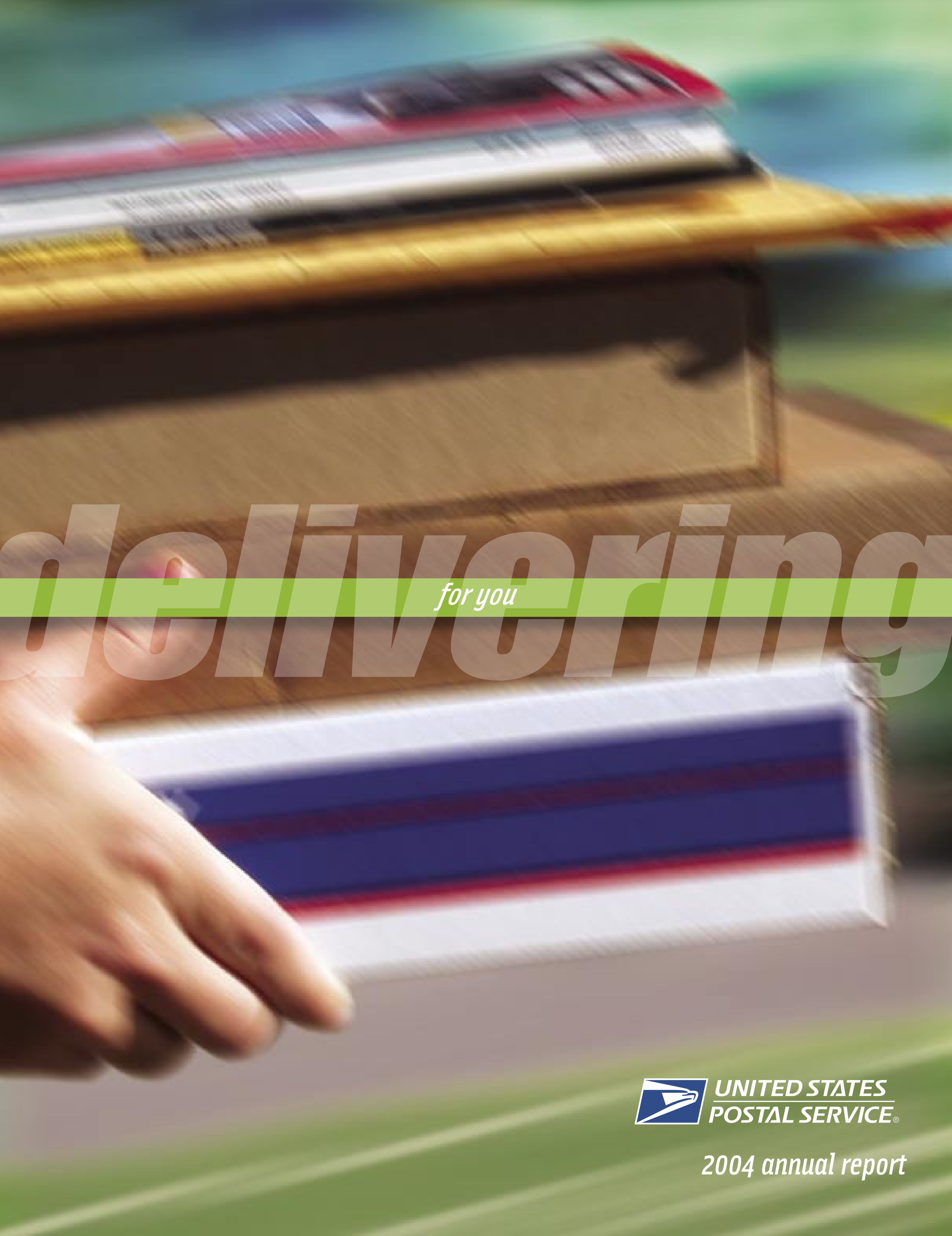


delivering
for you

UNITED STATES POSTAL SERVICE®

2004 annual report

Automated Postal Centers make shipping convenient for me.

I'm always in a hurry. Glad I heard about these Automated Postal Centers. They work on my schedule . . . for just about anything I need from the Post Office.

table of contents

financial highlights

(Dollars in millions)	Year Ended September 30, 2004	2003	2002	Percentage Change From Preceding Year 2004	2003	2002
Operating revenue	**$ 68,996**	$ 68,529	$ 66,463	**0.7%**	3.1%	1.0%
Operating expenses	**$ 65,851**	$ 63,902	$ 65,234	**3.0%**	(2.0%)	(0.6%)
Income from operations	**$ 3,145**	$ 4,627	$ 1,229			
Operating margin	**4.6%**	6.8%	1.8%			
Net income (loss)	**$ 3,065**	$ 3,868	$ (676)			
Cash outlays for purchase of capital property and equipment	**$ 1,685**	$ 1,314	$ 1,705	**28.2%**	(22.9%)	(42.4%)
Total debt	**$ 1,800**	$ 7,273	$ 11,115	**(75.3%)**	(34.6%)	(1.8%)
Interest expense***	**$ 10**	$ 334	$ 340	**(97.0%)**	(1.8%)	11.1%
Capital contributions of U.S. government	**$ 3,034**	$ 3,034	$ 3,034			
Retained earnings (deficit) since reorganization	**$ 897**	$ (2,168)	$ (6,036)			
Total net capital (deficiency)	**$ 3,931**	$ 866	$ (3,002)			
Number of career employees**	**707,485**	729,035	752,949	**(3.0%)**	(3.2%)	(3.0%)
Mail volume (millions of pieces)	**206,106**	202,185	202,822	**1.9%**	(0.3%)	(2.2%)
New delivery points served*	**1,782,900**	1,908,797	1,770,172			

* See page 33 in our Management's Discussion and Analysis for a description of a change we made in 2004 in how we count delivery points.

** As of the end of September for 2004 and 2003 and early September 2002.

*** Excluding interest expense on deferred retirement obligations.

year in review

Delivering Our Best
On-time delivery of overnight-committed First-Class Mail held at a record 95% for the year — and jumped to an incredible 96% in quarter three! And service in all measured categories reached record levels.* Customers told us they saw improvements in unmeasured service categories, as well.

Satisfying Customers
We delivered for our customers, and they noticed. Independently measured customer satisfaction scores for the fourth quarter reached a new height, with 94% of residential customers rating their experience with the Postal Service as excellent, very good or good.

Staying Productive
We achieved a record fifth straight year of positive total factor productivity (TFP). These gains have provided the equivalent of $6.1 billion in cost savings. TFP includes all factors of production and measures the growth in the ratio of resources we use — the inputs — to the products and services they produce — the outputs.

Cutting Costs
Managing our costs helps make mail a better value for every American family and business. Last year, we eliminated $1.5 billion in costs. Over the last three years, we have reduced costs by $4.3 billion as we approach our *Transformation Plan* goal of $5 billion in savings through 2006.

Expanding Access
With more than 37,000 retail locations, there's sure to be one near you. Our new, self-service Automated Postal Centers offer our most popular products and services at thousands of Post Office locations — many with extended hours. And our website, *usps.com*, turns your personal computer into your personal Post Office.

Transforming
We're continuing to transform. And it's making a difference. Service has never been better. Efficiency is up — way up. New products and services add new value to the mail. Our employees are more focused than ever on our customers. That's what our *Transformation Plan* is all about. And it will continue to be our guide as we evolve to meet changing customer needs.

Providing Solutions
How do you get your message through? That's the challenge. And mail offers one of the best solutions. People welcome it. They read it. They act on it. It's trusted and it's personal. And there have never been more creative mail options. How about Repositionable Notes — yellow stickies — on your mail? Or Customized MarketMail, pushing the envelope to just about any shape you can imagine.

Adding Value
You've got a great website. You've got great products. You've got great prices. But there are a lot of websites out there. How do you make sure yours is getting the traffic it should? That's easy — the mail! New research from comScore shows catalogs and other direct mail can move more customers to your site, and increase the time and money they spend there.

Helping Others
Our *Breast Cancer Research* stamp — the Postal Service's first semipostal stamp — raised $41 million to help find a cure. The *Heroes of 2001* semipostal raised $10 million for the families of emergency workers killed or injured in the 9/11 attacks. And, the *Stop Family Violence* semipostal has raised $1 million for the victims of this form of abuse.

Celebrating Diversity
The Postal Service — for the fifth straight year — was named by *Fortune* magazine as one of the nation's "50 Best Companies for Minorities." Among the top 10, the Postal Service, says *Fortune*, "has one of the better records for ensuring that diversity percolates all the way to the top."

Protecting Employees, Customers and the Mail
State-of-the-art Biohazard Detection Systems were installed in 50 major mail processing facilities, providing a new level of protection through early warning if biohazards are detected. Washington, DC's Curseen-Morris processing facility was returned to service and the Trenton, New Jersey, processing facility is being renovated in preparation for reopening in 2005. Both facilities were successfully decontaminated after the 2001 bioterrorist attacks.

Bringing Our Store to Your Door
Too busy to get to the Post Office? No problem! We'll bring the Post Office to you. *usps.com* already offers the services you need — stamps, postage, Click-N-Ship, shipping labels, track and trace, delivery and signature confirmation, mail hold and forwarding — and so much more. Now, with Carrier Pickup Online Notification, you can request next day pickup of your prepaid Express Mail and Priority Mail packages — at no extra cost!

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

What can I do at usps.com? I buy stamps, find ZIP Codes, print mailing labels and postage.
And how about this . . . I can ask my carrier to stop by and pick up my package. Delivering . . . and then some!

Using Click-N-Ship is convenient for me.

No stamps? No time? No worry! Click-N-Ship makes it easy to print out mailing labels and get postage and insurance . . . right from my computer. Convenience . . . with the works!

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:

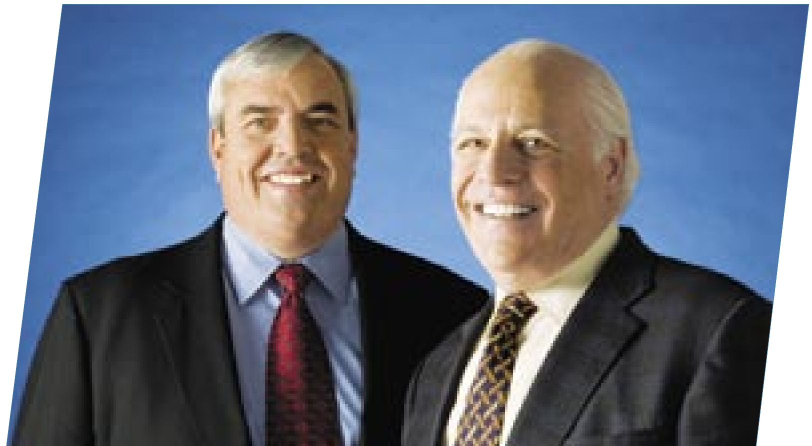
Innovation, performance and a focus on service contributed to a record year for the United States Postal Service.

We continued to serve a growing delivery network while achieving record levels of service performance and customer satisfaction. Financially, we had our second straight year of positive earnings — with a net income of $3.1 billion. In fiscal year 2004, we reduced our debt by $5.5 billion to its lowest level in 20 years: $1.8 billion. Additionally, we recovered all prior years' losses and, for the first time since postal reorganization in 1971, ended the year with positive retained earnings.

Productivity continued its upward movement in 2004 as we showed positive total factor productivity gains for the fifth straight year. Career staffing reached pre-1985 levels as a combination of process standardization and new technology brought our system to remarkable levels of efficiency. As our delivery network of more than 142 million homes and businesses continued its annual expansion by some 1.8 million new addresses, we pursued opportunities to further enhance the efficiency of delivery and mail processing operations.

