omnibus rate changes are required, the Committee monitors management's development of rate case filings.

During the year, the Committee assessed the impact on Postal Service financial statements of PL 108-18, the Postal Civil Service Retirement System Funding Reform Act of 2003. The legislation reduces the Postal Service's funding requirement for Civil Service Retirement System pensions. Management presented its determination of the pensions accounting treatment resulting from that Act, noting that it changed nothing in the retirement plan. The Board's auditors reviewed management's determination and concurred with management's conclusion.

The Committee asked management to evaluate its ability to comply voluntarily with the Sarbanes-Oxley legislation as it relates to internal controls. The Committee also reviewed the recommendations of the President's Commission on the United States Postal Service regarding enhanced financial transparency. Management is assessing the feasibility and cost of implementing these recommendations. The Committee will continue to monitor this work.

Ernst & Young LLP presented their work plan for the financial statement audit, and the Committee concurred with the scope and materiality levels they established. The Committee met jointly and independently with Ernst & Young LLP, the Postal Service's Inspector General, management and the General Counsel to discuss the progress of the audit and ensure independence and objectivity in the audit programs.

Accordingly, the Committee recommended, and the Board approved, the financial statements for 2003.

Albert V. Casey
Chairman, Audit and Finance Committee
December 9, 2003

financial section overview

Our total revenue increased $2.1 billion to $68.8 billion in 2003 while our total expenses decreased by $2.5 billion to $64.9 billion. Our revenue grew because of the postal rate increases we implemented on June 30, 2002. Our expenses declined primarily because of a $3.4 billion reduction in expense for the Civil Service Retirement System, as well as a reduction in compensation and benefits due to 24,000 fewer career employees.

Although the amount of mail we delivered declined from 202.8 billion pieces in 2002 to 202.2 billion pieces in 2003, we delivered mail to 141.4 million addresses, which is 1.9 million more addresses than we delivered to in 2002. While we deliver to 5.4 million more addresses than in 2000, the amount of mail we delivered has declined by 5.7 billion pieces since that time.

We do not plan to increase rates in 2004, nor do we expect revenue to grow from volume and volume mix changes.

In 2004, we will realize a smaller expense reduction from retirement reform because we will make the new normal cost contribution of 17.4% (increased from 7%) of CSRS employee salaries for the full year, instead of half the year as in 2003. Our total number of employees should continue to decline, but at a slower rate, due to the stabilization of our workload. We expect these factors, along with inflation and the cost of serving an expanding delivery network, to result in a 2004 net income of about half of our 2003 net income of $3.9 billion.

If we achieve our net income goal in 2004, we will nearly eliminate our remaining $2.2 billion deficit since postal reorganization. We will also generate positive cash flow to pay down our debt by more than $4 billion, resulting in a total debt at the end of 2004 of approximately $3 billion. This represents a 75% reduction in debt from the peak of $11.3 billion at the close of 2001.

description of business

The Postal Service (we) commenced operations on July 1, 1971 in accordance with the provisions of the Postal Reorganization Act. We provide mail service to the public, offering a variety of classes of mail service. Under the Postal Reorganization Act, we have a legal mandate to offer a "fundamental service" to the American people on a "fair and equitable basis." Our primary lines of business are First-Class Mail, Standard Mail, Priority Mail, Periodicals and Package Services. In addition to the individual and commercial customers whom we serve throughout the nation, the principal markets for these services are the communications, distribution and delivery, advertising and retail markets. Our products are distributed through our more than 37,000 Post Offices and a large network of consignees. Mail is delivered to 141 million city, rural, post office box and highway contract delivery points. We conduct our significant operations primarily in the domestic market, with international operations representing less than 3% of our total revenue.

Our labor force is primarily represented by the American Postal Workers Union, the National Association of Letter Carriers, the National Postal Mail Handlers Union and the National Rural Letter Carriers Association. Approximately 90% of our career employees are covered by collective bargaining agreements.

As an independent entity of the executive branch, we participate in federal employee benefit programs covering retirement, heath benefits and workers' compensation.

finance contents

message from the chief financial officer and executive vice president

I am proud to celebrate a year of great accomplishment. Our $3.9 billion net income is by far the largest net income ever earned. This net income erased more than two-thirds of the $6 billion deficit that had grown since postal reorganization in 1971 and thereby eliminated the $3 billion net capital deficiency.

We are making great strides in improving our financial management. With our positive cash flow we reduced our debt by $3.8 billion. We refinanced our debt, reducing our average interest rate from 5.1% to 1.1% and gaining additional flexibility to manage and retire debt in 2004. As a result of these accomplishments, we are on our soundest financial footing in many years and can defer the next general rate increase until at least 2006.

I would like to thank the men and women of the Postal Service for their contributions to this success. They worked together to produce record high levels of service, highlighted by an all-time high 95% overnight service performance for First-Class Mail and residential customer satisfaction metrics that rose to 94% in the last quarter of the year. At the same time, we achieved an unprecedented fourth straight year of productivity growth. Through the end of 2003, we estimate that we have achieved $2.7 billion of the $5 billion in cost savings and expense reductions we committed to realize over five years in our 2002 Transformation Plan.

My appreciation also extends to the efforts of the legislative and executive branches of the federal government, and the stakeholders who supported their efforts, for the rapid action on pension reform which resulted in Public Law 108-18, the Postal Civil Service Retirement System Reform Act of 2003. Without this law, we had already overfunded our CSRS pension obligation and were on course to overfund by a total of $105 billion.

While our strong financial performance is grounds for celebration, it masks long-term trends negatively affecting the viability of our business model. Again this year, the postal system grew by 1.9 million delivery points. Yet, volume dropped for the third straight year, and First-Class Mail volume declined by over 3 billion pieces to a level 4.6 billion pieces below its peak volume in 2001. Although we have historically depended on high contribution First-Class Mail to finance the growth of our delivery network, its decline means we can no longer rely on this contribution. We are challenged to find new expense reductions and revenue growth to compensate for the decline in this historic funding source.

In the last year, we established a new internal control group, developed a new accounting general ledger system, posted on the worldwide web quarterly reports on financial condition and results, and incorporated into this Annual Report expanded disclosures on legal proceedings, auditor fees, Postal Service operations, capital and financing. In 2004 we will report our interim financial results on a monthly basis as opposed to the thirteen, twenty-eight day periods we used previously.

We will continue to do everything possible to ensure the financial health of the Postal Service and to provide the outstanding service that our customers, the American people, have come to expect.

Richard J. Strasser, Jr.
Chief Financial Officer and
Executive Vice President

Tuesday, 3:30 p.m. . . . running late . . . too many meetings . . . and I still have to stop and pick up milk, peanut butter, bread and stamps on the way home. Glad I can do it all with one stop at the supermarket. Couldn't be easier!

outlook

Our mail volume and revenue growth is influenced by fluctuations in the business cycle. Although strong economic recovery after a recession has been typical in the U.S. economy, such a recovery has not occurred in this business cycle.

The most recent recession officially ended in November 2001, according to the National Bureau of Economic Research. In contrast to previous economic recoveries, however, employment is still over 2 million jobs below its pre-recession peak. Where we would normally expect increasing employment, we see continued job losses. This weakness in employment affects our mail volume because 79% of all mail originates from or is delivered to households. If employment does not increase, we expect continued weakness in mail volume.

In light of the slow recovery and indications that mail volume growth is a lagging indicator, we project total volume growth of just over 1% in 2004. If the economic recovery does not gain traction as the year progresses, we will make any necessary adjustments in our operations.

We expect First-Class Mail volume to decline for the third straight year, reflecting the continued impact of electronic diversion and sluggish economic growth. Standard Mail volume may benefit from the telemarketing regulations known as the "do not call" list that the Federal Trade Commission implemented in the fall of 2003. Standard Mail volume will also benefit from any economic growth and should grow faster in 2004 because the 2002 rate increase will have been fully absorbed by mailers. As in 2003, lower-margin Standard Mail will be our only significant source of volume growth. We expect Priority and Express Mail volume to continue to decline as the market moves to lower-priced ground shipment alternatives. This trend should favor our destination-entered Parcel Post products, pushing up the volume in the Package Services category. On the other hand, we expect the long-term decline in Periodicals and International Mail to continue.

Historically, the growth of First-Class Mail volume has financed the cost of expanding our delivery network. However, over the last several years the volume of First-Class Mail and the number of delivery points have moved in opposite directions. Since 2001, First-Class Mail volume has decreased by over 4 billion pieces while our delivery network has expanded by 3.7 million new delivery points. We absorbed these deliveries through productivity increases rather than hire the equivalent of 4,000 new carriers each year as well as purchase new vehicles and add facilities space.

We expect this delivery point growth to continue for the indefinite future. The Bureau of the Census reported housing starts in August 2003 at a seasonally adjusted rate of 1.82 million, while Harvard University's Joint Center for Housing Studies reported that housing production in the current decade is expected to "exceed the 16.6 million units built and manufactured between 1991 and 2000" due to "increasing household growth, strong demand for second homes and better balance in rental markets." Additionally, strong immigration, younger members of the baby-bust generation living on their own, aging baby-boomers purchasing second homes and shifts in family composition contribute to a projected average annual demand for 1.7 million new housing units.

Salaries and benefits are our biggest expense, and this expense is determined by the number of employees, the number of hours they work, their rates of pay and the benefits they receive, such as health and retirement benefits. Our expenses are also affected by increases in the premiums for the health plans of our retired employees. A significant source of expense growth in recent years has been the inflation in health benefits. Federal Employee Health Benefit Program premiums increased 13.3% in January 2002 and by 11.1% in January 2003. Premium increases averaging 10.6% are scheduled for January 2004. This has translated to health benefit cost increases of $471 million in 2002 and another $471 million in 2003.

Inflation rates have been low, with the Consumer Price Index averaging around 2% in 2002 and 2003. We expect inflation to remain low in 2004, possibly lower than the recent average, as the increases in energy prices that occurred earlier this year work their way out of the economic system. A rapid run-up in inflation could significantly affect our expenses because our cost of living adjustments (COLAs) for our bargaining employees are linked to changes in the Consumer Price Index for Urban and Clerical Workers.

In reducing the number of our career employees by 24,000 in 2003, following similar reductions in the past three years, we reduced work hours by 54 million hours below 2002. We plan an additional reduction of 25 million work hours in 2004, which translates to as many as 11,000 fewer career positions. We have reduced positions through attrition, by not filling certain vacancies and reassigning employees. While we will continue to reduce positions through attrition, we will also continue to offer the voluntary early retirement packages that we offered in 2003 to certain employees, including clerks and mail handlers. These retirement packages allow employees to retire early with reduced annuities, but do not offer incentive payments. We will not incur restructuring expenses in connection with these voluntary early retirements.

These reductions are achieved through our cost savings initiatives that fall into two general categories: cost savings programs and increases in operational efficiency. We have developed plans to continue productivity increases and control expense growth using both types of initiatives, but the majority of our savings will come from increases in operational efficiency.

The Postal Civil Service Retirement System Funding Reform Act of 2003 (Act) was signed into law by the President on April 23, 2003. This Act, PL 108-18, changed our funding requirements for CSRS retiree benefits and the related Postal Service payment schedules. The Office of Personnel Management (OPM) projected that without this reform, we had overfunded our pension obligations and, ultimately, would do so by $105 billion over the life of the system. The Act refers to these averted overpayments as “savings”, which the Act defines as the difference between the contributions the Postal Service would have made if this Act had not been enacted and the contributions made by the Postal Service under the Act. OPM estimated that these “savings” would be $3.4 billion for 2003, $2.7 billion for 2004 and $3.1 billion for 2005.

As directed by the Act, we are using the “savings” in 2003, 2004 and 2005 to reduce outstanding debt to the U. S. Treasury and to hold postal rates steady until 2006. The Act also requires any “savings” after 2005 be placed in an “escrow” account and counted as operating expenses for rate-making purposes until otherwise provided for by law.

In 2003 we added 1.9 million new addresses. That’s like adding two cities, one the size of Chicago, and one the size of Baltimore.

As required by the Act, we have submitted reports giving our recommendations on two issues. First, we recommended that the obligation to fund the military service costs of postal employees’ CSRS retirement benefits revert to the Department of the Treasury. Second, we recommended that the escrow provisions of the Act be eliminated and that the “savings” be used to fund retiree health care benefits, retire debt or fund capital expenditures. We do not know what actions, if any, will be taken regarding these proposals. Any of these issues could materially affect our financial results in 2004 and beyond.