Our focus also was on bringing new product and service initiatives to our customers. We added new value to the mail — making it quicker, easier and more convenient than ever for customers of all sizes to do business with the Postal Service. With new and enhanced features, our website, *usps.com*, has truly become an online Post Office.

The Postal Service's 37,000 retail locations offer unrivaled customer access. At a time when competitors pursue retail expansion strategies, we are enhancing our customers' retail experience through new technologies and alliances.



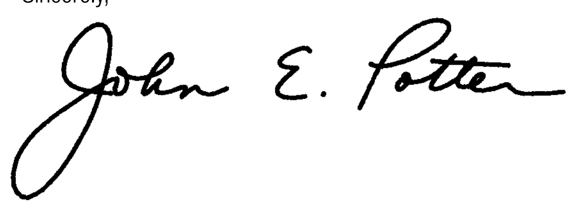
John E. Potter and S. David Fineman

And our employees played key roles in these efforts in 2004. For the first time, a pay-for-performance system directly tied the compensation of all management employees to the achievement of specific corporate and individual goals. Our workplace continues to improve, with demonstrated significant increases in safety and employee satisfaction.

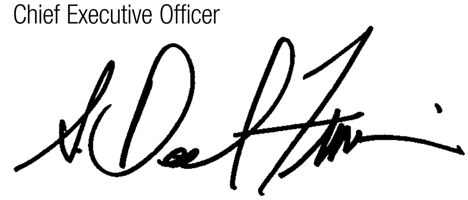
While our success has been significant, changing market dynamics still require a revision to our statutory business model to protect the long-term right of every American to affordable, universal mail service. During 2004 there was considerable activity in this area. We expect the new Congress to continue these efforts. At the same time, we strongly believe that Congress must resolve the issue of billions of dollars in costs that were placed on the Postal Service and its customers as a result of legislation that adjusted our payments to the Civil Service Retirement System.

Our success is tied to the strategies of our *Transformation Plan*. It has been at the heart of our efforts to provide exceptional service and value to every American family and business. Along with the support and commitment of our employees, the *Transformation Plan* will help us to continue delivering results.

Sincerely,



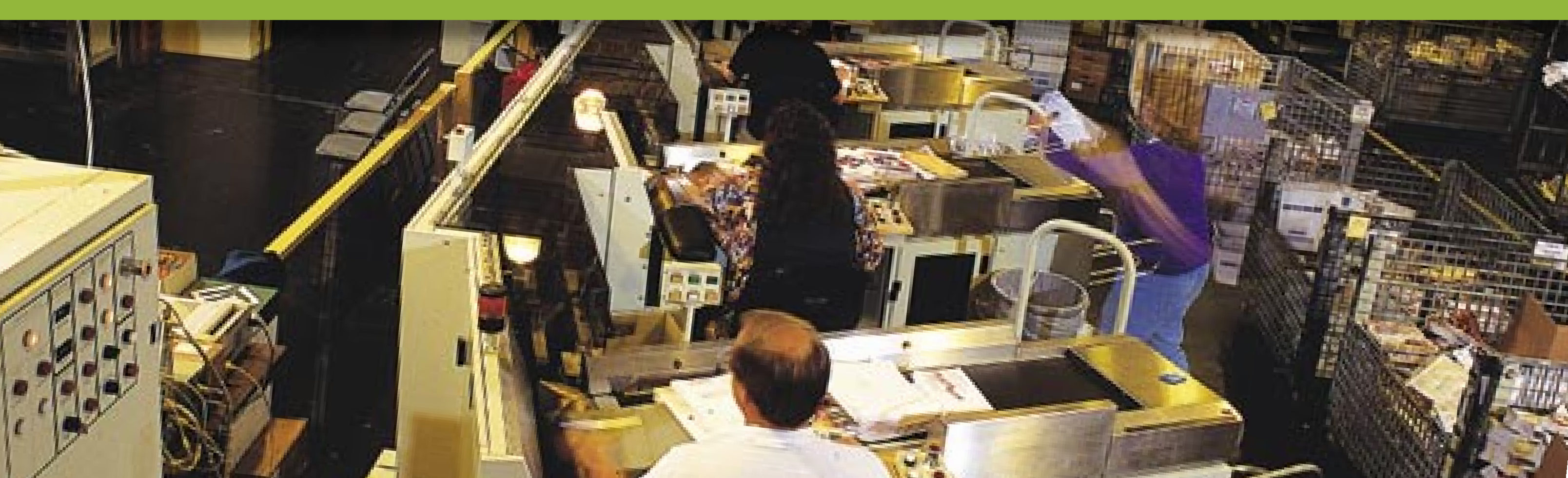
John E. Potter
Postmaster General and
Chief Executive Officer



S. David Fineman
Chairman, Board of Governors

Catalogs make shopping easy for me.

I love this lamp! It'll be great for Mom. And, even better, I can order it right from the catalog and don't have to pick it up. The Postal Service makes it easy for me.



Quick. Easy. Convenient. That's your Postal Service

Are you keeping up with us? We're not the same Postal Service that we were last year — or last month. And we won't be the same next year. That's because we're changing to meet your changing needs. We're keeping up with you to help you get more from your busy day.

Of course, you can still walk into any one of our 37,000 Post Offices. We'll be happy to see you. You can expect the same great service as ever — and the same friendly employees.

Thousands of your favorite Post Offices are getting even better, with our new Automated Postal Centers (APCs). Just about everything that's available at the counter is available through the APC. And because it's self service, you can skip the line and pay by credit or debit card. And many of our 2,500 APC locations offer extended hours.

We've made shipping simpler, too, with our flat-rate and prepaid Priority Mail envelopes. They're great for documents. And our new flat-rate Priority Mail boxes bring that same convenience to larger items. With two popular shapes, you can send your packages — no matter what they weigh — anywhere in the United States, for a single rate. And Priority Mail service offers two- to three-day delivery at a great price.

It doesn't get much easier than that — unless you visit *usps.com*. Our popular website brings our store right to your door.

Stamps? Shipping supplies? No problem. They're right there on *usps.com's* Postal Store.

Need an online shipping solution? Try Click-N-Ship. You can print out shipping labels — with or without postage. If it's valuable, you can add insurance. And Delivery Confirmation and Signature Confirmation services give you the delivery information you need.

No time to get to the Post Office? We can help. Just log on to *usps.com* and you can request next-day pickup of your prepaid Express Mail and Priority Mail package by your letter carrier — at no extra charge. With almost 300,000 carriers in just about every community, we've got you covered. Talk about quick, easy and convenient!

And if you're out, you don't have to make an extra stop just for stamps. Thousands of supermarkets, card stores, convenience stores and ATMs offer postage stamps at regular Post Office prices.

We're working hard to make your busy day a little easier.

Delivering for you

That's our job. It's what we do. And we do it just for you.

If it's important to you, it's important to us. And nothing says "it's important" as well as the mail.

It's personal. It's trusted. It's whatever you need it to be — when you need it and how you need it. If you're reaching out to millions at once or just one in a million, nothing does it like the mail.

The mail does it all, with you in mind. Every American — no matter who, no matter where — can count on the same great service. That's what you expect. That's what we deliver.

If you're simply keeping in touch with friends and loved ones, we're working for you. Door-to-door service — with a smile.

If you're a small business intent on becoming a bigger business, we're working for you. Team up our website, *usps.com*, with your letter carrier and your office becomes your Post Office. That saves time and keeps you focused on growing your business.

If you're a big business, you've got some big needs. And we're working for you. We offer the creative solutions and the support you need to manage customer relationships and build new business.

No matter what your needs, it's never been easier to make the Postal Service work for you. We've developed great new products and services with you in mind. We've made it more convenient than ever to take advantage of what we offer.

We brought a renewed commitment to our relationship with thousands of community based businesses. We're showing how mail can make a difference for them — easily and affordably.

We brought new focus and new energy to our partnership with the mailing industry. It's a vital part of the economy. So we have to make sure mail continues to offer the best choice.

Mail. It's part of the fabric of America. It's as fresh as tomorrow. And it's delivering for you.

postal service ambassadors

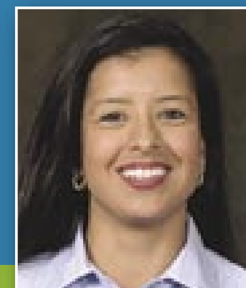
Appearing in television, radio and print advertising, our own letter carriers and customer service employees are telling the world about our quick, easy and convenient products and services.

letter carriers

Stephen Scully
Erie, PA

Alicia Tutt
Falls Church, VA

Adele Yoshikawa
Pearl City, HI

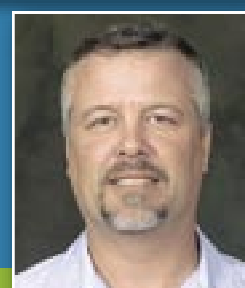


Gina Mendoza-Telck
Fort Worth, TX

John Dock
Mahwah, NJ

Diana Taylor
Tupelo, MS

Michael Cardarelli
Providence, RI



Jim Willson
Royal Oak, MI

Earl Keeton
Portland, OR

customer service employees

Deborah Kopplin
Postmaster
Tulare, SD

Robert Mcguire
Postmaster
Lakewood, CA

Fulin Ritt
Officer in Charge
Beachwood, NJ

Doreen Reichard
Customer Service Manager
Greenwich, CT

Elizabeth Owens
Customer Service Manager
Rogers Park Station
Chicago, IL

Normal Gilchrest
Postmaster
Forrest City, AR

Raymond Bernicchi
Postmaster
Arcadia, FL

Margie Washington
Officer in Charge
Wayne, PA

Jeanne Phillips
Postmaster
Fishing Creek, MD

Priority Mail flat-rate boxes make shipping a breeze.

Zones? Scales? Figuring out postage? Way too much work! But not with Priority Mail flat-rate boxes. Two convenient shapes . . . and one low price . . . coast to coast!

Legislation and the Postal Service

Postal reform was a key legislative focus with the introduction of bills in both the House and Senate. While House bill H.R. 4341, Postal Accountability and Enhancement Act, was reported favorably to the full House, and the Senate's similarly named S. 2468 was placed on the legislative calendar, no final action was taken before Congress' adjournment.

Despite some differences, both bills provided for a number of changes to reform the outdated Postal Reorganization Act of 1970. These include pricing flexibility and regulatory oversight. In addition, both bills would have corrected the financial burdens imposed by P.L.108-18, the Postal Civil Service Retirement System Funding Reform Act of 2003, which requires the Postal Service to fund an escrow account, beginning in 2006, for savings resulting from the Act. The Act also requires the Postal Service to contribute to the funding of retirement benefits earned by Postal Service employees while serving in the military. This funding was previously the responsibility of the Treasury.

Postmaster General John E. Potter and Board of Governors Chairman S. David Fineman testified several times before the Senate Governmental Affairs Committee and the House Government Reform Special Panel on the Postal Service on issues including postal reform and recommendations made by the President's Commission on the Postal Service.

In November 2004, Congress approved an omnibus appropriations bill for 2005 that provides the Postal Service with $29 million for revenue forgone debt repayment, $61.7 million to provide free mail for the blind and overseas voters, and $507 million for emergency preparedness to fund the acquisition and deployment of biohazard detection systems.

H.R. 2673, Consolidated Appropriations Act, 2004, enacted as Public Law 108-199, extended the sales period for the *Breast Cancer Research* semipostal stamp, first issued in 1998, for an additional two years. The period was due to expire at the end of calendar year 2003.

Throughout the year, the Postal Service advised legislators and their staffs on a wide range of issues affecting the nation's postal system, including aviation security and the ongoing deployment of biohazard detection systems in major mailprocessing facilities throughout the nation.

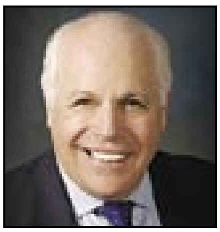
These issues are discussed in further detail in the financial review section of this report.

board of governors

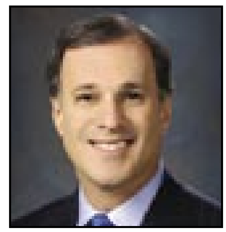
As the governing body of the Postal Service, the 11-member Board of Governors has responsibilities comparable to a board of directors of a publicly held corporation. The Board is composed of nine Governors appointed by the President of the United States with the advice and consent of the Senate. Not more than five Governors may be members of the same political party. 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 scheduled 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 United States Code. 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.



S. DAVID FINEMAN, CHAIRMAN Appointed May 1995, term expires December 2004. Elected Chairman, January 2003. Served as Vice Chairman, January 2001 through December 2002. Member, Strategic Planning and Audit and Finance Committees. 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 on international trade policy.

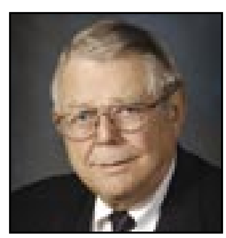


ALAN C. KESSLER Appointed November 2000. Term expires December 2008. Chairman, Strategic Planning Committee. Attorney and entrepreneur; Partner, Wolf, Block, Schorr and Solis-Cohen, LLP; Member, Board of Directors, Philadelphia Industrial Development Corporation; Chairman, Pennsylvania Supreme Court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

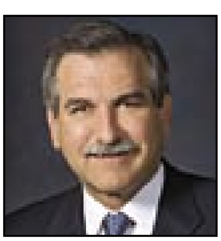
JOHN F. WALSH, VICE CHAIRMAN Appointed November 1999. Term expires December 2006. Elected Vice Chairman January 2003. Chairman, Capital Projects Committee. Former President, Ninth Square Association and Deputy Controller and Purchasing Agent, City of New Haven, Connecticut; Member, Board of Directors,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

JAMES C. MILLER III Appointed April 2003. Term expires December 2010. Member, Audit and Finance 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.

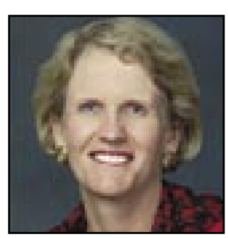
LEGREE S. DANIELS Appointed August 1990. Reappointed November 1999. Term expires December 2007. Member, Capital Projects Committee. Former Assistant Secretary for Civil Rights, U.S. Department of Education; Former member, U.S. Civil Rights Commission; Former member, Board of Directors, Center for International Private Enterprise; and 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. Chairman, 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.



LOUIS J. GIULIANO Appointed November 2004 through a recess appointment expiring in late 2005. With Senate confirmation, term expires December 2009. Chairman of the Board of Directors of ITT Industries and former President and Chief Executive Officer; Director of The ServiceMaster Company; Honorary Chairman of the Westchester County Red Cross Armed Forces Emergency Services.



CAROLYN LEWIS GALLAGHER Appointed November 2004 through a recess appointment expiring in late 2005. With Senate confirmation, term expires December 2005. Member of the President's Commission on the U.S. Postal Service; Former President and Chief Executive Officer of Texwood Furniture, Inc.; a Trustee and the immediate past chair of the board of St. Edward's University; and a Trustee of the Texas Employee's Retirement System.

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; Director of Operations for Merrill Lynch Production Technologies; Executive Board, National Postal Policy Council and the Mailers Council; Co-chairman of the Mailing Industry Task Force.

the executive committee

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.

John E. Potter
Postmaster General and CEO

John M. Nolan
Deputy Postmaster General

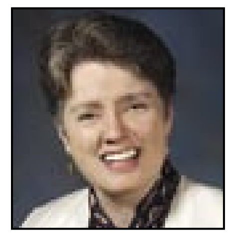
Patrick R. Donahoe
Chief Operating Officer and Executive Vice President

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

Suzanne F. 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
Senior 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

William P. Galligan Vice President, Delivery and Retail

DeWitt O. Harris Vice President, Employee Resource Management

Lee R. Heath Chief Postal Inspector

Alfred Iniguez Vice President, Area Operations (Pacific)

Jo Ann Feindt Vice President, Area Operations (Great Lakes)

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)

Lynn Malcolm Vice President, Finance, Controller (acting)

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 E. Weatherall Vice President, Diversity Development

Jerry W. Whalen Vice President, Sales

a message from the audit and finance committee

Robert F. Rider

This year, the Committee oversaw the completion of the multiyear modernization of most postal accounting systems. As recommended by the Committee and approved by the Board, the Postal Service began the process of voluntary adherence to those provisions of the Sarbanes-Oxley Act that are applicable to a non-publicly traded company.

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. Governors James C. Miller, S. David Fineman, and I are the current members of the Committee. Governor Albert V. Casey served on the Committee as Chairman until his death on July 10, 2004. Governor Fineman joined the Committee on July 23, 2004, and I succeeded Governor Casey as Committee Chairman and designated financial expert at that time.

In 2004, the Board approved changes to the Committee's charter that make it consistent with rules adopted by the New York Stock Exchange and approved by the Securities and Exchange Commission. At the Committee's recommendation, the Board updated its bylaws to make clear that responsibility for the selection of the Board's independent audit firm is vested with the Governors and is appropriately insulated from management, although it should be noted that this has always been the case in practice.

Fulfilling its primary responsibility, oversight of the integrity of Postal Service financial statements, the Committee periodically reviews the soundness of internal accounting and control practices and major financial statement estimates and 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 Postal Service Inspector General reports to the Governors and is represented at all Committee meetings.

The Committee monitors financial performance, debt levels and cash management. 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.

The Committee met five times in 2004. During the year, the Committee reviewed the Postal Service's use of the "savings" realized under Public Law 108-18 (P.L.108-18), the Postal Civil Service Retirement System Funding Reform Act of 2003, to reduce debt, as prescribed by the Law. The Committee reviewed Postal Service methodologies for evaluating the costs and benefits of various types of capital investments as well as the selection of appropriate discount rates for capital investments and long term leases. Also relating to capital investments, the Committee directed that post-implementation reviews of capital investments be provided on a regular basis. During the year, the Committee also reviewed the assumptions underlying estimates of the magnitude of long term financial obligations to fund retirement and workers' compensation programs.

The Committee monitors the Postal Service's financial reporting and internal control procedures to ensure compliance with best corporate practices, promote good governance and enhance transparency. This was an area of major accomplishment in 2004. This year, the Committee oversaw the completion of the multiyear modernization of most postal accounting systems. As recommended by the Committee and approved by the Board, the Postal Service began the process of voluntary adherence to those provisions of the Sarbanes-Oxley Act that are applicable to a non-publicly traded company.

To facilitate comparison of its own financials with those of other organizations, the Postal Service has adopted monthly reporting in place of its long-standing 28-day accounting period reporting system. Under the guidance of the Audit and Finance Committee, the Postal Service has restructured its interim and annual financial reports. The Postal Service issues quarterly financial reports and has expanded both the Management Discussion and Analysis and the forward-looking information provided in its quarterly and annual reports. This Security and Exchange Commission (SEC)-type reporting of information is similar to 8-K, 10-K and 10-Q reports. These improvements enhance the financial transparency of the Postal Service and flow directly from specific recommendations of the President's Commission on the United States Postal Service. These reports, as well as current and historical reports on revenues, volumes, costs and annual financial plans are posted on *usps.com,* the Postal Service's universal access website. The Postal Service continues to meet the voluminous reporting requirements of the Postal Rate Commission, Congress, the Government Accountability Office, the federal Office of Personnel Management and the federal Office of Management and Budget.

In directing the conduct of the 2004 financial statement audit, the Committee met with Ernst & Young LLP, and concurred with the scope and materiality levels they established in their work plan for the task. The Committee met jointly and independently with Ernst & Young LLP, the 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 2004.

Robert F. Rider
Chairman, Audit and Finance Committee
December 7, 2004

To facilitate comparison of its own financials with those of other organizations, the Postal Service has adopted monthly reporting in place of its long-standing 28-day accounting period reporting system. Under the guidance of the Audit and Finance Committee, the Postal Service has restructured its interim and annual financial reports.

a message from the chief financial officer and executive vice president

Richard J. Strasser, Jr.

> Our strengthened financial position results directly from our dedication to the strategies we established in our 2002 *Transformation Plan*. Increasing productivity and efficiency in all areas of our operations has allowed us to take costs out of the system, reduce debt and improve customer service.

I am pleased to report a net income of $3.1 billion and a new financial achievement for the independently financed Postal Service. In 2004, we recovered all prior years' losses and, for the first time since postal reorganization, ended the fiscal year with positive retained earnings.

Our strengthened financial position results directly from our dedication to the strategies we established in our 2002 *Transformation Plan*. Increasing productivity and efficiency in all areas of our operations have allowed us to take costs out of the system, reduce debt, and improve customer service. This year marked the fifth consecutive year in which we have achieved productivity gains, which are equivalent to approximately $6.1 billion in cost savings. In 2004, we reduced total workhours by 21 million, our fifth straight year of workhour reductions. Through productivity gains and attrition, we have reduced our total complement to pre-1985 levels. Most tellingly, since 1984, total delivery points have increased by 37% or 33 million and total mail volume increased 57% or 75 billion pieces. Yet, as the independently measured First-Class Mail delivery service scores attest, this year we delivered on-time service to postal customers at the highest levels of performance in our history.

We continue to achieve our financial management goals. With this year's greater than anticipated cash flow from operations, and reduced capital cash outlays, we paid down our debt by $5.5 billion, to $1.8 billion. This is a 75% reduction from last year's debt level and the lowest level of debt since 1984.

We have also made significant improvements to our financial reporting. On a voluntary basis, we have adopted SEC-type reporting and now issue 8-K, 10-K and 10-Q-type reports. We have expanded our Management Discussion and Analysis to provide more detailed and more forward-looking information in both our quarterly and annual reports. These reports are posted, as they are issued, on our universal access public website, *usps.com.*

Despite these exceptional achievements in business operations and financial management, we must confront deepening structural change in our industry that clouds our financial prospects. Our statutory business model centers upon our historical flagship product, First-Class Mail. Because it enjoyed the highest volumes and normally grew every year, and because it provided the highest margin over costs, covering over two-thirds of our institutional costs, First-Class Mail has financed most of our cost of providing universal service to every address in our ever-expanding delivery network. Impacted by electronic diversion, First-Class Mail volume declined again this year. As volume falls in First-Class Mail while overall volume and workload increase, it becomes more evident that the mail monopoly no longer has the business value it did at the time of postal reorganization. For the first time in history, in 2005 First-Class Mail is projected to fall below Standard Mail as our largest volume product. The shift in the mail mix from First-Class Mail to lower revenue-per-piece mail classes has resulted in stagnant revenue growth and shrinking contribution. Nonetheless, the costs of universal service will continue to increase.