In 2002, at the direction of Congress, we developed an Emergency Preparedness Plan to protect our employees and our customers from exposure to infectious biohazard agents, to screen and sanitize the mail, to decontaminate two mail processing plants that handled anthrax-laden letters and to repair or replace postal facilities affected by the September 11, 2001 terrorist attacks on New York City.

outlook

Congress appropriated $587 million for these purposes in 2002, and we spent or committed $42 million of that amount. In 2003 we spent or committed an additional $366 million. A majority of the spending this year continued to go toward facility restoration in Washington, DC and Hamilton, New Jersey. During 2003, the Board of Governors approved the Biohazard Detection System and the Ventilation and Filtration System, which totaled $573 million. We have scheduled deployment of these systems to begin in early 2004 and to be completed by mid-2005.

To support these various detection, protection and decontamination systems, we have requested a $350 million Congressional appropriation for 2004, which has not yet been authorized.

Expense Growth

We estimate that total expenses in 2004 will be $66.8 billion, which is 2.9% more than our 2003 total expenses of $64.9 billion.

We expect personnel expense, including workers' compensation and all other employee and retiree benefits, to increase by $1.8 billion, or 3.6% driven by the full year implementation of PL 108-18, contractual salary and benefits increases and health benefits inflation. We also estimate that health insurance premiums will increase by 10.6% in January 2004. In addition, 2004 is a leap year, and the one additional delivery day will add $170 million to 2004 personnel expenses.

We estimate that non-personnel expense will increase by $577 million, or 4.2%, due to investments to update and improve our information technology capabilities, improve customer access and service and upgrade our administrative support and logistics infrastructure.

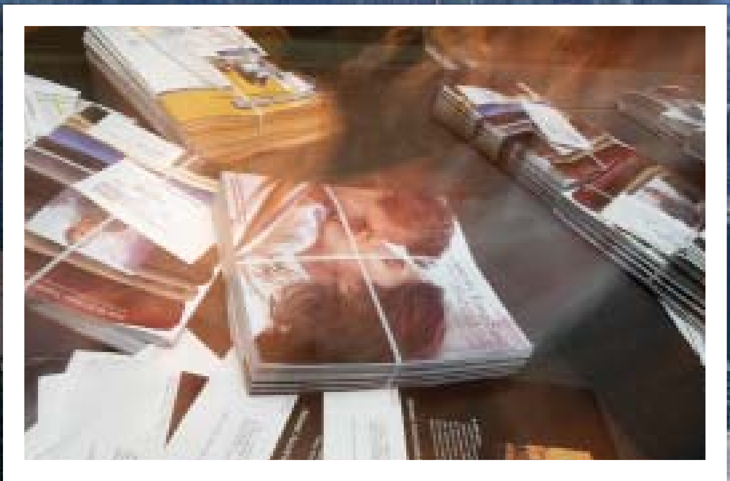
In addition to the absence of debt refinancing costs, we estimate that interest expense on borrowing will decrease $304 million in 2004. We also estimate interest expense on the CSRS deferred retirement costs to increase by $161 million to a total of $277 million due to a full year of operation under the Act.

Our expenses in 2004 would be 2.8% more than in 2003 if the effects of debt refinancing and the Act were excluded. While interest expense savings of $336 million from debt refinancing reduces expense growth in 2004 to 2.4%, total expenses increase by 2.9% because the CSRS reform savings in 2004 are less than 2003.

From 1971 through 1999, we had annual expense growth of less than 4.0% only twice. We expect that 2004 will be the fourth year out of the last five that expense growth will be less than 4.0%.

Our discussion in the Management Discussion and Analysis 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 estimate.

Thursday, 6 p.m. . . . smart move . . . opening a branch in Hong Kong . . . glad I got to help set it up . . . new people . . . new experiences . . . and great food . . . but when I get in at night, my mail brings me a taste of home. Nice!



operations

In 2003, our revenue grew because of the 7.7% average rate increase we implemented in June 2002. Our volume of mail declined slightly, from 202.8 to 202.2 billion pieces, as increases in some categories of mail were more than offset by volume decreases in other categories. While the volume of lower-margin Standard Mail increased, the volume of high-margin First-Class and Priority Mail declined. This year, largely because the effects of September 11 and the anthrax attacks had dissipated, volume declined less than in 2002, when it dropped by 4.6 billion pieces.

First-Class Mail volume fell again in 2003, continuing a long-term decline in single-piece mail due to the automation of business transactions and communications and the substitution of electronic technologies for correspondence and bill payments by consumers. In 2003, we experienced for the first time a drop in workshared First-Class Mail. We attribute this decline to the weak economy, an increase in the electronic distribution of bills and statements and a shift into Standard Mail. We expect the total volume of First-Class Mail to continue to decline in 2004. While the rate of decline should moderate as the economic recovery gains traction, we expect First-Class Mail will continue to be affected by technological substitution.

In contrast to First-Class Mail, electronic diversion is not causing declines in Standard Mail, which had robust growth in volume despite the June 2002 price change. Standard Mail is a highly targetable advertising medium that is well-placed in the highly competitive advertising market. Standard Mail reached a new all-time high volume of 90.4 billion pieces. However, much of the growth was concentrated in low margin, non-carrier route pieces. We expect increased growth of Standard Mail volume in 2004. While the implementation of "do not call" telemarketing restrictions may increase the volume of Standard Mail, much depends on a recovery in the general economy and especially in the advertising market.

A shift of the parcel market from air to ground products boosted Package Service products. While destination-entered Parcel Post benefited from this shift, Priority Mail declined, continuing a long-running trend. The expansion of the FedEx ground network and the increasing use of ground guaranteed services have cut into Priority Mail volume. Package Services volume rebounded to 1.1 billion pieces, led by increases in the Parcel Post, Bound Printed Matter and Media Mail subclasses. We expect the parcel products market to continue to move in the same direction, with Package Services volume growing in 2004 and Priority Mail volume declining.

Periodical volume fell in 2003 as a result of weakness in the advertising market and the continued move from hard copy news and entertainment sources to the Internet. These trends affected both the weight and size of the pieces that were delivered and the number of pieces sent, as titles ceased to exist or merged with others. We project continued decline in 2004.

Until the economy begins to pick up steam, lagging trends will continue in both volume and revenue. We expect volume growth to pick up in late 2004, with growth for the year of just over 1%, while revenue should stay flat, with growth in lower-margin products again compensating for the losses in high margin categories.

Operating Revenue and Volume

	Revenue			Volume		
	2003	2002	2001	**2003**	2002	2001
First-Class Mail	**1.5%**	1.7%	1.0%	**-3.2%**	-1.2%	0.1%
Standard Mail	**8.8%**	0.7%	3.4%	**3.6%**	-3.0%	-0.1%
Priority Mail	**-4.8%**	-3.9%	1.6%	**-13.9%**	-10.7%	-8.6%
Package Services	**6.5%**	4.3%	4.3%	**5.0%**	-1.6%	-3.1%
Periodical Mail	**3.2%**	-1.8%	1.6%	**-3.8%**	-3.8%	-2.8%
International Mail	**2.2%**	-8.8%	4.5%	**3.9%**	-16.5%	-1.5%
Total Mail	**3.0%**	0.5%	1.8%	**-0.3%**	-2.2%	-0.2%

Rate-Making Activity

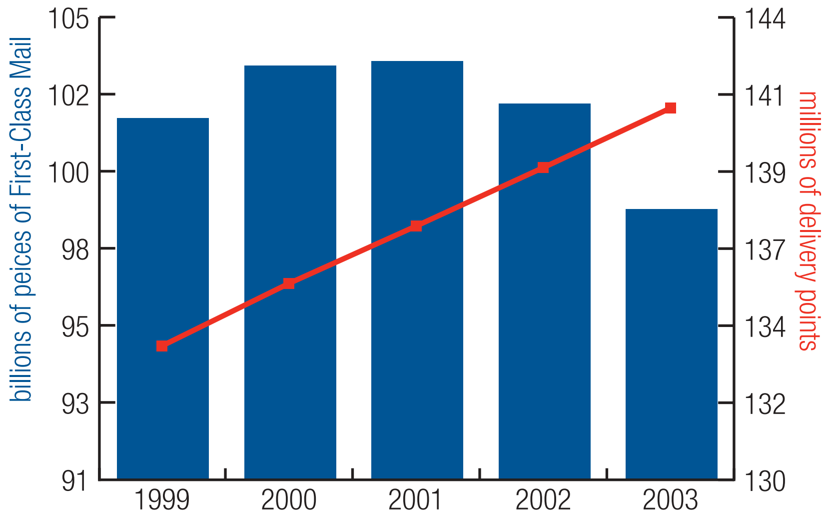
Until 1971, Congress set postage rates through legislation, and the relationship between the revenue from those rates and the actual costs of operating the postal system varied greatly. Since 1971, however, the Postal Reorganization Act has required the Postal Service to establish postal rates that cover 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 costs" in the future. 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, an independent establishment of the executive branch of the government. The submission is accompanied by detailed rate proposals supported by extensive testimony and lengthy documentation.

The Commission's proceedings take up to 10 months. It holds public hearings, during which interested parties such as mailers, competitors and consumer representatives are authorized to challenge or support the Postal Service's proposals and submit their own testimony and proposals. At the conclusion of the proceedings, the Commission 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 Commission's recommendations.

Contribution

Contribution is the difference between revenue and volume-variable costs. As the term implies, volume-variable costs are those costs that vary directly with changes in mail volume. For example, a high percentage of mail processing costs are considered volume-variable costs since changes in mail volume directly affect the number of hours clerks and mail handlers have to work. On the other hand, only a small fraction of postmaster salaries are considered volume-variable costs since these cost are, for the most part, unaffected by mail volume. In 2002, the latest year available, volume-variable costs totaled more than $38.4 billion, or about 57% of total costs. The more than $29.0 billion remaining costs are non-volume-variable and must be borne by the combined revenue of all classes of mail. In 2002, First-Class Mail, Priority Mail and Standard Mail combined to provide 94% of our volume and 90% of our contribution to non-volume variable costs.



Compensation and Benefits

Operating costs fell $1,332 million in 2003 due primarily to pension reform and work hour reductions. This decline in costs was tempered by wage increases and increasing health benefits cost for current and retired employees. Compensation and benefits make up nearly 80% of our operating costs.

Compensation and benefits costs decreased $2,614 million or 4.9% due to the retirement system reform act and our reduction in work hours. Our health benefits payments expense for current employees were $325 million greater than last year, driven mainly by

operations

Change in Compensation and Benefits Costs

2003	2002	2001
-4.9%*	0.4%	3.6%

*Without the retirement system reform act, increase for 2003 would have been 1.4%.

premium increases. As health care costs continue to increase, so will our health benefits expense for current employees.

Almost 90% of our career workforce is covered by collective bargaining agreements. These agreements have expiration dates from November 2004 to November 2006 and call for basic pay increases and cost of living adjustments (COLAs).

Our non-bargaining employees receive pay increases only through a pay-for-performance program that makes meaningful distinctions in performance. Unlike the rest of the federal government and our bargaining employees, these employees do not receive automatic salary increases, nor do they receive COLAs or locality pay.

With the conclusion in 2002 of our group incentive program that covered over 80,000 supervisors, managers, postmasters, executives and staff throughout the Postal Service, management met with representatives from supervisor and postmaster associations and designed a performance-based pay system that enhances accountability for individual contributions to organizational success. The new system provides clear expectations and feedback on progress toward established goals. It is also designed to reward and recognize exceptional individual performance for achieving challenging objectives.

Compensation and Benefits Details ($ millions)

	2003	2002	Change	Percentage Change
Compensation	**$37,144**	$36,877	$267	0.7%
Retirement	**5,877**	9,105	(3,228)	-35.5%
Health Benefits	**4,526**	4,201	325	7.7%
Retiree Health Benefits	**1,133**	987	146	14.8%
Workers' Compensation	**1,473**	1,524	(51)	-3.3%
Other	**391**	464	(73)	-15.7%
Total Compensation and Benefits*	**$50,544**	**$53,158**	**($2,614)**	**-4.9%**

**Equals compensation and benefits plus interest on deferred retirement on the financial statements*

Retiree Health Benefits

The Postal Reorganization Act of 1970, which created the Postal Service, allowed the Postal Service to either participate in the Federal Employees Health Benefits Program (FEHBP), or adopt a plan that would be no less favorable to our employees. The Postal Service has continued to participate in the FEHBP. Eligible postal employees with at least five consecutive years participation in the FEHBP immediately preceding retirement are entitled to continue this healthcare coverage after retirement.

Until 1987, the cost of postal retirees' health benefits under the FEHBP was paid from funds appropriated (tax dollars) directly to the federal Office of Personnel Management (OPM) 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 FEHBP 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.

FEHBP, which provides health benefits to all federal and postal employees and retirees, treats all participants as a single group. In addition, OPM and the various providers negotiate and control the benefits offered in FEHBP. All benefits are equally available to all participants. OPM also negotiates rates with the insurance carriers and the premiums charged by insurance carriers are based on the risk characteristics of the entire population of FEHBP participants.The Postal Service is billed and pays from postal revenues the premium cost for postal retirees. For all other federal agencies, this cost is paid by the U.S. Treasury through appropriations.