Public Law 108-18 adjusted our overpaid Civil Service Retirement System (CSRS) payments beginning in 2003, but also shifted to us the cost associated with military service of our employees and imposed on us an escrow requirement starting in 2006. As required by P.L.108-18, we provided detailed proposals to Congress, the President and the Government Accountability Office in which we recommended that the Department of the Treasury resume the obligation to pay the CSRS costs associated with the military service of postal employees. We also recommended that Congress eliminate the escrow requirement for all "savings" realized under P.L.108-18 after 2005, and that these "savings" be used to pre-fund postal retiree health benefits. We are still awaiting resolution of these issues.

By 2005, the "savings" realized under P.L.108-18 will have been fully absorbed by the escalating cost of postal operations. The greatest factors in this rise in costs are increasing personnel compensation costs, driven largely by health benefits inflation and the continuing need to service an ever-larger delivery and retail network. Each of these business drivers, First-Class Mail volume erosion, a growing retiree population and increasing cost pressures are structural in nature and each must be seen as an ongoing reality.

For 2005, our financial plan calls for virtual "breakeven" results, with revenue falling below this year's level due to the continuing shift in the mail mix as our costs continue to escalate. Under our conservative financial plan, a net loss of approximately $200 million in 2005 is forecast.

Our strategy for 2005 is to continue to pursue our transformation strategies, leveraging our resources to build the business. While these strategies have resulted in historic productivity levels and cost savings over the last few years, we must recognize that additional efforts to take costs out of system will require fundamental structural change. This will require public policy which does not interfere with management's decisions to take costs out of the system.

In closing, I would like to thank all of our postal employees for their continued hard work and dedication. Without the efforts of each of them, we could not have achieved this phenomenal financial and operational performance.

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

By 2005, the "savings" realized under P.L.108-18 will have been fully absorbed in covering the escalating cost of postal operations. The greatest factors in this rise in costs are increasing personnel compensation costs, driven largely by health benefits inflation and the continuing need to service an ever-larger delivery and retail network.

financial review
Part I

Item 1. Business

General Development of Business

During 2004, we began to prepare interim financial reports on a calendar month basis. Previously, our interim reporting was based on a 28-day, 13 accounting period calendar that had been used since before postal reorganization. As a result, 2003 interim data are management's representation of results for the same periods last year.

Financial Information about Segments

We operate in one segment throughout the United States and internationally. Our international operations are not financially significant.

Narrative Description of Business

Overview

The United States Postal Service (we) commenced operations on July 1, 1971, as an independent entity of the executive branch of the United States government. 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." We fulfill this legal mandate to offer universal services at a fair and uniform price by offering a variety of classes of mail services without undue discrimination among our many customers. This means that within each class of mail our price does not unreasonably vary by customer for the levels of service we provide.

We serve individual and commercial customers throughout the nation. Our services compete for business in the communications, distribution and delivery, advertising and retail markets. The rates and fees for postal services are subject to a regulatory review process controlled by the independent Postal Rate Commission (PRC).

Our products are distributed through our more than 37,000 Post Offices, stations and branches, contract postal units, our website *usps.com* and a large network of consignees. We deliver mail to 142 million city, rural, Post Office box, and highway 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, National Association of Letter Carriers, National Postal Mail Handlers Union and National Rural Letter Carriers Association. Approximately 90% of our career employees are covered by collective bargaining agreements. By law, we consult with management organizations representing most of the employees not covered by collective bargaining agreements. These consultations provide an opportunity to participate directly in the planning, development, and implementation of programs and policies affecting managerial employees in the field. The management organizations include the National Association of Postal Supervisors, the National League of Postmasters, and the National Association of Postmasters of the United States. We participate in federal employee benefit programs covering retirement, health benefits and workers' compensation.

We are not subject to regulation by the Securities and Exchange Commission (SEC). However, we comply voluntarily with the financial reporting requirements of the SEC to the extent that these requirements may be reasonably applied to a non-publicly traded, government-owned entity with a mandate to break even over time. Therefore, this report excludes certain SEC reporting elements normally included in a Form 10-K. Specifically, we have excluded: Item 4, Submission of Matters to a Vote of Security Holders; Item 5, Market for Registrant's Common Equity and Related Stockholder Matters; and Item 12, Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Postal Reform

In May 2004, Representative John McHugh, Chairman of the Government Reform Committee's Special Panel on the Postal Service, introduced H.R. 4341, Postal Accountability and Enhancement Act. The bill was reported favorably to the full House on the date of introduction.

Also in May, Governmental Affairs Committee Chairman Susan Collins introduced S. 2468, Postal Accountability and Enhancement Act. In August, the Committee placed the bill on the legislative calendar for action in the abbreviated Congressional session following the Labor Day recess. While there were some differences in the two bills, both provided for a number of changes designed to reform the outdated Postal Reorganization Act of 1970.

Both the Senate and House legislation reaffirmed the importance of universal service and significantly strengthened the role of the PRC granting it the authority to create a new system of rates and service standards, among other powers. Both bills granted us some pricing flexibility. The Senate bill introduced price caps to assure future affordability, while the House bill would have allowed the PRC to choose the pricing system. However, only the Senate version gave the PRC flexibility in crafting a price cap that took into account a variety of cost drivers. The House bill mandated the use of the Consumer Price Index. Neither bill provided the opportunity for relief from our major cost drivers, wages and benefits.

In 2004, we ranked 6th on *Fortune* magazine's list of the "50 Best Companies for Minorities."

Other key components of the legislation included authorizing the Postal Service Governors to establish rates and classes for products in the competitive categories of mail. The bills also addressed the financial burden imposed by the escrow account established by the Postal Civil Service Retirement System Funding Reform Act of 2003. Each repealed a provision of P.L.108-18 that addressed the disposition of savings caused by that Act, modified our contributions to the Civil Service Retirement and Disability Fund (CSRDF), and established a Postal Service Retiree Health Benefits Fund.

The bills were reported out of Committee unanimously but were unable to be considered before the end of the 108th Congress. The sponsors of the bills have indicated their intention to reintroduce the bills in the 109th Congress, which will convene in January 2005.

Products

The Postal Service is the centerpiece of the U.S. mailing industry. We provide a wide variety of products and services to meet almost any mailing need. Some of our major products and services are:

First-Class Mail — Postcards or letters, up to 13 ounces, can be sent using First-Class Mail. This service (or Express Mail or Priority Mail) is required for personal correspondence, handwritten or typewritten letters, and bills or statements of account. It also may be used for any mailable item, including advertisements and lightweight merchandise.

Priority Mail — This 2–3-day, nonguaranteed service is typically used to send documents, gifts, and merchandise.

Express Mail — This money-back guaranteed overnight to two-day service includes tracking, proof of delivery, and insurance up to $100. Delivery to most destinations is available 365 days a year with no extra charge for Saturday, Sunday, and holiday delivery.

Periodicals — Typical Periodicals are newspapers, magazines, and newsletters. This service requires prior authorization by the Postal Service.

Standard Mail — Letters containing mailable items weighing less than 16 ounces not required to be sent using First-Class Mail can be sent using Standard Mail. Standard Mail is typically used for advertisements and flyers. There are no postcard rates for Standard Mail, but postcards can be mailed at the letter rates. Additional content restrictions must be met for authorized nonprofit mailers.

Package Services — Includes Parcel Post, Bound Printed Matter and Media Mail.

Special Services — In addition to these and other classes of mail, we offer a variety of enhancements that add value to mail by providing additional security, proof of delivery, or loss recovery. These product enhancements include: Certified Mail, Registered Mail, Delivery Confirmation, Signature Confirmation, Click-N-Ship, and insurance.

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.

We must submit a request for any changes in postage rates and classification to the PRC, an independent establishment of the executive branch of the federal government. Our request may be minor, for such things as specific classification changes, extensions of current service classifications, adjustment to or introduction of specific rates or requests to proceed with experimental product offerings. At any point in time, the PRC may be considering several minor requests. In 2004, the PRC issued two Opinions and Recommended Decisions on minor cases, with three minor requests still pending.

We may also submit an omnibus rate request that involves a comprehensive revision of postage rates as well as major classification changes. In an omnibus case, postage rates are revised so that there will be sufficient revenue to allow us to break even in a prospective test year. Adjudication of an omnibus rate request is a lengthy and complicated process that begins when we determine that rate changes are consistent with the policies of the Postal Reorganization Act and in the public interest. With the approval of the Board of Governors, we submit a request to the PRC for a recommended decision on rate and fee changes. We include with our request detailed rate proposals supported by extensive testimony and lengthy documentation.

The PRC's proceedings in an omnibus rate case take up to 10 months and include public hearings in which interested parties such as mailers, competitors, and consumer representatives are authorized to submit their own testimony and proposals, as well as to challenge or support our proposals. At the conclusion of the proceedings, the PRC sends its recommended decision to the Governors. The Governors may approve, reject, allow under protest, or, under certain limited circumstances after more proceedings, modify the PRC's recommendations.

Competition

The Internet and the World Wide Web continue to dramatically change the communications market. Within the next decade further innovations such as mobile commerce, broadband, interactive TV, data mining software, and new printing technologies will change the way businesses and consumers interact. While hard copy mail retains tremendous effectiveness, there is little doubt that its share of the overall communications market will shrink.

Of greatest impact on us are electronic alternatives to business correspondence and transactions, particularly for First-Class Mail items such as bills, statements, and payments. First-Class Mail volumes have already been affected by the telephone, fax machine, Internet, and other electronic communications.

The Internet is also forcing us into greater competition with the private sector by changing the mix of mail. The Internet and electronic commerce are stimulating utilization of other postal products, such as package delivery and targeted ad mail. These products are subject to competition from traditional sources (e.g., newspaper and TV ads and other package delivery firms).

We are losing share in the overall delivery services market. Major corporations now dominate parcel and express markets. Under the current regulatory structure, competitors have far more flexibility to respond to changes in market conditions and to target specific customers than does the Postal Service.

The competitive landscape for postal services is becoming much more global. Foreign postal operators such as Deutsche Post World Net (DPWN) (Germany) and TNT Post Group (TPG) (the Netherlands) are moving well beyond traditional postal services, offering logistics, financial services, and electronic services. Four foreign posts — DPWN, TPG, Consignia (United Kingdom), and La Poste (France) — have limited operations in 18 major metropolitan centers nationwide, including New York, Boston, Washington, DC, Houston, Salt Lake City, Los Angeles, San Francisco, and Seattle. These operations feature some sales offices and offer mail, parcel, logistics, and financial services to the American market. DPWN recently acquired a controlling interest in DHL, the leading global express company, originally a U.S. firm. DPWN owns one of the largest global freight forwarders, also based in the United States.

Intellectual Property

The Postal Service owns valuable intellectual property including trademarks, service marks, patents, copyrights, trade secrets and other proprietary information. We routinely generate intellectual property in the course of developing and improving our systems, products, and operations.

Seasonal Operations

Our operations are somewhat seasonal. Mail volume and revenue tend to be greatest in our first fiscal quarter and lowest in our fourth quarter.

Working Capital Practices

Information about our working capital practices is included in Management's Discussion and Analysis of Financial Condition and Results of Operations for the years ended September 30, 2004, 2003 and 2002 in Part II, Item 7, pages 23 through 35, and the Statement of Cash Flows for the years ended September 30, 2004, 2003 and 2002 on page 43.

Customers

Our business is not dependent upon a single customer or small group of customers.

Backlog

We do not have any backlog.

Government Contracts

No material portion of our business is subject to renegotiation of profits or termination of contracts or subcontracts at the election of the U.S. government.

Research and Development

We operate a research and development facility in Virginia. While research and development activities are important to our business, these expenditures are not material. Independent suppliers also conduct research activities that benefit us.

Environmental Matters

We are not aware of any federal, state or local environmental laws or regulations that will materially affect our financial results or competitive position or result in material capital expenditures. However, we cannot predict the effect on our operations of possible future environmental legislation or regulations.

In October 2001, the United States became the target of biological terrorism, utilizing the mail as the delivery medium. In response to the continuing threat, the Board of Governors approved the Biohazard Detection System and the Ventilation

Americans on the move. In 2004 we processed 43 million changes of address.

Filtration System projects. These projects will provide a level of protection to our employees and customers from potential contamination.

Number of Employees

At year-end, we had 707,485 career employees, substantially all of whom reside in the United States. We also had 100,111 noncareer employees. See Operating Statistics on page 54 for additional detail.

Available Information

The United States Postal Service is not subject to the informational requirements of the Securities Exchange Act of 1934 (Exchange Act). We do not file periodic reports, proxy statements or other information with the SEC.

Financial and other information can be accessed on the "About USPS and News" section of our website at *usps.com.* We make available, free of charge, copies of our annual report, as soon as reasonably practicable after it is produced. Copies of financial and other information are available free of charge by sending a request to United States Postal Service Public Affairs and Communications, 475 L'Enfant Plaza, SW, Washington, DC 20260-5241.

Information on our website is not incorporated into this document.

Item 2. Properties

The Postal Service currently controls more than 34,000 leased or owned facilities in the United States, its possessions, and territories. We also contract with almost 3,000 more locations to distribute our products. The size of our facilities range from fifty square feet to as large as 33.7 acres under one roof. The types of real estate include, but are not limited to, standard Post Offices, carrier facilities, mail processing plants, retail outlets, business office space, warehouse space, vehicle maintenance facilities, and other permanent or temporary space. The vast majority of these facilities are Post Offices, stations, branches, and carrier annexes. We have 416 processing and distribution facilities and bulk mail facilities, and 25 other facilities primarily devoted to logistics and transportation management.

Real estate inventory (Square feet in thousands) (Dollars in millions)	2004
Owned facilities	8,807
Owned interior square feet	215,293
Owned land in square feet	939,056
Leased facilities	25,413
Leased interior square feet	97,817
GSA/other government facilities	425
GSA/other government interior square feet	4,194
Annual rent paid to lessors	$946

We have one of the largest vehicle fleets in the country, including an extensive fleet of alternative fuel vehicles.

Vehicle inventory	2004
1/2-Ton Trucks	179,508
2 and 1/2-Ton Trucks	7,484
Trailers	4,683
Service Vehicles	5,379
Administrative Vehicles	5,546
All other	9,538
Total Owned	**212,138**

Item 3. 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, or the full Board of Governors. In our evaluation, no single claim is material to our financial statements taken as a whole. We have accrued in our financial statements of September 30, 2004, the estimated impact of those claims we think it probable we will pay.

Item 4. Submission of matters to a vote of security holders

Not applicable to this report.

financial review
Part II

Item 5. Market for registrant's common equity and related stockholder matters
Not applicable to this report.

Item 6. Selected financial information
See Financial History Summary on page 56.

Cautionary Statements
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 estimates.

Certain forward-looking statements are included in this report. They use such words as "may," "will," "expect," "believe," "plan," and other similar terminology. These statements reflect our current expectations regarding future events and operating performance and speak only as of the date of this report. These forward-looking statements involve a number of risks and uncertainties.

The following are some of the factors that could cause actual results to differ materially from those expressed in or underlying our forward-looking statements: effectiveness of operating initiatives; success in advertising and promotional efforts; changes in national and local business and economic conditions, including their impact on consumer and business confidence; fluctuations in currency exchange and interest rates; labor and other operating costs; oil, fuel and other transportation costs; the effects of war and terrorist activities; competition, including pricing and marketing initiatives and new product offerings by our competitors; consumer preferences or perceptions concerning our product offerings; spending patterns and demographic trends; availability of qualified personnel; severe weather conditions; effects of legal claims; cost and deployment of capital; changes in laws and regulations; and changes in applicable accounting policies and practices. The forgoing list of important factors is not all-inclusive.

We have no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

TABLE 1. VOLUME (Pieces in millions)

				% Change	
	2004	2003	2002	04–03	03–02
First-Class Mail	**97,926**	99,059	102,379	-1.1%	-3.2%
Priority Mail	**849**	860	998	-1.3%	-13.9%
Express Mail	**54**	56	61	-3.1%	-8.9%
Periodicals	**9,135**	9,320	9,690	-2.0%	-3.8%
Standard Mail	**95,564**	90,492	87,231	5.6%	3.7%
Package Services	**1,132**	1,129	1,075	0.3%	5.0%
International	**844**	805	904	4.8%	-10.9%
Other*	**602**	464	484	29.7%	-4.1%
Total	**206,106**	**202,185**	**202,822**	**1.9%**	**-0.3%**

Note: Percentages are calculated based on unrounded numbers.

*Postal Service volume, mailgrams and free matter for the blind are included in the "Other" category.

TABLE 2. REVENUE (Dollars in millions)

				% Change	
	2004	2003	2002	04–03	03–02
First-Class Mail	**$36,377**	$37,048	$36,483	-1.8%	1.5%
Priority Mail	**4,421**	4,494	4,722	-1.6%	-4.8%
Express Mail	**853**	888	910	-4.0%	-2.5%
Periodicals	**2,192**	2,235	2,165	-1.9%	3.2%
Standard Mail	**18,123**	17,231	15,819	5.2%	8.9%
Package Services	**2,207**	2,216	2,080	-0.4%	6.5%
International	**1,696**	1,587	1,580	6.9%	0.5%
Other*	**3,160**	3,065	2,929	3.1%	4.6%
Total	**$69,029**	**$68,764**	**$66,688**	**0.4%**	**3.1%**

Note: Percentages are calculated based on unrounded numbers.

* Mailgrams are included in the "Other" category as are special service revenues, other income and investment income.

We rank 27th on *Fortune* magazine's latest "Global 500 World's Largest Corporations" list.

Item 7. Management's discussion and analysis of financial condition and results of operations

Volume and Revenue

In 2004, our revenue was slightly more than last year, while the results by product line were mixed. The economy also grew slightly more than projected.

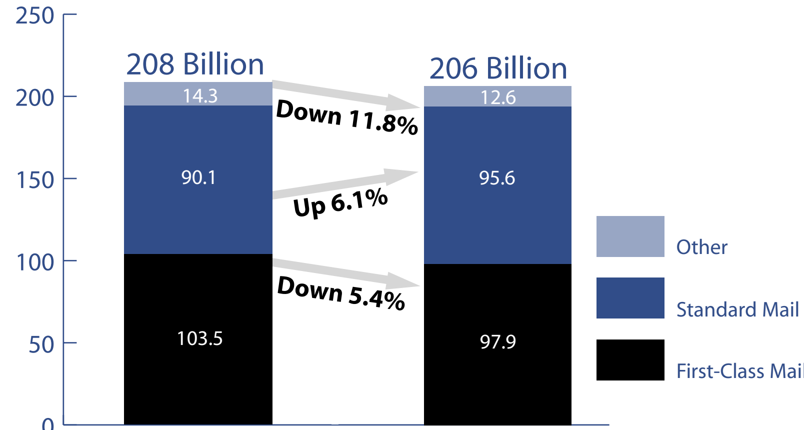
Standard Mail volume continued to grow in 2004, causing total volume to increase. Most of the growth in Standard Mail volume was in the regular automation presort category. Economic growth and increases in advertising spending and corporate profits spurred the growth in Standard Mail volume and revenue. Standard Mail has also benefited from the "Do Not Call" telephone restrictions. International Mail volume increased as well. Revenue and volume growth in Standard Mail and International Mail offset declines in other classes of mail.

First-Class Mail, which is our largest mail class in terms of both volume and revenue, declined in volume for the third consecutive year in 2004. The declines in volume and revenue in First-Class Mail reflect the impact of electronic diversion as businesses, nonprofit organizations, governments, and households increasingly automate their financial transactions and divert correspondence to the Internet. The volumes of Priority Mail and Express Mail also declined as we continue to lose market share in the package market. Package Services volume increased slightly because growth in Bound Printed Matter and Media Mail volume offset losses in Parcel Post volume. Periodical Mail volume and revenue are declining as businesses and consumers increasingly rely on the Internet as a substitute for hardcopy publication of news, information, and entertainment.

The mix of mail has changed significantly in recent years. As recently as 2000, First-Class Mail was by far the largest component of the mailstream. However, over the past four years, First-Class Mail volume has declined 5.4% while Standard Mail volume has grown 6.1%. This change in the mix of mail has flattened revenue because revenue growth has been coming from Standard Mail, which has an average revenue per piece of only 19 cents, compared with the average 37 cents per piece of the First-Class Mail it is replacing. In this new era, volume growth has been accompanied by the hollowing out of revenues.

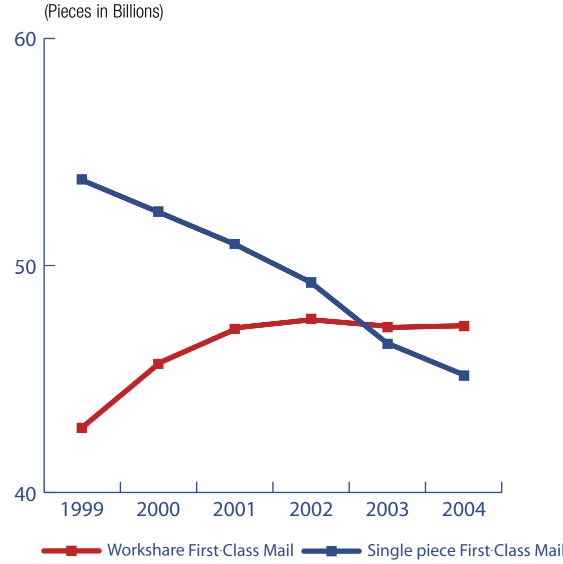
E-commerce and e-mail are replacing personal correspondence and hard copy commercial transactions that formerly traveled as First-Class single-piece Mail. In 2003, we also experienced our first ever annual decline in the volume of workshare First-Class Mail, which is mail that a large-scale mailer has presorted and prepared for entry into our system before delivering it to us for processing. Some of the decline in workshare mail was related to the weakness of the economy, but the decline is at least as much due to the absence of new hard-copy billing and statement applications and electronic diversion of bills and statements. Workshare volume increased slightly in 2004. We expect this growth to be transitory as First-Class Mail continues to decline due to long term trends in communication and payment technologies.

MAIL MIX COMPARISON
(Pieces in billions)



Similar volume = $4.4 billion less revenue (at constant rates)

FIRST-CLASS MAIL VOLUME
(Pieces in Billions)



Part II

We believe that we can maintain stable rates through calendar 2005 because of the reduction in our contributions to the Civil Service Retirement and Disability Fund (CSRDF) that were effected by P.L.108-18 in 2003 and the savings we have achieved from our continued productivity improvements. However, we will have to adjust postage rates in 2006 because increased costs will exceed the benefits from productivity improvements. Starting in 2006, P.L.108-18 requires that we place in escrow the "savings" attributable to its enactment. These funds are to be held in escrow, pending a decision by Congress as to how they are to be used. We are also required by this law to consider these "savings" as an operating expense, thus enlarging the size of the rate increase that will generate the revenues we will need to cover costs.

Operating Expenses

Our costs can be categorized into two types: volume-variable and non volume-variable. 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 2003, the latest year available, volume-variable costs totaled approximately $37 billion, or about 57% of total costs. The approximately $28 billion remaining costs are non-volume-variable and must be borne, ultimately, by the combined revenue of all classes of mail.