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 contribution is due.

Based on analysis of FAS 106 when the standard was issued, management determined that our participation in the FEHBP for retirees most closely matches the characteristics of a multi-employer plan.

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 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. In 2002, we estimated the present value of future premium payments to be between $40 and $50 billion, based on Postal Service employment through September 2002. The range in the estimate exists only because long-term medical inflation assumptions differed by 1%. All other economic and demographic assumptions for health plan utilization and benefits were identical.

An estimate for 2003 was developed incorporating updated census data and higher near-term medical inflation assumptions in the optimistic (lower) estimate. The 6.25% discount rate as well as all other assumptions remained the same. The new value of future premium payments is estimated between $47 and $57 billion.

The increase from the 2002 estimates is driven by four components. The largest component of the change is caused by an interest accrual of 6.25% on the prior year unfunded obligation. The second largest component relates to the current service cost for postal employees, representing the portion of their retiree health benefit costs earned in 2003. The current obligation estimate further increased from substitution of actual health premium inflation in 2003 for the estimate used in the 2002 calculation. Finally, updating for 2003 census data relative to plan enrollment changes, coverage options and life expectancy changes caused actuarial losses, further increasing the new obligation estimate.

In the Postal Civil Service Retirement System Funding Reform Act of 2003 (Act), Congress expressed its sense that a portion of the "savings" from the reduced CSRS annual payments be used to address unfunded obligations for postretirement health benefits. The Act requires that we submit proposals detailing how we will use any refund or reduction in future postal retirement payments ("savings") after 2005. Also, a second proposal was required stating our position on responsibility for retirement obligations related to military service. In our report submitted September 30, 2003, we proposed two alternatives for funding postretirement health benefits, both responding to the sense of Congress and involving the use of "savings" from the changes in Civil Service Retirement and Disability Fund (CSRDF) funding.

The first proposal, our preferred approach, would return to the U.S. Treasury responsibility for retirement obligations arising from military service. Under this proposal, our CSRS pension obligation is over-funded. These funds would be transferred to a newly established "Postal Service Retiree Health Benefit Fund."

Our second proposal would use Act "savings" to finance, in priority sequence: first, fund and prefund post-retirement health care benefits; second, to repay debt and third, to fund productivity and cost savings capital investments. Under this proposal there is an indirect benefit achieved that addresses the sense of Congress relating to delaying or moderating increases in postal rates. Beginning in 2006, this proposal would pre-

Each of our 291,015 letter carriers delivered an average of 42.7 tons of mail in 2003. That's equal to carrying over 10 average-sized male elephants.

fund post-retirement health benefits for all new employees who were hired in 2003 or later. It would also provide a funding source for the annual cost of these benefits for all retirees.

We believe that these proposals respond to concerns underlying the expression of the sense of Congress for the use of "savings" resulting from the passage of the Act. Both proposals would reduce our unfunded postretirement health benefits obligations presented above and provide an approach for the systematic funding of these obligations in future years. This would allow us to continue meeting our obligations to our current and retired employees without overburdening our current and future customers with large and disruptive rate changes.

We delivered over 202,000,000,000 pieces of mail in 2003.

Under the FEHBP, 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 $1,133 million in 2003, $987 million in 2002 and $858 million in 2001. In 2003, the increase in these costs represented 0.2% of total costs.

These retiree health benefit costs are currently included in our rate base. In 2003 retiree health benefits costs represent 1.7% of our total costs.

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 fund these costs in the future as they have in the past.

Retirement Expense

The Postal Civil Service Retirement System Funding Reform Act of 2003 (Act), signed by the President on April 23, 2003, significantly affects our finances. The Act changes the way we fund our Civil Service Retirement System (CSRS) obligation. According to a 2003 GAO report, we had overfunded our pension obligation and, without this legislation, were on course to overfund by approximately $105 billion.

Previously, the Office of Personnel Management (OPM) determined the liability each year that resulted from any pay increases we granted to our employees. We were then required to discharge this liability over 30 years at 5% interest. When all Civil Service retirees received an annual cost-of-living adjustment (COLA), OPM calculated the future cost of that benefit, which we funded over 15 years at 5% interest.

Using this funding method, our liability as of September 30, 2002 was $32 billion. However, OPM conducted a special analysis that revealed we overfunded our CSRS obligation because of higher than assumed historical interest earnings, lower than assumed outlays and other factors. With the retroactive transfer of CSRS military service costs from the federal government to us, OPM estimated that our 2002 unfunded retirement obligation was closer to $4.8 billion. The Administration, therefore, proposed the Act.

In May 2003, we began to pay 17.4% of our current CSRS employees' wages to the retirement fund rather than the 7% we previously paid. Also, in 2004 we will be required to make the first of 40 annual payments, if necessary. The actual amount of our payment is to be derived from OPM's new calculation of the fund balance due June 30, 2004 under the Act.

The Act also transfers to us from the U. S. Treasury the responsibility for funding the costs of CSRS benefits that current and former Postal Service employees have earned through military service. Thus, the Act transfers $27 billion in cost from U. S. taxpayers to our ratepayers. Without this transfer, we over-funded these obligations by $10 billion.

However, the Act provided an opportunity to reconsider this transfer by requiring the Postal Service, Department of the U.S. Treasury and the OPM to submit proposals "detailing whether and to what extent the Department of the U.S. Treasury or the Postal Service should be responsible for the funding of benefits attributable to the military service of current and former employees of the Postal Service." We recommended that the responsibility for these costs should be returned to the U.S. Treasury. The General Accounting Office (GAO) prepared a written evaluation of each proposal and submitted its evaluation to the Committee on Government Reform of the House of Representatives and the Committee on Governmental Affairs of the Senate on November 26, 2003.

The Act places additional requirements on the Postal Service. Specifically, the Act identifies as "savings" the difference between the contributions we would have made if the Act had not been enacted and the contributions we make under the Act. In 2003 and 2004, we must use these "savings" to reduce our outstanding debt to the U. S. Treasury. We estimated the 2003 "savings" at $3.5 billion, and we reduced our debt with the U.S. Treasury by $3.8 billion in 2003, thus exceeding the requirements of the Act. We will use the "savings" in 2005 to hold postal rates steady until at least 2006.

Congress will consider what to do with the post-2005 "savings," but until Congress acts, any "savings" after 2005 must be placed in escrow. As required by the Act, we submitted on September 30, 2003, our proposal to the President, Congress and the GAO on how the "savings" after 2005 should be used. Based on its impact on postage rates and its effects on the mailing industry, the general public and the economy as a whole, we recommended the elimination of the escrow requirement. We believe that the "escrowed savings" requirement of the Act will result not only in increased postage rates but also more frequent postage rate increases as the over-funding amounts escalate. From the standpoint of the postal ratepayer, there are no "savings" flowing to postage rates as long as the escrow continues in effect.

We believe, and we have proposed to Congress, that the military service responsibility should be returned to the U.S. Treasury, with the resulting $10 billion in over-funding remaining in the Civil Service Retirement and Disability Fund in a separate account designated as the "Postal Service Retiree Health Benefit Fund." With this change, we would begin pre-funding retiree health benefits for employees and retirees. If the military service charge is not returned to the U.S. Treasury, we believe the "savings" or over-funding should be used to fund current retirees' health benefits and pre-fund new employees' post-retirement health care benefits, repay debt and fund productivity and cost saving capital investments.

Separately, we have taken issue with the methodology OPM used to calculate our CSRS obligations. Specifically, we believe that OPM used an allocation methodology to attribute CSRS pension costs of the pre-July 1, 1971 service that assigns an unreasonably large share of the burden to us for payment. We requested OPM to consider an alternative allocation methodology that is consistent with the approach OPM previously used to allocate the increase in CSRS pension costs created by annual cost-of-living-adjustments granted to retirees. After OPM rejected our proposal, we recommended a different compromise to allocate between us and the federal government the pre-July 1, 1971 and post-June 30, 1971 CSRS pension costs for the former Post Office Department on a more equitable basis. Under the Act, we may request the Board of Actuaries of the Civil Service Retirement System to review and make adjustments to OPM computations. We are considering filing such an appeal.

(See Notes 6 and 7 of the Notes to the Financial Statements for additional information.)

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. However, we pay all workers' compensation claims out of postal funds.

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 2003, we estimate our total liability for future workers' compensation costs at $7,114 million, an increase of $589 million or 9.0%. In 2003, we recorded $1,457 million in workers' compensation expense, compared to the $1,511 million we recorded in 2002. These amounts exclude Post Office Department workers' compensation costs, of $17 million in 2003 and $13 million in 2002.

In the past, workers' compensation expenses tended to increase every year as more and more employees received benefits. With medical costs rising as they have in the past several years, it remains imperative that we reduce workplace injuries, manage current claims and eliminate fraudulent claims.

We expect costs related to workers' compensation to remain stable in 2004 as a result of initiatives that will help to minimize the impact of rising medical costs. These initiatives include actions to increase the rigor of medical bill reviews, increase the recovery of expenses related to injuries sustained by employees as a result of their own actions and a joint initiative with the Office of Workers' Compensation Programs to increase the number of injured employees returned to work.

In addition to the cost of workers' compensation claims, OWCP charges us an administrative fee for processing claims. In 2003, the administrative fee was $45 million compared to $37 million in 2002 and $31 million in 2001.

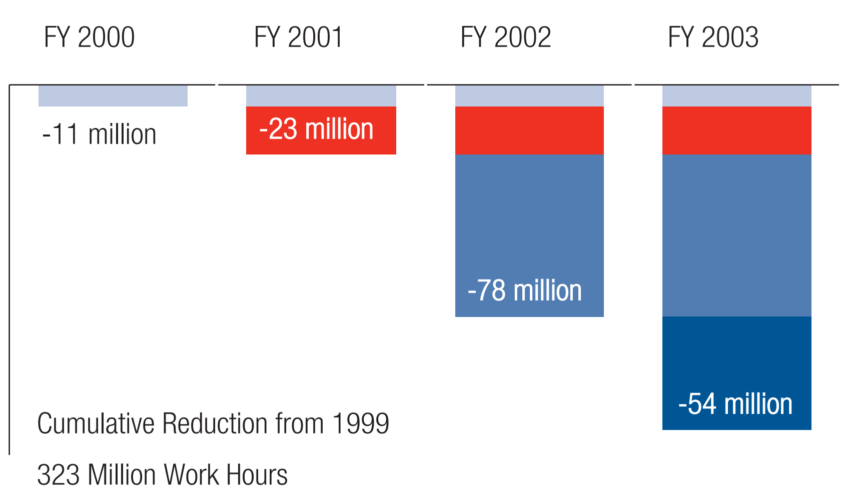
(See Notes 2 and 3 of the Notes to Financial Statements for additional details.)

Productivity

We use two indicators to measure our efficiency. First, we use Output per Work Hour, 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 outputs, or workload and all the resources used in producing these outputs. Our main outputs are mail and special services and carrier services to an expanding delivery network. TFP calculations include inputs for all resources including labor, materials, transportation and capital investments.

During 2003, our Output per Work Hour grew by 2.3% and our TFP improved by 1.8%. This TFP growth is equivalent to $1,196 million in expense reductions. This marks our fourth consecutive year of positive TFP growth, with equivalent expense reductions totaling over $4.4 billion over this time. Our productivity growth continues to be driven by substantial restraints on the resources we use to produce our outputs. Again in 2003 we were able to achieve positive TFP growth as our workload declined for the third consecu-

Year Over Year Work Hour Reductions



tive year, in contrast to the years before 2001 when our strong TFP growth was achieved by absorbing an increasing workload.

Transportation

Transportation expenses decreased by $143 million in 2003. After the terrorist attacks on September 11, 2001 the Federal Aviation Administration placed restrictions on mail pieces weighing more than 16 ounces, which prohibited us from using commercial air carriers. We were thus forced to move virtually all Priority Mail to the FedEx network and our surface network, with a small volume of mail on expensive air taxis. Although the FedEx network is less expensive than our old dedicated network, it is more expensive than commercial air carriers. We are currently moving 51% of Priority Mail on our surface network and 48% on FedEx.

Change in Transportation Expenses

2003	2002	2001
-2.8%	1.5%	7.4%

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 negotiated changes to the FedEx contract that lowered our rates as volume on that network increased. A midyear decline in fuel prices also helped reduce transportation costs.

We think that our transportation costs for 2004 will remain in line with our costs for 2003. We continue to work with the Transportation Safety 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.

Cost Reduction Initiatives

We will continue our efforts not just to control costs but to reduce them. For 2004, we plan $1,368 million in cost reductions. We will reduce operating costs by continuing our Breakthrough Productivity Initiative. We plan a reduction of 25 million work hours in 2004, even with the additional work hours from an extra delivery and retail day due to a leap year. This reduction, which is equal to approximately 11,000 full-time equivalent employees, will be the fifth consecutive year that we have reduced work hours, for a five-year total work hour reduction of 191 million. We continue to reduce our total work hours and our costs even as we deliver to 1.9 million new addresses each year.

Thursday, 2 p.m. . . . got a great deal on the apartment . . . the moving van just unloaded . . . and my mail's already here . . . that online address change is great . . . that's my Post Office . . . ready when I am.

Capital cash outlays are the funds we invest for such capital improvements as facilities, automation equipment and information technology.

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. The charts illustrate the direct relationship between the CAPEX ratio and borrowing. Whenever our capital outlays appreciably exceed our cash flow, we must make up the difference by either reducing cash on hand or by borrowing, or some combination of the two.

While the funding for a project is authorized in one year, the commitment, or contract to purchase or build, may occur over several years. Similarly, actual payment for the project, or capital cash outlays, may take place over several years. The $1.277 billion in capital outlays for 2003 represents outlays for commitments made in previous years as well as commitments made in 2003 for all 59 projects.

Of the 49 active Board-approved projects at the close of the year, 25 were for mail processing equipment and vehicles, 9 were for facilities and 15 were for other projects such as retail equipment and information infrastructure support.

	Cash Flow from Operations ($ millions)	Capital Cash Outlays ($ millions)	CAPEX Ratio
2003	**$6,405**	**$1,277**	**501.6**
2002	1,443	1,675	86.1
2001	1,255	2,932	42.8
2000	1,207	3,254	37.1
1999	2,863	3,788	75.6

When the CAPEX ratio is above 100%, we can pay for capital with internally generated funds.

... and debt changes proportionately.

	Change in Debt ($ millions)
2003	**$(3,841)**
2002	(200)
2001	1,999
2000	2,399
1999	496

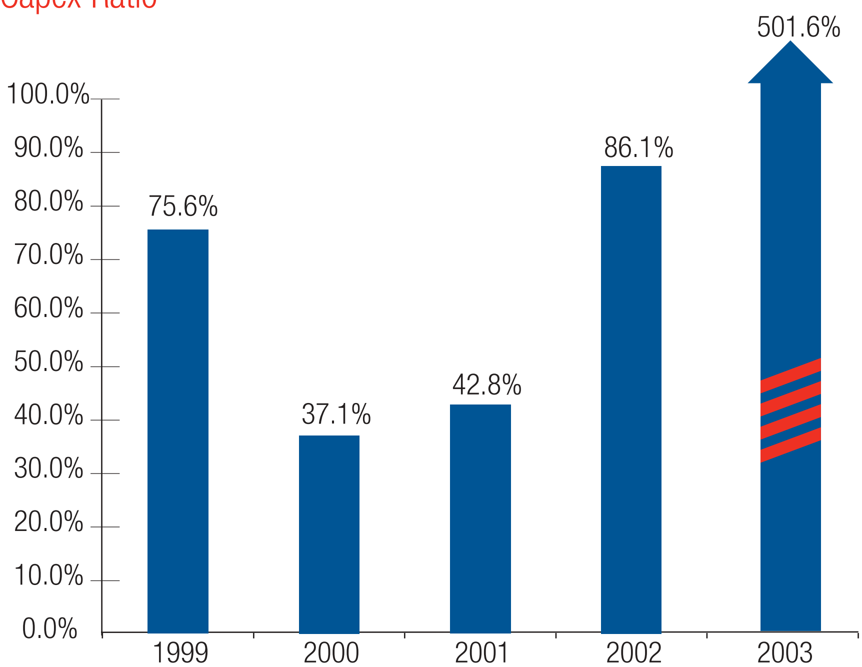
Capital Investments

The Board of Governors approves the capital budget each year. The Board also approves all major capital projects, generally defined as projects greater than $10 million. At the beginning of the year, there were 50 Board-approved projects in progress representing $5.7 billion. During the year, the Board approved 17 new projects for $2.2 billion and 17 projects were completed, representing $811 million.

We estimate the total capital commitment plan for 2004 at $3.2 billion, with estimated cash outlays of $2.2 billion, of which approximately $1.5 billion is for commitments made in prior years and the remaining $700 million is for new commitments in 2004.

capital

Capex Ratio



Future

Our capital plan for the future calls for cost management by developing and deploying new automation and mechanization equipment that will increase our operating efficiency. We will continue to concentrate on maintaining such infrastructure as facilities, vehicles and systems, as well as return on investment (ROI) projects. Under this plan, we will make investments in programs that reduce work hours in our distribution, processing and delivery operations. These investments include the Optical Character Reader Enhancement Program, Postal Automated Redirection System (PARS) for Letters – Phase 2 and PARS for Flats. The Optical Character Reader Enhancements for Letter Automation Program replaces outmoded Multi-line Optical Character Readers and results in a significant reduction in space requirements for the equipment, improved productivity and less maintenance. PARS for Letters will automate the processing of Undeliverable-As-Addressed mail and greatly reduce the labor and time needed to process this mail.

Our facilities program will continue to address life, health, safety and security issues. We will use existing space whenever possible, invest in new construction only when necessary and maintain our customer service facility infrastructure to support the growth of the delivery network.

The Emergency Preparedness Plan (EPP) includes projects that address biohazard detection and ventilation filtration systems to provide a level of protection for our employees and customers from potential contamination. The Board of Governors has approved the Biohazard Detection System and the Ventilation Filtration System projects which we will deploy during 2004 and beyond. A portion of these investments has been funded under the Homeland Security authorization in the 2002 Department of Defense Appropriations Act. The remaining capital funding for these and any other EPP-related projects will be allocated from the 2004 capital plan as necessary, pending any new appropriations.

(See Note 11 of the Notes to the Financial Statements for additional information.)

Debt

The amount we borrow is largely determined by the difference between our cash flow from operations and our capital cash outlays. Our capital cash outlays are the funds we invest back into the business for our capital investments in new facilities, new automation equipment and new services. From 1997 through 2002, our outlays for capital investment exceeded cash from operations by $5.6 billion, so we covered the difference with borrowed funds. From the end of 1997, which was the lowest end-of-year debt level in the last 10 years, to the end of 2002, our debt outstanding to the Department of the Treasury's Federal Financing Bank increased from $5.9 billion to $11.1 billion.

Our debt management strategy has been based on the assumption that we would always have a core amount of debt outstanding. Therefore, we have maintained a mixture of fixed- and floating-rate debt, striking a balance between short- and long-term debt. Thus, as interest rates declined to historically low levels during 2002, we shifted the balance of our debt portfolio toward more fixed-rate, long-term debt in order to protect ourselves against future increases in interest rates. Under this strategy, we began 2003 with $7.3 billion in long-term debt that carried a weighted-average interest rate of 5.1%.

With the enactment of the Postal Civil Service Retirement System Funding Reform Act of 2003 (Act), we had to completely change our debt management strategy. The Act requires us to apply all cash savings we realize under its provisions in 2003 and 2004 to debt reduction. In 2005, we must use any savings to maintain steady postal rates and to reduce debt. Congress has yet to state how we are to use any savings realized after 2005.

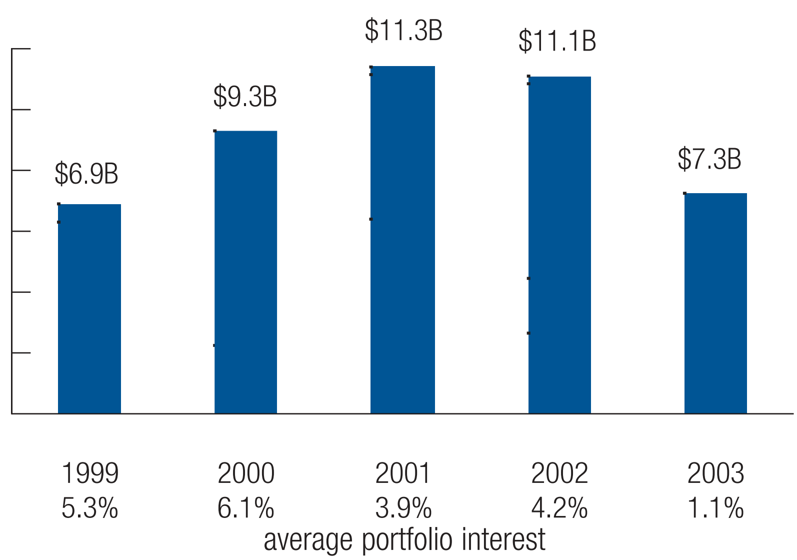
We could have achieved the required debt reduction for 2003 by paying off short-term debt. However, the requirement for 2004, estimated at $2.7 billion, would have been a challenge because only $750 million of our debt was scheduled to mature. In other words, we would have had to prepay some long-term debt before maturity at an unknown price. We decided instead to retire more long-term debt this year so we will have the flexibility to reduce debt next year without a penalty.

The repurchase price of our debt depends on the interest rates for Treasury securities with maturity dates and terms similar to our debt. If the interest rate for Treasury securities falls below the level at which our debt was issued, we have to pay a premium to pay off our debt. If interest rates are roughly equivalent to the interest rates at the time we incurred the debt, we do not have to pay a premium.

Before the passage of the Act, we had already undertaken steps to refinance and reduce our outstanding debt. In January we paid off $777 million in long-term debt without a net premium. In July, following enactment of the Act, we retired an additional $547 million, for a total of $1.3 billion. Because we did not have to pay a premium to retire this debt, we realized net savings from these transactions immediately, through lower interest expense. The weighted average interest rate for the retired debt was 4.5%.

In August, we used more favorable market conditions to retire our remaining $6 billion of long-term debt by paying a premium of $360 million, a charge to this year's net income. The retired debt carried an average interest rate of

Debt at End of Year



5.1% and was replaced by debt carrying an average interest rate of 1.1%. Although we paid a premium to retire this debt, we will more than make it up because of the much lower interest we will pay in the future. The economics of the transaction were compelling, with the difference between long-term interest rates and short-term interest rates reaching levels not seen since 1992. In November 1992, we restructured a smaller level of debt while paying a higher premium.

As a result of our 2003 refinancing, we saved $62 million in interest in 2003, and we expect to save an additional $336 million in 2004. We also gained flexibility in paying off a substantial amount of debt in 2004 as required by the Act. Our net cash flow can now be applied to debt reduction without concern of paying any penalty.

In requiring debt reduction, the Act effectively creates limits for our debt outstanding for 2003 and 2004. Our debt outstanding cannot exceed $7.6 billion for 2003 and approximately $4.6 billion for 2004. We ended 2003 with $7.3 billion debt outstanding, some $300 million lower than required by the Act. Because of our debt refinancing, we are now well positioned not only to meet but to far exceed the Act's requirements for additional debt reduction for 2004. We can now apply all cash in excess of current needs toward debt reduction on a daily basis. As a result, we project interest expense on our debt in 2004 will be the lowest since 1974. Moreover, we project debt reduction of between $4.2 billion and $4.7 billion in 2004, well beyond the estimated $2.7 billion required by the Act.

Our opportunity for debt reduction in 2005 will depend upon our ability to operate at close to break even, combined with our ability to finance capital investment through depreciation expense. Our level of debt for 2006 and beyond will be influenced by these same factors and will also be greatly influenced by the yet to be specified requirements of the Act which requires that savings attributable to the legislation after 2005 be held in escrow and not obligated or expended until otherwise provided for by law.

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 was renewed this year, and 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 the funds are needed. 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.

For 2004, the Act, with its mandatory debt reduction requirement, limits our liquidity somewhat by removing financing as a possible source of funds. Our liquidity will be comprised of the cash that we have entering the year plus the cash flow that we can generate from operations. That said, we expect cash flow from operations to not only supply enough excess cash to fund our capital investments but to far exceed our mandatory debt reduction requirements. For 2005 and beyond, with our access to financing, if needed, being restored, liquidity will be enhanced.

Market Risk Disclosure

In the normal course of business, we are exposed to market risk from changes in commodity prices, certain foreign currency exchange rate fluctuations and interest rates. With the limited exception explained below, we do not use derivative financial instruments to manage market risks. Additionally, we do not purchase or hold derivative financial instruments for speculative purposes.

Commodity Price Risk

We are exposed to changes in commodity prices primarily for diesel fuel, unleaded gasoline and aircraft fuel for transportation of the mails and natural gas for heating facilities. We currently do not use derivative commodity instruments to manage the risk of changes in energy prices.

Foreign Currency Exchange Rate Risk

We have foreign currency risk related to the settlement of terminal dues and transit fees with foreign postal administrations for international mail. The majority of our international accounts are denominated in Special Drawing Rights (SDRs). The SDR exchange rate fluctuates daily based on a basket of currencies comprised of the euro, Japanese yen, the pound sterling and the U.S. dollar. Changes in the relative value of these currencies will increase or decrease the value of our settlement accounts and result in a gain or loss from revaluation reported in the results of operations. The actual currency used to settle accounts varies by country.