COMPENSATION AND BENEFITS DETAILS (Dollars in millions)

	2004	2003	2002	2004–2003 % Change	2003–2002 % Change
Compensation	**$37,876**	$37,144	$36,877	2.0%	0.7%
Retirement	**6,574**	5,877	9,105	11.9%	-35.5%
Health Benefits	**4,845**	4,526	4,201	7.0%	7.7%
Retiree Health Benefits	**1,313**	1,133	987	15.9%	14.8%
Workers' Compensation	**1,239**	1,473	1,524	-15.9%	-3.3%
Other	**390**	391	464	-0.3%	-15.7%
Total Compensation and Benefits*	**$52,237**	**$50,544**	**$53,158**	**3.3%**	**-4.9%**

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

WORKHOURS (In thousands)

	2004	2003	2002
Operations			
Operations Support	**9,077**	9,102	9,106
Mail Processing	**336,737**	347,964	374,597
Rural Delivery	**171,628**	166,873	169,939
City Delivery	**464,683**	464,300	470,075
Vehicles Services	**31,947**	32,111	32,835
Limited Duty and Rehabilitation	**6,356**	21,455	25,742
Plant & Equipment Maintenance	**81,302**	81,807	82,127
Customer Services & Retail	**233,237**	232,529	241,491
Postmasters & Installation Heads, Supervisors, Administration and Other	**117,354**	117,652	121,510
Total Workhours	**1,452,321**	**1,473,793**	**1,527,422**

Compensation and Benefits

Personnel compensation and benefits, which totaled $52,237 million in 2004, make up more than 79% of our operating expenses. These costs grew $1,693 million or 3.3% in 2004, compared to 2003. This year's growth was due primarily to contractual labor rate increases, cost-of-living-adjustments (COLAs), and health benefits payments for current and retired employees. Our 2004 average hourly labor rates increased by 1.7%, and our 2004 health benefits expense for current employees and retirees increased by $499 million over 2003 to over $6 billion, driven mainly by premium increases.

In addition to labor and benefits rates, the other major driver of our compensation and benefits expense is workhours. This year's growth in costs was tempered by a reduction of over 21 million workhours. The 2004 workhour reduction is the fifth consecutive year in which workhours have been less than the prior year. In 2003, we eliminated 54 million workhours. Approximately one-

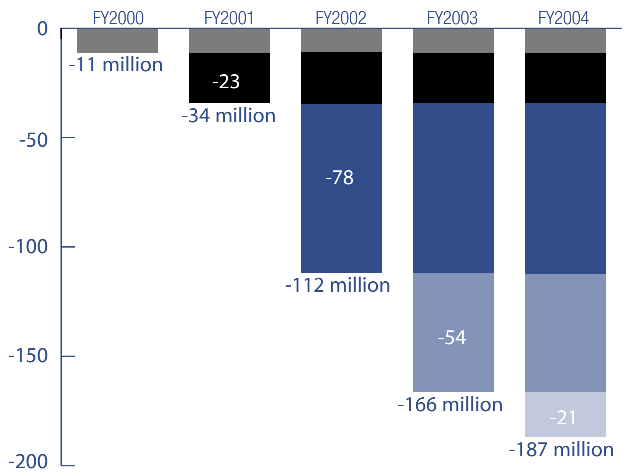
Fulfilling Our Mandate

Since 1971 our total revenues (equivalent to $4,200 for every person in the U.S.) have exceeded our total expenses by less than 1% (that's just 9 cents per year per person).

Total Revenue	$ 1,237,927,362,433
Total Expenses	$ 1,237,030,131,433
Net Income	$ 897,231,000

CUMULATIVE WORKHOUR REDUCTIONS

(Hours in millions)



Cumulative reduction of 510 million workhours

half of the reduction over the two years was in mail processing. In 2004, we experienced slight growth in workhours for city and rural delivery. This growth was driven by the addition of almost 1.8 million delivery points and by increased volume. In 2003, we reduced workhours in delivery by almost 9 million. Thus, in spite of the addition of over three million delivery points since 2002, we are operating with fewer delivery workhours. Cumulatively, beginning in 2000, we have eliminated about 510 million workhours. This is the single biggest contributor to the ongoing achievement of our *Transformation Plan* savings targets. In 2004, we made a change in how we track workhours for employees in limited duty or rehabilitation assignments. The workhours for these employees are now included in their functional areas.

In 2003, compensation and benefits expenses of $50,544 million were $2,614 million (4.9%) less than the prior year due to the impact of P.L.108-18, which reduced expenses by approximately $3,500 million and to a reduction of 54 million workhours, or approximately 24,000 career employees. The reduction in our retirement costs generated by P.L.108-18 and by our workhour reduction completely offset the growth in contractual wage rates, COLAs, and benefits expenses.

Almost 90% of our career workforce is covered by collective bargaining agreements. In 2002 and 2003, we reached agreements through negotiated settlements with all of the major unions and in 2004 we reached an agreement to extend an existing contract with one union through 2006. These agreements, which have expiration dates ranging from November 20, 2005 to November 20, 2006, call for annual basic pay increases and semi-annual cost-of-living adjustments (COLAs).

Our nonbargaining employees receive pay increases only through a pay-for-performance program that makes meaningful distinctions in performance. These employees do not receive automatic salary increases, nor do they receive COLAs or locality pay.

Retirement Expense

With certain exceptions, our employees participate in one of three retirement programs based on the starting date of their employment with the Postal Service. These programs are the Civil Service Retirement System (CSRS), the Dual CSRS/Social Security System, and the Federal Employees Retirement System (FERS). Each of these programs is described in further detail in note 6 to our financial statements. The programs are administered by the Office of Personnel Management (OPM). The expenses of all of our retirement programs are included in compensation and benefits expense.

The implementation of P.L.108-18 in May 2003 did not alter the fact that retirement expenses remain a significant portion of our total expenses. Retirement contributions for current employees represented 10.0% of our total expenses in 2004. They increased by $697 million compared to 2003, when these benefits represented only 9.1% of total expenses due to the one-time reduction in our retirement expenses resulting from the enactment of P.L.108-18. The impact of P.L.108-18, which is discussed below, was so significant that it resulted in an overall reduction in our benefits expenses in 2003. In 2002, prior to the enactment of P.L.108-18, retirement costs represented 13.5% of total expenses.

Public Law 108-18 and Proposed Legislation

The Postal Civil Service Retirement System Funding Reform Act of 2003, P.L.108-18, changed the way we fund our Civil Service Retirement System obligations and altered the related schedules for our payments to the CSRDF. P.L.108-18 was enacted in response to a November 2002 review of estimates and the Postal Service's payments into and returns earned by the CSRDF made by the OPM. OPM determined that at our then 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.

As required by P.L.108-18, in May 2003 we began to fund our obligations to the CSRDF based on dynamic assumptions. This increased our biweekly payroll contribution for CSRS employees' retirement from 7.0% of basic pay to 17.4%.

In 2004 we also made the first required annual payment on the "supplemental liability" calculated by OPM. This "supplemental liability" represents the excess of the actuarial present value of future benefits over the actuarial present value of plan assets, future plan contributions, earnings, and other factors.

P.L.108-18 requires that the dynamic funding assumptions include the full value of future benefits related to military or volunteer service when calculating the actuarial present value of future benefits. This provision of P.L.108-18 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. P.L.108-18 thus transfers $27 billion in obligations from U.S. taxpayers to our ratepayers.

P.L.108-18 stipulates that the Postal Service shall be allowed to request a reconsideration and review of the OPM computations by the Board of Actuaries of the Civil Service Retirement System. In January 2004, we asked the Board of Actuaries of the Civil Service Retirement System to review the method and computations used by OPM in its calculation of our portion of CSRS benefits because we believe that OPM used an allocation methodology to attribute CSRS pension costs of pre-July 1, 1971, service that assigns an unreasonably large share of the burden to us for payment. The Civil Service Board of Actuaries upheld the OPM methodology in September 2004.

In September 2004, OPM informed us that our first supplemental payment, based on the September 30, 2003 valuation, would be $240 million. We included $125 million of this payment in our 2003 expenses and $115 million in 2004. See note 7 to our Financial Statements for further explanation.

P.L.108-18 identifies as "savings" the difference between the contributions we would have made to the CSRDF had the legislation not been enacted, and the contributions we now make under the law. In 2003 and 2004 we were required to use these "savings" to reduce our debt. In 2003, we calculated our "savings" to be $3.5 billion, and we reduced our debt with the U.S. Treasury by $3.8 billion, thus exceeding the requirements of the law. In 2004, we used "savings" of $2.7 billion to reduce our outstanding debt to the U. S. Treasury, and we reduced our debt by an additional $2.8 billion, for a total debt reduction of $5.5 billion in 2004. We will use the "savings" in 2005 to offset operational expenses and to hold postal rates steady.

Future Use of "Savings"

Congress will consider what to do with the post-2005 "savings" but until Congress acts, any "savings" after 2005 must be placed in escrow. This escrow provision, if not repealed or substantially modified, will significantly impact our financial results and ultimately postage rates. We estimate that without Congressional action, the escrow requirement of P.L.108-18 will require postal rate increases in 2006 to be approximately 5% higher than they otherwise would have been. This will adversely impact the mailing industry, the general public, and ultimately the Postal Service itself, by further exacerbating existing trends of revenue and volume weakness.

As required by P.L.108-18, on September 30, 2003, we submitted two proposals to the President, Congress, and the Government Accountability Office. The first presents our position as to how the "savings" realized after 2005 should be used; the second presents our position that CSRS obligations arising from military service be returned to the U.S. Treasury. In both proposals, we recommend eliminating the escrow requirement and propose using a portion of the "savings" after 2005 to help finance retirement health benefit obligations. The escrowed "savings" requirement of P.L.108-18 will require postal rate increases which negatively affect the mailing industry and the general public. From the standpoint of the postal ratepayer, there can be no "savings" under P.L.108-18 so long as its escrow requirement is in effect.

Our preferred proposal would return responsibility for funding CSRS military service obligations to the U.S. Treasury. Under this proposal, our CSRS pension obligation would be overfunded by $10 billion. This excess CSRS funding would be transferred to a newly established "Postal Service Retiree Health Benefit Fund." We would then fund the "full cost" of retirement health benefit costs on a current basis. Any remaining "savings" would be used to reduce debt.

Our alternate proposal assumes that CSRS military service obligations remain the responsibility of the Postal Service. Under this proposal, we would use the "savings," in a priority sequence, to: first, fund and pre-fund retirement health care benefits; second, repay debt; and third, fund productivity and cost saving capital investments. Beginning in 2006, this proposal would pre-fund retirement health care benefits for all new employees hired in 2003 or later.

206,000,000,000. We delivered 206 billion pieces of mail in 2004. In 1971 we delivered 87 billion pieces of mail.

We believe that these proposals respond to the stated Sense of Congress regarding the use of the "savings". Each of these proposals balance the need to meet our obligation to fund health care benefits for prospective, current and retired employees against the interests of current and future customers in avoiding large and disruptive rate changes.

Pending Legislation

Legislation addressing the use of "savings" after 2005 was introduced in the House of Representatives and the Senate in the 108th Congress and is expected to be reintroduced in the 109th Congress. Either piece of legislation would profoundly change the Postal Service's regulatory processes as well as the funding of the CSRS and retiree health benefit obligations. Both legislative proposals require continuation of universal service and greatly strengthen the role of the regulator, granting it authority to create a new system of rate and service regulation. Each bill would also return responsibility for funding CSRS obligations arising from military service to the U.S. Treasury. Both pieces of legislation contain a number of other complex provisions to provide for adequate funding of retirement health care benefits.