We purchase the required currency at the time of settlement, but when we know the timing and the amount of scheduled payments in advance, we may purchase short duration forward contracts. In 2003 we purchased short term forward contracts for Canadian dollars representing approximately $34 million for provisional payments to Canada under a previous year bilateral agreement. We completed the delivery of funds under these contracts before the end of the year.

On average, every one of our 56,776 mail handlers moved 3.56 million pieces of mail in 2003.

We adjust the reported international payables and receivables to reflect their value based on the SDR rate in effect at year end. This revaluation resulted in a loss of $9 million in 2003 solely due to the change in the SDR rate from 2002. In addition to the year end revaluation, we also recognize gains and losses on our receivables and payables when we settle with foreign postal administrations. Due to our status as a net international debtor, coupled with the decline in the dollar relative to the SDR, in 2003 we recognized $12 million in settlement-related net losses on foreign exchange. We do not use derivative financial instruments to manage the risk of changes in the SDR.

Interest Rate Risk

As described in Note 5 of the Notes to the Financial Statements, we refinanced all of our outstanding long term Federal Financing Bank debt with short term debt in 2003. We have not used derivative financial instruments to manage risk related to interest rate fluctuations for debt instruments.

Legal Proceedings

We are subject to various claims and liabilities that arise in the ordinary and normal course of postal operations. These claims generally cover labor, tort and contract disputes and are regularly reviewed by management and, where significant, by the Audit and Finance Committee of the Board of Governors and/or the full Board of Governors. In our evaluation, no single claim is material to our financial statements taken as a whole. We have incorporated into our financial statements of September 30, 2003 the estimated impact of those claims we think it is probable we will pay.

other issues

Auditors' Fees

In 2002, the Board of Governors selected Ernst & Young LLP as its independent auditor to perform external auditing services. The competitively awarded five-year contract, with an option for renewal of up to 36 months, has an estimated value of $11.7 million. This contract covers the financial statement audits for fiscal years 2003-2007. As with previous contracts for external audit services, Ernst & Young LLP will not perform consulting work for us for the duration of its contract.

Code of Ethics

The *Standards of Ethical Conduct for Employees of the Executive Branch* at 5 CFR §2635 apply to all postal employees. The *Standards* were issued in 1993 by the U.S. Office of Government Ethics, and replaced the individual agency standards then applicable to all employees of the Executive Branch. Our employees are also *covered by the Supplemental Standards of Ethical Conduct for Employees of the United States Postal Service* at 5 CFR §7001. The *Standards* and *Supplemental Standards* are detailed and contain many examples to help employees recognize and resolve ethical issues. We give employees a summary of the Standards, and other ethical conduct materials, at new employee orientation training. We also provide annual ethics training for all employees who file a financial disclosure report. We encourage our employees to seek ethics advice and information from Postal Service ethics officials, and we publicize an ethics phone line and email address they can use for this purpose.

Friday, 9 a.m. . . . our dream house . . . lookin' good . . . and the contractor says they're ahead of schedule . . . even better, our Postmaster says the new route will be coming out this way the day we move in. Great!

auditor's report

Board of Governors

United States Postal Service

We have audited the accompanying balance sheets of the United States Postal Service as of September 30, 2003 and 2002 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, 2003. 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 applicable to 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, 2003 and 2002 and the results of its operations and its cash flows for each of the three years in the period ended September 30, 2003, in conformity with accounting principles generally accepted in the United States.

In accordance with *Government Auditing Standards*, we have issued our report dated November 14, 2003, on our consideration of the United States Postal Service's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations and contracts. 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 in considering the results of our audit.

Ernst + Young LLP

McLean, VA
November 14, 2003

statements of operations

(dollars in millions)	**2003**	2002	2001
	Year ended September 30,		
Operating revenue — Note 8	**$68,529**	$66,463	$65,834
Operating expenses:			
Compensation and benefits — Notes 2, 3, 6 and 7	**50,428**	51,557	51,351
Transportation	**4,989**	5,132	5,056
Other	**8,485**	8,545	9,233
Total operating expenses	**63,902**	65,234	65,640
Income from operations	**4,627**	1,229	194
Interest and investment income	**58**	46	35
Interest expense on deferred retirement liabilities — Notes 6 and 7	**(116)**	(1,601)	(1,603)
Interest expense on borrowings	**(334)**	(340)	(306)
Debt repurchase expense	**(360)**	-	-
Emergency preparedness appropriations — Note 11	**177**	179	-
Emergency preparedness expenses — Note 11	**(184)**	(189)	-
Net income (loss)	**$ 3,868**	$ (676)	$ (1,680)

See accompanying notes to financial statements.

balance sheets

(dollars in millions)	September 30, 2003	2002
Assets		
Current Assets:		
Cash and cash equivalents — Note 2	**$ 2,266**	$ 1,156
Receivables:		
Foreign countries	**744**	592
U.S. government	**359**	125
Consignment	**50**	55
Other	**144**	137
Receivables before allowances	**1,297**	909
Less allowances	**106**	112
Total receivables, net	**1,191**	797
Supplies, advances and prepayments	**366**	327
Total Current Assets	**3,823**	2,280
Other Assets, Principally Revenue Forgone Appropriations Receivable — Note 8	**365**	368
Property and Equipment, at Cost:		
Buildings	**19,759**	19,513
Equipment	**17,166**	16,421
Land	**2,809**	2,776
Leasehold improvements	**1,060**	1,098
	40,794	39,808
Less allowances for depreciation and amortization	**18,717**	16,895
	22,077	22,913
Construction in progress	**977**	1,223
Total Property and Equipment, Net	**23,054**	24,136
Deferred Retirement Costs — Notes 2, 6 and 7	**—**	32,231
Total Assets	**$27,242**	$59,015

See accompanying notes to financial statements.

balance sheets

(dollars in millions)	September 30, 2003	2002
Liabilities and Net Capital (Deficiency)		
Current Liabilities:		
Compensation and benefits	**$ 2,518**	$ 5,113
Estimated prepaid postage	**1,349**	1,500
Payables and accrued expenses:		
Foreign countries	**879**	748
U.S. government	**112**	246
Unexpended appropriations — Note 11	**406**	583
Other	**1,863**	584
Total payables and accrued expenses	**3,260**	2,161
Prepaid box rentals, permit and metered mail	**1,925**	2,011
Outstanding postal money orders	**768**	986
Current portion of debt	**7,273**	3,815
Total Current Liabilities	**17,093**	15,586
Long-Term Debt, Less Current Portion — Note 5	**1**	7,300
Other Liabilities:		
Deferred retirement costs — Notes 2, 6 and 7	**—**	32,231
Less current portion reported in compensation and benefits	**—**	(2,185)
	—	30,046
Workers' compensation costs — Notes 2 and 3	**6,324**	5,815
Employees' accumulated leave	**1,932**	2,088
Other	**1,026**	1,182
Total Other Liabilities	**9,282**	39,131
Commitments and Contingencies — Notes 9 and 10		
Total Liabilities	**26,376**	62,017
Net Capital (Deficiency):		
Capital contributions of the U.S. government	**3,034**	3,034
Deficit since reorganization	**(2,168)**	(6,036)
Total Net Capital (Deficiency)	**866**	(3,002)
Total Liabilities and Net Capital (Deficiency)	**$27,242**	$59,015

See accompanying notes to financial statements.

statements of changes in net capital (deficiency)

Year ended September 30, 2003, 2002 and 2001

(dollars in millions)	Capital Contributions of U.S. Government	Deficit Since Reorganization	Total Net Capital (Deficiency)
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)
Net income	—	**3,868**	**3,868**
Balance September 30, 2003	**$3,034**	**$(2,168)**	**$866**

See accompanying notes to financial statements.

statements of cash flows

(dollars in millions)	2003	2002	2001
	Year ended September 30,		
Cash flows from operating activities:			
Net income (loss)	**$3,868**	$(676)	$(1,680)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	**2,295**	2,296	2,223
Loss on disposals of property and equipment, net	**64**	6*	16
Decrease in other assets, principally revenue forgone appropriations receivable	**3**	4	3
Increase in USPS workers' compensation	**589**	721	244
(Decrease) increase in Post Office Department workers' compensation	**(63)**	13	(21)
(Decrease) increase in employees' accumulated leave	**(156)**	(36)	34
(Decrease) increase in other liabilities	**(156)**	196	167
Changes in current assets and liabilities:			
Increase in receivables, net	**(394)**	(189)	(19)
(Increase) decrease in supplies, advances and prepayments	**(39)**	(7)	63
(Decrease) increase in compensation and benefits	**(427)**	(877)	310
(Decrease) increase in estimated prepaid postage	**(151)**	(123)	29
Increase (decrease) in payables and accrued expenses	**1,276**	(28)	(283)
(Decrease) increase in prepaid box rentals, permit and metered mail	**(86)**	145	(103)
(Decrease) increase in outstanding postal money orders	**(218)**	(2)	272
Net cash provided by operating activities	**6,405**	1,443*	1,255
Cash flows from investing activities:			
Purchase of property and equipment	**(1,314)**	(1,705)	(2,961)
Proceeds from sale of property and equipment	**37**	30*	29
Net cash used in investing activities	**(1,277)**	(1,675)*	(2,932)
Cash flows from financing activities:			
U.S. government appropriations – received	**—**	762	—
U.S. government appropriations – expended	**(177)**	(179)	—
Issuance of debt	**4,609**	2,700	5,651
Payments on debt	**(8,450)**	(2,900)	(3,652)
Net cash (used in) provided by financing activities	**(4,018)**	383	1,999
Net increase in cash and cash equivalents	**1,110**	151	322
Cash and cash equivalents at beginning of year	**1,156**	1,005	683
Cash and cash equivalents at end of year	**$2,266**	$1,156	$1,005

See accompanying notes to financial statements.

**Restatement of prior year*

notes to the financial statements

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, Priority Mail, Periodicals and Package Services. The principal markets for these services are the communications, distribution and delivery, advertising and retail markets. Our products are distributed through our more than 37,000 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. The agreements with the major unions expire between November 20, 2004 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 at original cost less accumulated depreciation. The initial transfer of assets, including property, equipment and cash, totaled $1.7 billion. Subsequent cash contributions and transfers of assets 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 Post Office Department. However, under the Balanced Budget Act of 1997, the remaining liability for Post Office Department workers' compensation costs was 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.

We have foreign currency risk related to the settlement of terminal dues and transit fees with foreign postal administrations for international mail. The majority of our international accounts are denominated in Special Drawing Rights (SDRs). The SDR exchange rate fluctuates daily based on a basket of currencies comprised of the euro, Japanese yen, the pound sterling and the U.S. dollar. Changes in the relative value of these currencies will increase or decrease the value of our settlement accounts and result in a gain or loss from revaluation reported in the results from operations. The actual currency used to settle accounts varies by country.

The loss recorded on the statement of operations from this revaluation was $9 million in 2003, $7 million in 2002 and $0 in 2001. In addition to the year end revaluation, we also recognize gains and losses on our payables and receivables when we settle with foreign postal administrations. The impact on the statement of operations from these settlement losses was $12 million in 2003, $7 million in 2002 and $7 million in 2001.

Supplies, Advances and Prepayments

Supplies, advances and prepayments are primarily composed of our inventories of supplies, motor vehicle parts, 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 $123 million at the end of 2003 and $136 million at the end of 2002.

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 $1 million in 2003, $23 million in 2002 and $50 million in 2001. Repairs and maintenance are charged to expense as incurred. This expense amounted to $692 million in 2003, $577 million in 2002 and $600 million in 2001.

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 that the assets might be impaired. In accordance with FAS Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, we have written down our impaired assets to the lower of cost or fair value. No material impairments were recorded in 2003, 2002 or 2001.

Allowance for Doubtful Accounts

We provide an allowance for doubtful accounts in our outstanding receivables based on our collection history and an estimate of uncollectible accounts.

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 was a $113 million reduction of the liability in 2002.

Compensation and Benefits Payable

These are 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

We are an independent establishment of the executive branch of the U.S. government. We provide pension benefits as defined by OPM and, therefore, have a parent-subsidiary relationship. We accounted for our participation in the U.S. government sponsored retirement plans as a participant in a multi-employer plan arrangement in accordance with FAS 87, *Employer's Accounting For Pension Costs*. See Notes 6 and 7 for additional information.

Post-Retirement Health Benefits

Retiree health benefits costs are those obligations we pay as 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 injured 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 2003. 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 pay the 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. Appropriations received for capital equipment will be offset against depreciation expense over the life of the equipment. See Note 11 for additional information.

3 workers' compensation

At the end of 2003, we estimate our total liability for future workers' compensation costs, excluding the Post Office Department (POD) liability, at $7,114 million. At the end of 2002, this liability was $6,525 million. The payout period for this liability will, for some claimants currently on the rolls, be for the rest of their lives. The liability is sensitive to changes in inflation and discount rates. A change of 1% in the assumptions would change our estimate of the liability by approximately $600 million.

In 2003, we recorded $1,457 million in workers' compensation expense, compared to the $1,511 million we recorded in 2002 and the $970 million we recorded in 2001. Our liability for future workers' compensation costs for POD claims was $122 million in 2003 and $185 million in 2002. In 2003, we recorded an expense of $17 million for POD, compared to the $13 million we recorded in 2002 and $9 million in 2001.

4 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 paid for 16.7% of the cost in 2003, and we paid 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 the Statement of Financial Accounting Standards (FAS) 106, *Employers' Accounting for Postemployment Benefits Other Than Pensions.* Our retiree FEHBP costs amounted to $1,133 million in 2003, $987 million in 2002 and $858 million in 2001. 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
2004	$7,273
After 2008	1
Total	$7,274

Cash outlays for interest were $426 million in 2003, $339 million in 2002 and $339 million in 2001.

In January, July and August 2003, we repaid debt with maturity dates that extended to 2031. In connection with the August transaction, we paid a premium (debt repurchase expense) of $360 million which was expensed when incurred.

At year-end, the current estimated market value of our debt is $7,283 million in 2003 and $11,991 million in 2002 (Note 2). All notes payable to the

Our Debt Consists of the Following:

(dollars in millions)

Interest Rate %	Terms *	September 30, 2003	2002
	Notes payable to the Federal Financing Bank (FFB):		
1.167	Payable February 5, 2004	**$2,000**	$ -
1.195	Payable February 17, 2004	**250**	-
1.084	Floating rate; payable August 15, 2004	**1,750**	-
1.026**	Short-term, floating rate, revolving credit facility; final maturity date May 6, 2005 and May 9, 2004	**3,273**	2,450
1.729	Overnight revolving credit facility; final maturity date May 10, 2003	**-**	$ 214
5.568	Payable December 31, 2002	**-**	200
4.543	Payable February 28, 2003	**-**	200
3.858	Payable July 31, 2003	**-**	750
3.636	Payable February 15, 2005	**-**	300
4.780	Payable November 15, 2005	**-**	200
5.412	Payable November 15, 2005	**-**	500
4.437	Payable May 15, 2006	**-**	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
5.546	Payable August 15, 2007	**-**	150
5.426	Payable May 15, 2008	**-**	200
4.981	Payable May 15, 2008	**-**	200
4.910	Payable May 15, 2008	**-**	200
4.806	Payable November 17, 2008	**-**	300
5.355	Payable August 16, 2010	**-**	500
4.999	Payable February 15, 2011	**-**	200
4.925	Payable August 15, 2011	**-**	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, 2011	**-**	250
5.959	Payable November 15, 2027	**-**	400
5.726	Payable November 15, 2027	**-**	100
5.606	Payable November 15, 2027	**-**	300
4.836	Payable November 15, 2027	**-**	100
6.299	Payable May 15, 2030	**-**	250
5.591	Payable May 15, 2030	**-**	250
5.417	Payable February 18, 2031	**-**	200
4.976	Payable February 18, 2031	**-**	250
5.552	Payable February 18, 2031	**-**	200
		7,273	11,114
	Mortgage Notes Payable:		
5.00 to 9.25	Maturing from years 2004 through 2039 secured by land, buildings and equipment with a carrying amount of $6.7 million.	**1**	1
		7,274	11,115
Less current portion of debt		**7,273**	3,815
		$ 1	$7,300

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

** *Weighted average interest rate; prior year's interest rate was 1.790%*

Federal Financing Bank (FFB) may be repurchased at current value at any time with five days' notice of intent to do so.

6 retirement programs

Our employees, retirees and their survivors participate in a pension program of the U.S. government. As an "independent establishment" of the U.S. government, we account for our involvement in these programs as participation in a multi-employer plan arrangement, in accordance with the Statement of Financial Accounting Standards (FAS) 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.

Civil Service Retirement System (CSRS)

Under the Postal Reorganization Act, officers and career employees hired prior to January 1, 1984 are covered by the Civil Service Retirement System, which provides a basic annuity. We do not match contributions to the Thrift Savings Plan for employees who participate in 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 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 FERS. This system consists of Social Security, a basic annuity plan, and a Thrift Savings Plan.

We and the employee contribute to Social Security 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.

Employer and employee base contributions, as a percentage of employee compensation, are as follows for each of the three plans for 2003, 2002 and 2001:

	2003	2002	2001
CSRS			
Employer	**17.40***	7.00	7.00
Employee	**7.00**	7.00	7.00
Dual CSRS			
Employer	**17.40***	7.00	7.00
Employee	**0.80**	0.80	0.80
FERS			
Employer	**10.70**	10.70	10.70
Employee	**0.80**	0.80	0.80

* As of May 2003, Public Law 108-18 changed our base contribution level for the CSRS. See Note 7.

The number of employees enrolled in each of the retirement plans at the end of 2003, 2002 and 2001 is as follows:

	2003	2002	2001
CSRS	**211,913**	230,632	248,347
Dual CSRS	**10,122**	10,828	11,440
FERS	**505,728**	510,237	514,870

Deferred Retirement Liability – Civil Service Retirement System

Prior to Public Law 108-18 (see Note 7), when we increased CSRS employees' current basic pay we were liable for the estimated additional deferred retirement liability. The Office of Personnel Management determined and billed us for the current portion of the increase in the estimated deferred liability of the Civil Service Retirement and Disability Fund (CSRDF) resulting from basic pay increases. We expensed as billed those amounts as they became payable in 30 equal annual installments, which included interest computed at a rate of 5% per year. We made the first payment at the end of the year in which employees received 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 and $313 million in 2001.

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

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

Prior to Public Law 108-18 (see Note 7) each year OPM determined the current portion of the increase in our share of the estimated liability of the CSRDF and billed us for COLAs granted for the current year. We expensed those billed amounts as they became payable in 15 equal annual installments, which included 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 and $1,668 million in 2001.

Deferred Retirement Costs

We have expensed all billed amounts for CSRS through 2002. The amounts reported as a deferred asset and a deferred liability on the balance sheet for 2002 represented OPM's calculation of the amounts payable in the future.

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

	2002
CSRS	$24,602
CSRS retirees' and survivors' cost of living adjustments	7,629
Total	$32,231

There are no deferred retirement costs associated with FERS. For information on supplemental costs of CSRS after April 2003 see Note 7.

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 2003, 2002 and 2001 (dollars in millions):

	2003	2002	2001
CSRS	**$1,128**	$ 740	$ 769
FERS	**2,172**	2,121	2,046
FERS — Thrift Savings Plan	**856**	827	789
Dual CSRS	**52**	33	33
Social Security	**1,544**	1,511	1,498
Accrued Postal Supplemental Liability	**9**	-	-
Amortization of deferred cost:			
CSRS	**-**	1,393	1,333
Annuitant COLAs	**-**	879	814
Interest expense on deferred liabilities	**116**	1,601	1,603
Total retirement expense	**$5,877**	**$9,105**	**$8,885**

Employer cash contributions to retirement plans were $4,031 million in 2003, $6,013 million in 2002 and $5,799 million in 2001. These amounts do not include Social Security contributions and interest expense on deferred retirement liabilities.

7 The Postal Civil Service Retirement System Funding Reform Act of 2003 – Public Law 108-18

On April 23, 2003, the President signed into law Postal Civil Service Retirement System Funding Reform Act of 2003 – Public Law 108-18 (PL108-18), which changed the way we fund our CSRS retirement plan. Although the law changed the funding of the plan, postal management determined that we are still a participant in a multi-employer pension plan. The parent-subsidiary relationship that we have as an "independent establishment" of the executive branch of the United States government allows for this accounting treatment under FAS 87. As a "subsidiary" we cannot direct the costs, benefits or funding requirements of the federally-sponsored plan.

In November 2002, the Office of Personnel Management (OPM) advised us that it had completed a review of estimates and our then current scheduled funding of the Civil Service Retirement and Disability Fund (CSRDF). OPM determined that at our current rate of funding, we would pay substantially more than would be needed to cover the future benefits expected to be paid to our employees and retirees participating in CSRS. The projected over-funding was mostly 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. A subsequent GAO report stated that were it not for the transfer of the cost of military service to us, the plan was already overfunded by approximately $6 billion. Adding the present value of participant future contributions increases the overfunding to $10 billion.

Because of OPM's projection of significant overfunding, the Administration proposed PL108-18.

As part of PL108-18, in May 2003 we began to dynamically fund the plan at 17.4% of our current CSRS employees' wages. The Act further requires that the Postal Service pay an additional annual amount, if necessary, each September beginning 2004 as determined by OPM. The additional amount is based on a calculation of any potential "supplemental liability", if one exists. It would represent the excess of the actuarial present value of future benefits over the actuarial present value of future contributions, earnings, and other actuarial factors related to postal participants in the CSRS plan. Such additional obligations may result due to the deviation of actual results from valuation assumptions used by OPM to determine the CSRS base contributions. Pursuant to PL 108-18, commencing September 30, 2004, we will pay each September 30th a portion of the calculated supplemental liability, if any, sufficient to fully fund the amount in forty years after the enactment of the law. Under multi-employer plan accounting, such amounts will be recognized by us when payable.

OPM's original estimate of the "supplemental liability" of $4.8 billion as of September 30, 2002, assumed the dynamic funding of the plan starting October 1, 2002. Since the law went into effect April 23, 2003, and the first payment of our supplemental deferred liability, if necessary, will not be due until September 30, 2004, we estimated, and OPM confirmed, that the present value of the liability increased to $5.8 billion as of September 2003. The increase adds interest to the prior balance at 6.75% and calculates an additional liability due to the delayed start in dynamic funding. Under the law OPM is not required to furnish the final actuarial calculation of the September 30, 2003 liability until June 30, 2004. OPM will recalculate the supplemental liability, if any, on an annual basis. Each September 30th, we will make any required payment resulting from this calculation.

OPM's 2002 assumptions of 3.75% annual CPI, 4.25% annual salary increases and 6.75% annual interest used in calculating the supplemental liability are not postal specific and do not reflect the most current experience. OPM advised that the actual inflation adjustments were 1.4% for 2003 and 2.1% for 2004.We anticipate these adjustments will be included in OPM's new calculation of the September 30, 2003, supplemental liability estimate if any exists. On September 30, 2004, we will be required to make any necessary payment to the CSRDF. We estimated the September 30, 2004 amount payable based upon the OPM estimate of the supplemental liability and began accruing that payable over the period from the enactment of the law to September 30, 2004. The related expense in 2003 amounted to $125 million. Our previously recorded deferred retirement cost liability and equal asset offset were removed from our balance sheet effective on the date the law was enacted. Under prior law, the liability represented the total amount of fixed payments to CSRDF as determined by OPM. The potential liability under the new law is variable in nature. Therefore we are disclosing information on any potential supplemental liability in these notes.

8 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 appropriated 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 $31 million for 2003, $48 million for 2002 and $67 million for 2001. Legislation enacted in 2002 and 2001 delayed payment of the amount authorized for 2003 and 2002 until the first day of the subsequent fiscal 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 fiscal years 1991 through 1998. The amounts receivable as of September 30, 2003 and 2002 were $367 million and $370 million, respectively.

9 commitments

At September 30, 2003, we estimate our financial commitment for approved capital projects in progress to be approximately $2,395 million.

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

	2003	2002	2001
Non-cancelable real estate leases including related taxes	**$923**	$894	$863
Facilities leased from General Services Administration subject to 120-day notice of cancellation	**53**	45	41
Equipment and other short-term rentals	**201**	214	312
Total	**$1,177**	**$1,153**	**$1,216**

At September 30, 2003, our future minimum lease payments for all non-cancelable leases are as follows (dollars in millions):

Year	Operating	Capital
2004	$ 718	$ 80
2005	679	80
2006	631	80
2007	580	80
2008	560	80
After 2008	5,500	562
	$8,668	$962
Less: Interest at 4.5%		220
Total capital lease obligations		742
Less: Short-term portion of capital lease obligations		48
Long-term portion of capital lease obligations		$694

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 $963 million in 2003 and $1,038 million in 2002. Total accumulated amortization is $259 million in 2003 and $264 million in 2002. Amortization expense for assets recorded under capital leases is included in depreciation expense.

10 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 probable that we will pay 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 $92 million decrease in the contingent liabilities balance in 2003, compared to an increase of $187 million in 2002 and an $88 million increase in 2001. We recognized settlements, payments and changes in estimates of claims and lawsuits 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.

11 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 are 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 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 as well as continued annual updates of the Emergency Preparedness Plan. We have submitted all required plans and updates. Unspent funds that are not reallocated with Congressional approval are required to be returned to the United States Treasury.