If there is no legislative change, beginning in 2006 we will be required to escrow the CSRS postal reform "savings" and recognize their full amount as an operating expense for the purpose of determining postage rates and fees. Based on OPM's most recent estimate, we would have to place $3.1 billion in escrow and include that amount in the determination of postage rates and fees in 2006. We estimate a double digit rate increase would then be required to fund these "savings."

Health Benefits

We participate in the Federal Employees Health Benefits Program (FEHBP). Eligible postal employees with at least five consecutive years participation in the FEHBP immediately preceding retirement are entitled to continue FEHBP coverage into retirement. We account for employee and retiree health benefit costs as an expense in the period our contribution is due and payable to the FEHBP. This expense is included in compensation and benefits.

The major drivers of our active employee health care costs are the number of employees electing coverage and the premium costs of the plans they select. Premiums for each plan participating in FEHBP are determined annually by OPM. In 2004 health benefits expenses for active employees were $4,845 million, an increase of $319 million over 2003. This was 7.3% of our total expenses. The 2003 expense of $4,526 million was 7.0% of our total expenses and increased by $325 million over 2002 when employee health benefits were only 6.2% of our expenses.

Retiree health benefits costs of $1,313 million in 2004 represent 2.0% of our total expenses, up from $1,133 million (1.7%) in 2003 and $987 million (1.5%) in 2002. This cost has risen steadily over the last three years, driven by double digit increases in FEHBP premium costs, an increasing number of annuitants enrolled in the plan, and the declining number of annuitants for whom a portion of the premium cost is allocable to Post Office Department service. The combined effect of these drivers increased retiree health benefit costs by 15.9% ($180 million) in 2004, 14.8% ($146 million) in 2003 and 15.0% ($129 million) in 2002.

OPM recently announced a 7.9% average increase in average health benefit premiums, to take effect in January 2005. Compared to the double digit increases in average premiums over the last several years, this is an encouraging development. However, the pool of covered annuitants will continue to grow rapidly into the future. As of the end of 2004, there were approximately 438,000 Postal Service annuitants and survivors compared to 430,000 in 2003. We estimate that over 250,000 of our current employees will be eligible for retirement by 2008. As a result of the growing pool of retirees, we project that retiree health benefits costs will continue to grow at a 10% or greater annual rate over the next several years.

If we were not considered 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 on the assumptions used. Based on September 30, 2004, data, we estimated the 2004 present value of future premium payments to be between $48 billion and $59 billion. Based on September 30, 2003, data, we estimated the 2003 value of future payments to be between $47 billion and $57 billion. In both cases, the range in the estimate exists only because long-term medical inflation assumptions differed by 1%.

In December 2003, President Bush signed into law the Medicare Prescription Drug Modernization Act of 2003. The Act will add a voluntary prescription drug benefit to the Medicare program. The provisions of the Medicare legislation could have a significant impact on future Postal Service health care costs.

As the Postal Service is a participant in the Federal Employees Health Benefits Program, the availability of the rebate provision of this Act may be affected by how it is implemented by OPM.

If the full provisions of the Act are applied to the Postal Service, our annuitant health benefit obligations could be reduced by over $6 billion.

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. Thus, our bottom line is directly affected every time an employee is injured.

We record as a liability the present value of all future payments we expect to make to those employees receiving workers' compensation. At the end of 2004, we estimate our total liability for future workers' compensation costs at $7,579 million, an increase of $343 million or 5% over 2003.

For 2004, because of a 5.9% decrease in the number of medical claims and a 1.8% decrease in the cost per medical claim, we had lower workers' compensation costs. This builds on the 3.3% reduction in costs we had in 2003 from 2002. These lower costs are a result of our multi-year efforts to prevent injuries and are reflected in every available measure — total accident rates, lost workdays, injuries reported to OWCP, and new compensation and medical claims. As part of our safety program, we attempt to identify anything that might contribute to the possibility of worker injuries.

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 manage current claims, minimize new claims and eliminate fraudulent claims.

We expect workers' compensation costs to remain stable in 2005 as a result of our continuing efforts to improve safety and prevent injuries, to manage the impact of rising medical costs, and to increase the recovery of expenses related to injuries sustained by employees as a result of their own actions. We also have a joint initiative with OWCP to increase the number of injured employees returned to work. Finally, OWCP has instituted a more rigorous review of medical bills to lower costs.

In 2004, we made changes to the discount rates we use to estimate our liability in order to improve the accuracy of our estimate. We discuss these changes in note 3 of the Notes to the Financial Statements.

Transportation

Transportation expenses decreased by $20 million, or 0.4%, in 2004 to $4,969 million. Although fuel prices rose to record levels in 2004 and were a major factor in our transportation expense, we were able to offset this increase in several ways. During our peak holiday season, we significantly reduced the number of dedicated airplanes we use to move mail. This saved us approximately $54 million. We also moved more mail by truck and by the FedEx network. Not only did these changes result in reduced costs, they also improved service.

In 2003, our transportation expenses amounted to $4,989 million, a reduction of $143 million from 2002. We achieved this reduction primarily by transporting a larger percentage of Priority Mail on ground transportation and by negotiating changes to our FedEx® contract that lowered our rates as volume on that network increased. A midyear dip in fuel prices also helped to reduce transportation costs.

CHANGE IN TRANSPORTATION EXPENSE

2004	2003	2002
-0.4%	-2.8%	1.5%

There is every indication that fuel prices will not significantly decrease in the near future. Since we cannot offset cost increases by charging our customers a fuel surcharge, we must control this expense growth through cost savings. We use approximately 800 million gallons of fuel (gasoline, diesel and jet fuel) each year to transport and deliver the mail. A one-cent increase in fuel prices for one year adds approximately $8 million to our expenses.

We have implemented, and are continuing to implement, a number of measures to control fuel expenditures. These efforts have focused on leveraging our size and buying power to obtain more favorable pricing by purchasing fuel in bulk. For example, we reduced our fuel cost for certain highway contract routes by 9.3 cents per gallon by consolidating our fuel purchases. We also purchase fuel in bulk through the Defense Energy Support Center wherever we have bulk facilities. In addition, as we continue our multiyear program to improve our information gathering systems, we have better data that allows us to make better decisions and to refine our network to respond more efficiently to changing demands.

AVIATION SECURITY

Bills intended to improve aviation security continued to be introduced in the second session of the 108th Congress. In particular, Representative Edward Markey introduced two aviation security bills that had significant implications for us, We deliver more than 312 million pieces of mail every day, handling 46% of the world's mail volume. Japan is second, with 6%.

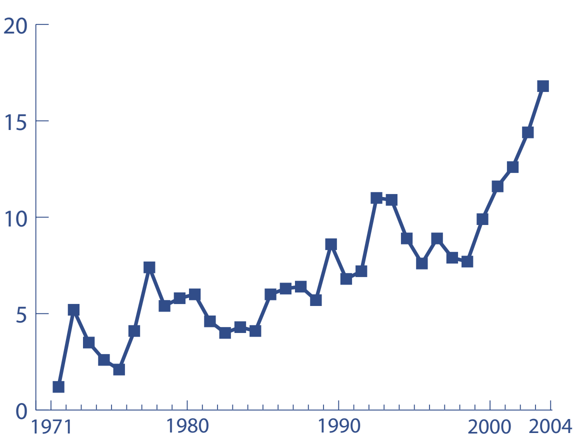
H.R. 3798 and H.R. 4312. Both bills would have required that cargo transported on passenger planes be screened or inspected using the same equipment, technology and personnel that are used to screen passenger baggage. H.R. 3798 would have also required "shippers" to pay fees to passenger airlines to cover the costs of additional screening. Our preliminary analysis suggests that we would be considered a shipper and would have to pay such fees if similar legislation is enacted in the future.

Productivity

We use two indicators to measure our efficiency. We use output per workhour which measures the change in the relationship between workload (mail volume and deliveries) and the labor resources used to do the work. We use total factor productivity (TFP) to measure the change in the relationship between outputs, or workload, and all the resources used in producing these outputs. Our main output is delivered mail and special services and carrier service to an expanding delivery network. TFP calculations include inputs for all resources including labor, materials, transportation and capital investments.

During 2004, our output per workhour grew by 2.4% and our TFP improved by 2.4%. This TFP growth is equivalent to $1.6 billion in expense reductions. This marks our fifth consecutive year of TFP growth, with equivalent expense reductions totaling over $6.1 billion over this time. By comparison, in 2003 our output per workhour was 2.3% and our TFP was 1.8%. Our productivity growth continues to be driven by substantial restraints on the resources we use to produce our outputs. We were able to achieve TFP growth with only a small increase in workload, in contrast to the years before 2001 when our TFP growth was fueled largely by managing an ever-increasing workload. We have instituted measures to ensure continued TFP growth. It is now our policy to develop an annual budget so that the net income target also yields positive and sustainable TFP growth.

TOTAL FACTOR PRODUCTIVITY CUMULATIVE % CHANGE



Capital Investments

The Board of Governors approves the budget for investments in capital property and equipment 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 49 Board-approved projects in progress, representing $6,609 million. During the year, the Board approved 21 new projects for $1,816 million and 21 projects were completed, representing $2,685 million.

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 $1,685 million in capital outlays for 2004 represents outlays for commitments made in previous years as well as commitments made in 2004 for all 49 projects.

Of the 49 active Board-approved projects at the close of the year, 24 were for mail processing equipment, 12 for facilities, and 13 for other projects such as retail equipment, vehicles and information infrastructure support.

Our total capital commitment plan for 2005 is $3.3 billion, with cash outlays planned at $2.0 billion, of which approximately $1.2 billion is for commitments made in prior years and the remaining $800 million for new commitments in 2005.

Future

Our capital plan for the future calls for developing and deploying new automation and mechanization equipment that will increase our operating efficiency. We will continue to maintain our infrastructure, including facilities, vehicles, and systems, as well as making return on investment projects. We will make investments in programs that reduce workhours in our distribution, processing and delivery operations. We have set our capital commitment plan at a level higher than 2004 to invest in programs that reduce workhours in our distribution, processing and delivery operations, such as Phase II of the Postal Automated Redirection System and the Optical Character Reader Enhancements for Letter Automation program. As we continue to focus on customer and employee safety, the Biohazard Detection System will be attached to the Advanced Facer-Canceller System and flats cancellers to detect potential biohazards.

financial review
Part II

Our facilities program will continue to address life, health, safety, and security issues. Our facility plan has increased as we invest in those facilities in our delivery system that we have placed on a priority list. With an annual average growth of approximately 1.8 million delivery points every year, we will maintain our infrastructure through high priority replacement projects and ongoing repair and alteration projects.