The appropriations during 2003 and 2002 which have been expended or committed are as follows (dollars in millions):

	2003	2002
Operating expenses	$ -	$ 16
Non-operating expenses	177	163
Capital equipment	189	38
Total	$366	$217

Detection and filtration systems are being tested and evaluated and will then be deployed in 2004 and beyond. The amounts expected to be spent in future years although we have not been appropriated the total amount are as follows (dollars in millions)

Building restoration	$ 85
Biohazard detection system	223
Ventilation and filtration	632
Miscellaneous	18
	$958

Our Emergency Preparedness expenditures are not all covered by the appropriations we received. The Emergency Preparedness expenses for the years ended September 30 are as follows (dollars in millions):

	2003	2002
Operating expenses:		
Personnel costs	$ 12	$ 73
Total operating costs	$ 12	$ 73
Nonoperating expenses:		
Safety measures	$ 15	$ 128
Research and development	3	5
Building restoration	125	54
Miscellaneous	41	2
Total nonoperating expenses	$184	$189
	$196	$262

We recognize the appropriations as income in the year in which the related expenditure is recognized as an expense or when the government approves the reimbursement of a previously incurred expense. The Emergency Preparedness appropriations revenues recognized during the years ended September 30 are as follows (dollars in millions):

	2003	2002
Personnel costs	$ -	$ 16
Safety measures	-	121
Research and development	3	5
Building restoration	135	35
Miscellaneous	39	2
	$177	$179

As a result, the funds that had not been spent or reallocated as of September 30, 2003 and 2002 of $406 million and $583 million are reflected in our Balance Sheets as a non-interest bearing liability and have been reflected in the 2003 and 2002 Statements of Cash Flows as a financing activity.

The funds spent in 2002 were for irradiation equipment that did not meet our needs. With the approval of OMB, six of the eight machines valued at $17 million were transferred to other government and public agencies, and the manufacturer provided us with a more powerful machine at no additional cost. This new machine is valued at $14 million and is to be deployed at a future date.

Saturday, 10:30 a.m. . . . that's what I love about the city . . . you're near everything . . . especially the essentials . . . groceries, cleaners, coffee shop, Post Office . . . that's how I spell convenience!

operating statistics

(in millions of units indicated)

Class of Mail	2003	2002	2001	2000	1999*
First-Class Mail					
Pieces, number	**99,058.7**	102,378.6	103,655.6	103,525.7	101,936.5
Weight, pounds	**4,236.3**	4,283.6	4,362.8	4,392.0	4,299.9
Revenue	**$37,048.3**	$36,483.2	$35,876.0	$35,515.9	$34,933.2
Priority Mail					
Pieces, number	**859.6**	998.2	1,117.8	1,222.5	1,189.5
Weight, pounds	**1,622.9**	1,875.1	2,149.7	2,352.3	2,142.6
Revenue	**$ 4,494.3**	$ 4,722.5	$ 4,916.4	$ 4,837.1	$ 4,533.3
Express Mail					
Pieces, number	**55.8**	61.3	69.4	70.9	68.7
Weight, pounds	**53.2**	59.1	72.1	80.0	78.3
Revenue	**$ 888.1**	$ 910.5	$ 995.7	$ 996.1	$ 942.0
Mail grams					
Pieces, number	**2.8**	2.8	3.3	3.7	4.1
Revenue	**$ 1.2**	$ 1.4	$ 1.4	$ 1.5	$ 1.6
Periodicals					
Pieces, number	**9,319.9**	9,689.8	10,077.4	10,364.8	10,273.8
Weight, pounds	**3,995.0**	4,006.1	4,408.3	4,720.3	4,482.6
Revenue	**$ 2,234.8**	$ 2,164.9	$ 2,205.2	$ 2,170.7	$ 2,115.3
Standard Mail					
Pieces, number	**90,358.5**	87,230.6	89,938.4	90,057.1	85,661.7
Weight, pounds	**10,797.3**	10,315.5	10,822.2	11,142.6	10,648.3
Revenue	**$17,203.1**	$15,818.8	$15,704.9	$15,193.3	$14,435.8
Package Services					
Pieces, number	**1,128.5**	1,075.1	1,093.0	1,128.4	1,043.1
Weight, pounds	**3,793.8**	3,690.6	3,801.7	3,773.8	3,533.2
Revenue	**$ 2,215.7**	$ 2,080.1	$ 1,993.9	$ 1,912.3	$ 1,828.5
International Economy Mail					
Pieces, number	**29.9**	38.6	60.4	78.7	103.2
Weight, pounds	**60.5**	65.3	80.3	89.4	96.1
Revenue	**$ 145.9**	$ 150.4	$ 177.7	$ 180.3	$ 193.9
International Airmail					
Pieces, number	**909.2**	865.2	1,022.1	1,020.7	927.5
Weight, pounds	**183.0**	151.8	171.6	169.7	152.2
Revenue**	**$ 1,469.4**	$ 1,429.4	$ 1,554.0	$ 1,477.2	$ 1,434.2
U.S. Postal Service					
Pieces, number	**391.4**	424.9	380.6	362.9	382.3
Weight, pounds	**80.1**	87.5	82.3	95.3	102.6
Free Mail for the Blind and Handicapped					
Pieces, number	**70.4**	56.8	44.6	46.6	53.2
Weight, pounds	**29.8**	28.1	24.9	25.1	26.6
Totals***					
Pieces, number	**202,184.7**	202,821.9	207,462.6	207,882.2	201,643.5
Weight, pounds	**24,851.9**	24,562.7	25,975.9	26,840.6	25,562.2
Revenue	**$65,700.7**	$63,761.1	$63,425.2	$62,284.3	$60,417.8

* *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	2003	2002	2001	2000	1999
Registered*					
Number of articles	**8.2**	9.1	11.4	13.3	13.7
Revenue	**$ 82.1**	$ 86.6	$ 98.4	$ 98.4	$ 95.2
Certified*					
Number of articles	**271.4**	283.5	269.0	270.5	268.1
Revenue	**$ 624.2**	$ 605.9	$ 494.8	$ 385.4	$ 377.3
Insurance*					
Number of articles	**59.1**	59.8	60.0	58.0	48.6
Revenue	**$ 138.3**	$ 135.2	$ 123.1	$ 108.9	$ 91.5
Delivery Receipt Services**					
Number of articles	**748.8**	535.5	421.1	356.9	249.3
Revenue	**$ 503.1**	$ 460.4	$ 370.8	$ 316.8	$ 284.7
Collect on Delivery					
Number of articles	**1.9**	2.3	2.7	4.1	4.0
Revenue	**$ 11.1**	$ 13.8	$ 15.3	$ 21.5	$ 19.8
Money Orders					
Number issued	**202.5**	218.0	227.2	232.8	220.9
Revenue	**$ 230.7**	$ 239.4	$ 225.4	$ 234.7	$ 228.3
Face value of issues (non-add)***	**$29,151.7**	$29,721.2	$30,770.3	$29,945.2	$28,491.4
Other					
Box rent revenue	**$ 788.1**	$ 750.6	$ 699.0	$ 684.2	$ 667.2
Stamped envelope and card revenue	**$ 24.4**	$ 29.3	$ 27.1	$ 15.4	$ 30.7
Other revenue, net	**$ 395.8**	$ 333.3	$ 287.5	$ 326.0	$ 442.0
Totals					
Special Services revenue	**$ 2,797.8**	$ 2,654.5	$ 2,341.4	$ 2,191.2	$ 2,236.7
Mail revenue	**$65,700.7**	$63,761.1	$63,425.2	$62,284.3	$60,417.8
Revenue forgone	**$ 30.7**	$ 47.6	$ 67.1	$ 64.4	$ 71.2
Operating revenue	**$ 68,529.2**	$66,463.2	$65,833.7	$64,539.9	$62,725.7

* *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.*

operating statistics

	2003	2002	2001	2000	1999
Headquarters Career Employees*					
Headquarters	1,867	1,712	1,836	2,279	2,372
Headquarters-Field Support Units	3,971	3,848	5,653	5,566	4,357
Inspection Service (field)	3,903	3,875	4,047	4,190	4,334
Inspector General	723	722	713	664	387
Total HQ and Related Employees*	10,464	10,157	12,249	12,699	11,450
Field Career Employees*					
Area Offices	2,205	2,107	1,377	1,597	1,875
Postmasters/Installation Heads	25,509	25,771	26,113	26,121	26,108
Supervisors/Managers	35,360	37,829	38,754	38,797	38,835
Prof. Admin. Tech. Personnel	9,436	9,661	9,764	9,959	11,097
Clerks	242,276	256,656	269,792	281,956	292,400
Nurses	171	173	180	191	188
Mail Handlers	56,776	59,259	60,102	60,851	62,237
City Delivery Carriers	229,404	233,639	240,295	241,079	242,300
Motor Vehicle Operators	8,778	9,092	9,325	9,347	9,270
Rural Delivery Carriers-Full Time	61,611	60,817	59,790	57,111	54,588
Bldg. and Equip. Maintenance Personnel	41,469	42,275	42,604	42,284	41,873
Vehicle Maintenance Personnel	5,576	5,513	5,558	5,546	5,574
Total Field Career Employees*	718,571	742,792	763,654	774,839	786,345
Total Career Employees*	729,035	752,949	775,903	787,538	797,795
Non-Career Employees*					
Casuals	17,373	19,065	30,317	29,572	25,067
Non-Bargaining Temporary	910	807	761	712	707
Rural Subs/RCA/RCR/AUX	56,451	56,474	58,134	57,532	57,357
PM Relief/Leave Replacements	12,161	12,234	12,313	12,423	12,485
Transitional Employees	11,025	12,847	13,577	13,461	12,355
Total Non-Career Employees*	97,920	101,427	115,102	113,700	107,971
Total Employees*	826,955	854,376	891,005	901,238	905,766
Offices, Stations and Branches					
Post Offices	27,556	27,791	27,876	27,876	27,893
Classified stations and branches	5,796	5,900	5,835	5,802	5,788
Contract stations and branches	2,777	2,500	2,876	2,833	2,903
Community Post Offices	1,450	1,492	1,536	1,549	1,585
Total Offices, Stations and Branches	37,579	37,683	38,123	38,060	38,169
Residential Delivery Points**					
City	77,490,203	77,014,294	76,578,169	76,131,249	75,575,844
Rural	33,324,799	32,141,581	31,004,518	29,915,385	28,753,812
PO Box	15,730,694	15,772,964	15,818,625	15,904,400	16,048,325
Highway Contract	2,153,056	2,073,145	2,004,837	1,938,395	1,857,689
Total Residential	128,698,752	127,001,984	125,406,149	123,889,429	122,235,670
Business Delivery Points**					
City	7,208,608	7,197,207	7,183,431	7,197,776	7,175,729
Rural	1,192,144	1,132,049	1,071,201	1,013,269	956,301
PO Box	4,203,433	4,065,877	3,969,279	3,796,343	3,638,737
Highway Contract	58,339	55,362	52,247	49,234	46,237
Total Business	12,662,524	12,450,495	12,276,158	12,056,622	11,817,004
Total Delivery Points**	141,361,276	139,452,479	137,682,307	135,946,051	134,052,674
Change in Delivery Points	1,908,797	1,770,172	1,736,256	1,893,377	1,459,261

** Complement data from On-Rolls and Paid Employees Statistics database as of end of September 2003 and early September 1999-2002.*

*** Delivery point data from Address Management Systems database as of end of September 2003 and early September 1999-2002. New delivery points in 2003 comparable to 2002-2001 data would be approximated at 1,820,000.*

Wednesday, 2 p.m. . . .
things haven't changed much
around here in years . . . well,
Dad's retired . . . we're fixing up
the old place . . . but we're still
on the water before dawn . . .
and when we come back,
we'll see Bonnie waving at us
from the Post Office. That's a
tradition I like.

financial history summary

	2003	2002*	2001*
Statements of Operations			
(dollars in billions)			
Total revenue	**$ 68.8**	$ 66.7	$ 65.9
Total expense	**64.9**	67.4	67.6
Net income (loss)	**3.9**	$ (0.7)	$ (1.7)
(dollars in millions)			
Operating revenue	**$66,498**	$66,415	$65,767
Revenue forgone appropriation	**31**	48	67
Total operating revenue	**66,529**	66,463	65,834
Compensation and benefits	**50,428**	51,557	51,351
Restructuring costs	**—**	—	—
Other expenses	**13,474**	13,677	14,289
Total operating expenses	**63,902**	65,234	65,640
Income from operations	**4,627**	1,229	194
Interest and investment income	**58**	46	35
Interest expense on deferred retirement liabilities	**(116)**	(1,601)	(1,603)
Interest expense on borrowings	**(694)****	(340)	(306)
Emergency preparedness, net	**(7)**	(10)	—
Income (loss) before retroactive assessments and extraordinary items	**3,868**	(676)	(1,680)
Retroactive assessments for employee benefits***	**—**	—	—
Income (loss) before extraordinary item	**3,868**	(676)	(1,680)
Extraordinary item — debt restructuring premium	**—**	—	—
Net income (loss)	**$ 3,868**	$ (676)	$ (1,680)
Balance Sheets			
Assets			
Current assets	**$ 3,823**	$ 2,280	$ 1,933
Property and equipment, deferred retirement costs and other assets	**23,419**	56,735	57,158
Total assets	**$27,242**	$59,015	$59,091
Liabilities and net capital (deficiency)			
Current liabilities	**17,093**	$15,586	$17,457
Other liabilities	**9,282**	39,131	38,209
Long-term debt	**1**	7,300	5,751
Net capital (deficiency)	**866**	(3,002)	(2,326)
Total liabilities and net capital (deficiency)	**$27,242**	$59,015	$59,091
Changes in Net Capital (Deficiency)			
Beginning balances			
Capital contributions of the U.S. government	**3,034**	$ 3,034	$ 3,034
Deficit since reorganization	**(6,036)**	(5,360)	(3,680)
Total beginning balance net capital (deficiency)	**(3,002)**	(2,326)	(646)
Net income (loss)	**3,868**	(676)	(1,680)
Ending balance****	**$ 866**	$ (3,002)	$ (2,326)

* *Certain reclassifications have been made to previously reported amounts.*
** *Includes $360 million in debt repurchase expense.*
*** *Relates to OBRA 1993.*
**** *Some totals may not add exactly due to rounding.*

financial history summary

2000*	1999*	1998*	1997	1996*	1995*	1994*	1993*
$ 64.6	$ 62.7	$ 60.1	$ 58.3	$ 56.6	$ 54.5	$ 49.6	$ 48.0
64.8	62.4	59.5	57.0	55.0	52.7	50.5	49.8
$ (0.2)	$ 0.4	$ 0.6	$ 1.3	$ 1.6	$ 1.8	$ (0.9)	$ (1.8)
$64,476	$62,655	$60,005	$58,133	$56,309	$54,176	$49,252	$47,418
64	71	67	83	93	117	131	164
64,540	62,726	60,072	58,216	56,402	54,293	49,383	47,582
49,532	47,333	45,596	44,093	42,676	41,931	39,609	38,448
—	—	—	—	—	—	—	129
13,460	13,309	12,190	11,038	10,437	8,799	8,846	7,745
62,992	60,642	57,786	55,131	53,113	50,730	48,455	46,322
1,548	2,084	2,286	3,085	3,289	3,563	928	1,260
41	29	44	115	142	216	193	404
(1,568)	(1,592)	(1,613)	(1,629)	(1,496)	(1,443)	(1,433)	(1,416)
(220)	(158)	(167)	(307)	(368)	(566)	(601)	(620)
—	—	—	—	—	—	—	—
(199)	363	550	1,264	1,567	1,770	(913)	(372)
—	—	—	—	—	—	—	(857)
(199)	363	550	1,264	1,567	1,770	(913)	(1,229)
—	—	—	—	—	—	—	(536)
$ (199)	$ 363	$ 550	$ 1,264	$ 1,567	$ 1,770	$ (913)	$ (1,765)
$ 1,655	$ 1,296	$ 1,893	$ 1,736	$ 1,670	$ 2,975	$ 2,683	$ 4,478
56,628	54,713	53,015	51,675	50,157	46,146	43,733	42,803
$58,283	$56,009	$54,908	$53,411	$51,827	$49,121	$46,416	$47,281
$18,277	$15,436	$15,278	$14,107	$12,796	$11,499	$11,665	$10,140
38,150	37,466	37,652	37,439	37,746	34,794	32,985	33,503
2,502	3,554	2,788	3,225	3,909	7,019	7,727	8,686
(646)	(447)	(810)	(1,360)	(2,624)	(4,191)	(5,961)	(5,048)
$58,283	$56,009	$54,908	$53,411	$51,827	$49,121	$46,416	$47,281
$ 3,034	$ 3,034	$ 3,034	$ 3,034	$ 3,034	$ 3,034	$ 3,034	$ 3,034
(3,481)	(3,844)	(4,394)	(5,658)	(7,225)	(8,995)	(8,082)	(6,318)
(447)	(810)	(1,360)	(2,624)	(4,191)	(5,961)	(5,048)	(3,283)
(199)	363	550	1,264	1,567	1,770	(913)	(1,765)
$ (646)	$ (447)	$ (810)	$ (1,360)	$ (2,624)	$ (4,191)	$ (5,961)	$ (5,048)

Monday, 11 a.m. . . . it may look quiet now . . . but that'll change in just a few hours . . . when the mail starts coming . . . that's when it all starts humming . . . processing more than 670 million pieces of mail for 141 million homes and businesses . . . six days a week. Incredible!

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

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.

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

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 infective, 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.

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.

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, with a cost over $3,000 and a useful life of greater than one year.

General Accounting Office (GAO): investigative arm of legislative branch of federal government (Congress).

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: The Inspector General is appointed by and reports directly to the Governors of the Postal Service and is independent of postal management. The Office of Inspector General (OIG) primarily investigates and evaluates 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 Improvement: An asset that gives the Postal Service the right to use property under a lease.

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

Office of Personnel Management (OPM): agency of federal government responsible for human resource policies and benefits for federal government employees.

Other Postemployment Benefits (OPEBS): OPEBS include retirement benefits other than pensions, such as retiree health benefits.

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

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.

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: Bulk advertising mail formerly known as Third-Class Mail.

Tracking: Maintenance of records concerning various aspects of mailings such as response rates, mail dates and location of respondents.

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

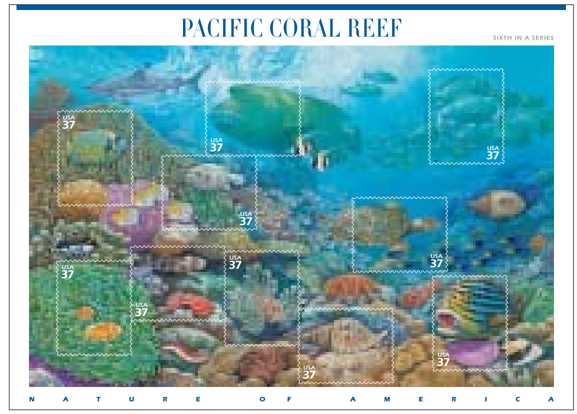
United States Postal Service (USPS): The successor to the Post Office Department, the USPS was established by the Postal Reorganization Act of July 1, 1971, as an independent, self-supporting federal agency within the executive branch.

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.

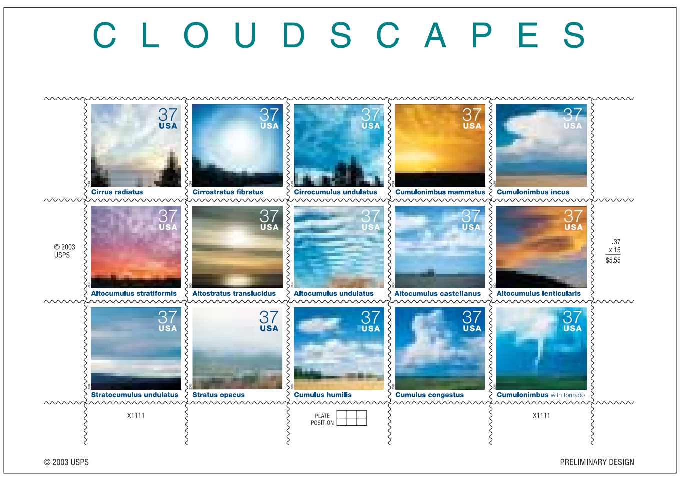
Year: As used in the financial section of this report, it means the Postal Service fiscal year, which is the 12-month period during which the Postal Service keeps accounts, beginning October 1 and closing September 30.

2004 stamp program

Pacific Coral Reef • Lunar New Year: Year of the Monkey • Black Heritage: Paul Robeson • Love: Candy Hearts • Theodor "Dr. Seuss" Geisel • Columbia University • Wilma Rudolph • U.S. Air Force Academy • Henry Mancini • Moss Hart • Lewis and Clark Bicentennial • American Choreographers • Historic Preservation: Harriton House • R. Buckminster Fuller • American Treasures: Martin Johnson Heade • James Baldwin • Sickle Cell Anemia • Art of the American Indian • Holiday Ornaments • Kwanzaa • Hanukkah • Madonna and Child • Cloudscapes • Isamu Noguchi • USS Constellation



Nature of America: Pacific Coral Reef
Issue Date: January
Format: souvenir sheet of 10

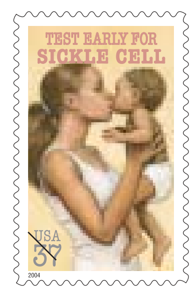


Cloudscapes
Issue: October
Format: pane of 15

Love: Candy Hearts
Issue Date: January
Format: booklet of 20

Theodor "Dr. Seuss" Geisel
Issue Date: March
Format: pane of 20

Black Heritage: Paul Robeson
Issue Date: January
Format: pane of 20

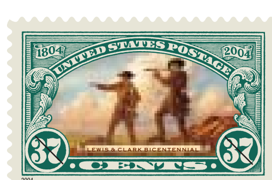


Sickle Cell Anemia
Issue Date: September
Format: pane of 20

American Treasures: Martin Johnson Heade
Issue Date: August
Format: book of 20

Harriton House
Issue Date: June
Format: stamped card

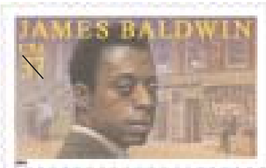
Moss Hart
Issue Date: October
Format: pane of 20



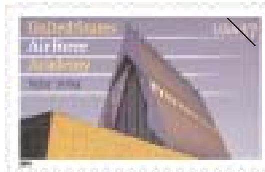
Lewis and Clark Bicentennial
Issue Date: May
Format: pane of 20

Lewis and Clark
Issue Date: May
Format: booklet of 20

Lewis and Clark
Issue Date: May
Format: booklet of 20

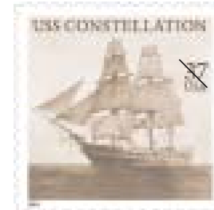


Literary Arts: James Baldwin
Issue Date: August
Format: pane of 20



United States Air Force Academy
Issue Date: April
Format: pane of 20

Lunar New Year: Year of the Monkey
Issue Date: January
Format: pane of 20

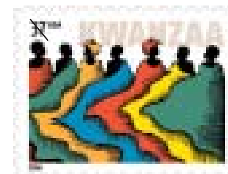


USS Constellation
Issue Date: June
Format: pane of 20

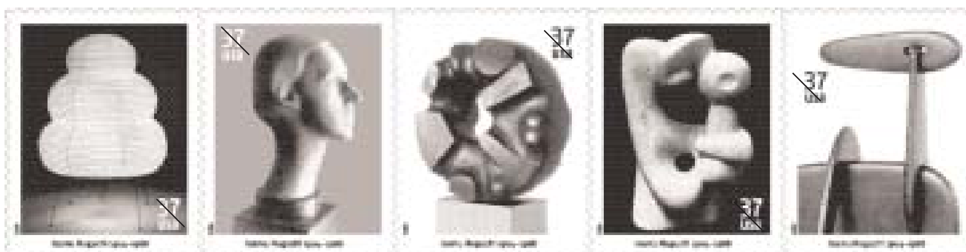
Holiday Ornaments
Issue Date: October
Format: pane of 20

Columbia University
Issue Date: March
Format: stamped card

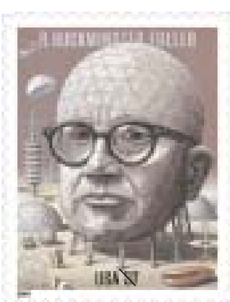
Henry Mancini
Issue Date: April
Format: pane of 20



Kwanzaa
Issue Date: October
Format: pane of 20



Isamu Noguchi
Issue Date: May
Format: pane of 20



R. Buckminster Fuller
Issue Date: July
Format: pane of 20

Art of the American Indian
Issue Date: September
Format: souvenir sheet of 10

Wilma Rudolph
Issue Date: March
Format: pane of 20
booklet of 10

Madonna and Child
Issue Date: October
Format: booklet of 20

American Choreographers
Issue Date: May
Format: pane of 20

Hanukkah
Issue Date: October
Format: pane of 20

1 p.m. . . . Friday . . . power's still out . . . there's a tree down in front of the house . . . phone's gone . . . but here comes my mail. Some things just don't quit!

The Annual Report of the United States Postal Service is published by:
United States Postal Service
Public Affairs & Communications
475 L'Enfant Plaza, SW
Washington, DC 20260-3100
We welcome your financial questions and comments at:
United States Postal Service
Corporate Accounting
475 L'Enfant Plaza, SW
Washington, DC 20260-5241
Visit our Annual Report on the web at www.usps.com/history/anrpt03