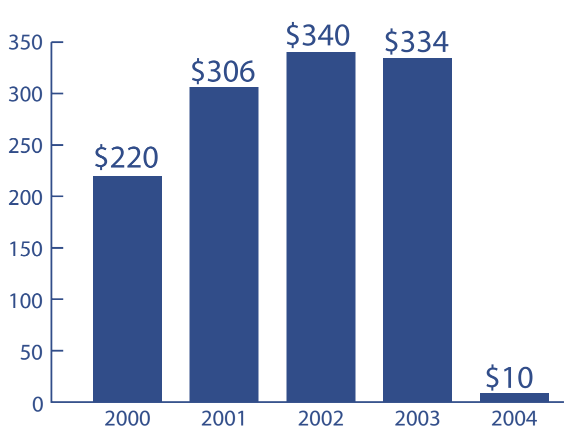
Finance

DEBT

Unlike other federal agencies, we receive no tax dollars for our operations. We are self-supporting, and have not received a public service appropriation since 1982. The last year that we received any substantial contribution of capital from the U.S. government was 1977, when we received $500 million that we were required to use to repay operating debt. Like any private sector organization, we fund our operations mostly from cash generated from operating revenue. However, unlike our private sector counterparts, we cannot raise capital through the equity markets, and because we are expected to break even over time, we are not expected to accumulate a substantial amount of retained earnings for extended periods to increase our capital. Consequently, our only source of outside capital is through issuing debt obligations. An additional challenge is that unlike the private sector we are not free to set our own prices for our products and services. For us, the rate setting process, which by law we must rely upon, is a complex and lengthy process that can take eighteen months to complete. As a result, we cannot easily adjust our revenue stream to react to changing market conditions.

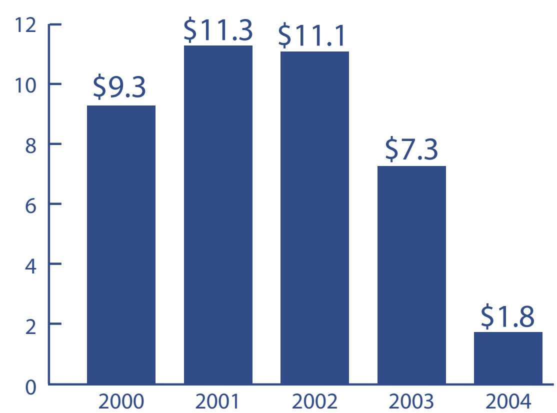
The amount we borrow is largely determined by the difference between our cash flow from operations and our capital cash outlays. Our capital cash outlays are the funds we invest back into the business for our capital investments in new facilities, new automation equipment and new services. From 1997 through 2002, our outlays for capital investment exceeded cash from operations by $5.4 billion, so we covered most of the difference with borrowed funds. From the end of 1997 to the end of 2002, our debt outstanding with the Department of the Treasury's Federal Financing Bank increased from $5.9 billion to $11.1 billion. In 2003 we reduced our debt by $3.8 billion to $7.3 billion and in 2004 by $5.5 billion to $1.8 billion, our lowest level of debt since 1984.

OTHER INTEREST EXPENSE (Dollars in millions)



The enactment of P. L.108-18 in 2003 dramatically increased our cash flow by $6.2 billion over two years. However, under this law, we are required to apply the savings attributable to the law to debt reduction in those two years. The required debt reduction amounted to $3.5 billion in 2003 and an additional $2.7 billion in 2004.

DEBT AT YEAR END (Dollars in billions)



In 2003, we completely overhauled our debt portfolio, paying off all of our long-term debt obligations and replacing most of them with short-term debt that would be available for retirement during the course of 2004. As a result of the overhaul, we benefited from both lower interest rates on short-term debt and the flexibility to repay debt with available cash on a daily basis. A major benefit was the reduction in our interest expense payable to the Federal Financing Bank. Reflecting this change, other interest expense, net of capitalized interest, was $10 million in 2004, the lowest since 1972, versus $334 million in 2003, and $340 million in 2002. The 2003 debt transactions also provided us with the flexibility to pay off substantially more debt in 2004, $5.5 billion, than the estimated $2.7 billion required by the statute, without concerns for paying a prepayment premium. Finally, because we expect our interest earnings on investments to exceed the interest expense on our debt for 2005, we will benefit from any rise in short term-interest rates.

On average, every one of our 54,769 mail handlers moved 3.7 million pieces of mail in 2004.

Our opportunity for debt reduction in 2005 will depend upon our ability to operate at close to break even, combined with our ability to control our level of capital investment. Our debt level 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 P.L.108-18, which requires that savings attributable to the legislation after 2005 must be held in escrow and can not be obligated or expended until otherwise provided for by law. An additional factor that will affect our 2006 debt level is the uncertain result of any rate case filings with the Postal Rate Commission. In the event that we implement a rate increase and the resulting additional revenues do not cover both the normal projected increases in expenses and also the escrow requirement, then the shortfall will need to be covered by increasing debt, all else remaining constant.

INTEREST EARNING INVESTMENTS

Whenever we determine that we have funds in excess of our current needs, we invest those funds with the U.S. Treasury's Bureau of Public Debt. We invest primarily in overnight securities issued by the U.S. Treasury, but by statute we may invest in any obligation of, or any obligation guaranteed by, the U.S. government, through the Secretary of the Treasury. We favor short-term investments because of the nature of our cash flow patterns, but also to ensure that our investments are not unnecessarily exposed to the price risk associated with increases in interest rates. Investment income was $33 million in 2004, versus $58 million in 2003 and $46 million in 2002.

Cash Flow

NET CASH PROVIDED BY OPERATING ACTIVITIES

During 2004, net cash provided by operating activities was $5.8 billion compared with $6.4 billion in 2003. The decrease of $570 million was due primarily to increased operating expenses resulting from higher benefit costs. The main driver of these benefit increases was a $697 million (11.9%) increase in retirement costs mainly as a result of a full year of funding CSRS retirement contributions at 17.4% as required by P.L.108-18 and a $180 million (15.9%) increase in retiree health benefit costs. These increases were offset by an additional $247 million in accrued payroll and benefit expenses caused by one additional day of accrued payroll at year end.

During 2003, net cash provided by operating activities was $5 billion higher than 2002 mainly due to P.L.108-18 which decreased our pension payments by $3.5 billion.

NET CASH USED IN INVESTING ACTIVITIES

During 2004, 2003 and 2002, net cash used in investing activities was $1.7 billion, $1.3 billion and $1.7 billion respectively. The increase in 2004 from 2003 reflects an increased investment strategy in mail processing and retail equipment as well as increased funds spent on building improvements. The 2003 decrease reflects a reduction of spending on mail processing equipment, building construction and building improvements.

NET CASH USED IN FINANCING ACTIVITIES

In both 2004 and 2003 the net cash used in financing activities of $5.6 billion and $4.0 billion respectively, reflect our desire, and the requirement of P.L.108-18, that any "savings" generated by the enactment of the law be used to pay down debt. Consequently in 2004 we paid down $5.5 billion in debt and in 2003 we paid down a net $3.8 billion in debt. In 2002 the $383 million of cash provided by financing activities reflects the balance of appropriations provided by the President and Congress for emergency preparedness expenses of $583 million and a reduction of debt of $200 million.

Liquidity

Liquidity is the cash that we have in the bank (the Postal Service Fund in the U.S. Treasury) and the amount of money we can borrow on short notice if needed. In recent years we have relied less on the cash we have on hand and more on the readily available cash we can borrow as needed. Our Note Purchase Agreement with the Federal Financing Bank, renewed this year, provides for revolving credit lines of $4 billion. These credit lines enable us to draw up to $3.4 billion with two days' notice and up to $600 million on the same business day 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. The notes provide us the flexibility to borrow short-term or long-term, using fixed or floating rate debt, and can be either callable or non-callable. We believe that our arrangement with the Federal Financing Bank provides us with adequate tools to effectively manage our interest expense and risk.

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 fiscal year cannot exceed $2 billion for capital purposes and $1 billion to defray operating expenses ($3 billion maximum annual limit). For 2005, we do not project an increase in debt, and we have not asked the Governors to authorize an increase.

Our liquidity will be comprised of the cash that we have entering 2005 plus the cash flow that we can generate from operations. We expect cash flow from operations to not only supply enough cash to fund our capital investments, but to generate some additional cash flow that could be applied to further debt reduction. However, the amount of cash and debt that we have at the end of 2005 will be influenced by developments regarding the escrow fund requirement and a potential rate case. A less than favorable outcome for these uncertainties would cause us to favor carrying more cash and debt into 2006 as a liquidity cushion.

Other Developments

TRANSFORMATION PLAN

In April 2002, we submitted to the President of the United States and Congress our *Transformation Plan* that analyzes both the challenges facing the Postal Service and the future viability of the institution. Since that time, the *Transformation Plan* has served as the blueprint for every aspect of our business. This blueprint has focused on what we can do in the near-term, without legislative reform, to fulfill our legislative mandate to "bind the Nation together through the personal, educational, literary, and business correspondence of the people."

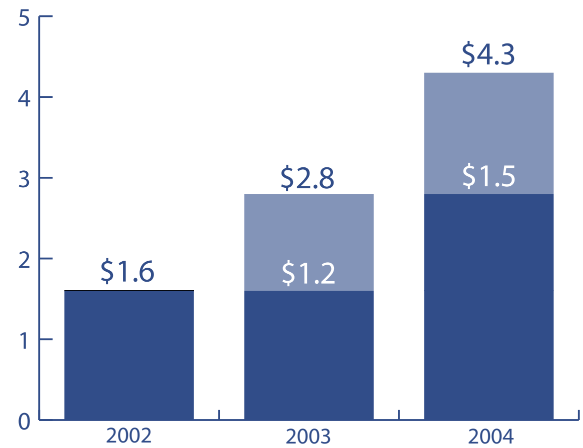
The transformation strategies have helped us achieve our transformation goals: foster growth through customer value, increase operational efficiency, move toward a performance-based culture, and restructure enabling functions. The success of transformation is visible today throughout our organization. We have completed some strategies identified in the 2002 Plan. We are continuing to integrate some strategies into our normal organizational processes and procedures, while we have discontinued a few after analyzing them.

We are on track to meet and perhaps even exceed our $5 billion savings commitment we made in the 2002 *Transformation Plan*. Through 2004 the estimated incremental annual savings are $4.3 billion. Cumulatively, that equates to $8.7 billion for the first three years of the *Transformation Plan*. At the same time, we have achieved record-breaking service nationwide and historically high employee satisfaction scores on Voice of the Employee surveys. Enhancements to core products and services helped mitigate the decline in revenue associated with the loss of First-Class Mail volume. In addition, the Postal Service has reduced its outstanding debt from $11.3 billion at the end of 2001 to $1.8 billion at the end of 2004.These transformation achievements, along with five years of increased productivity, have allowed mailers to enjoy rate stability since June 2002. Transformation of the Postal Service is succeeding and will continue to drive further improvements.

EVOLUTIONARY NETWORK DEVELOPMENT

In our mission to provide universal mail service, we manage one of the largest and most complex logistics networks in the world. As we have worked to meet the demands of a growing nation, our network has grown and evolved into a structure based on a mixture of factors, such as the mail class and the shape of the pieces of mail. Today we face relatively stagnant overall mail volume with the volumes of some classes of mail increasing while others decrease.

TRANSFORMATION PLAN
INCREMENTAL ANNUAL SAVINGS (Dollars in billions)



In response, we have developed what we call an Evolutionary Network Development (END) process with which we will respond to the challenges of declining mail volumes, aging infrastructure, network redundancies and operating inefficiencies. END will enable us to create a flexible logistics network that reduces our costs, increases overall operational effectiveness, and improves consistency of service. Through END, we can bring postal management, mailers, and industry experts together to improve network operations by locating and eliminating inefficiencies in our systems and processes, as well as find new ways to improve our services.

The END initiative is one of the core sub-strategies in our *Transformation Plan*. It is an investment in developing a network optimization infrastructure that will enable us to keep our mail processing and transportation networks efficient and our systems affordable.

Outlook

We believe the 2005 economic environment will be relatively favorable, with growth in economic output and aggregate demand, and moderate inflation. Also, 2005 will be the third year since the last increase in postal prices. Led by Standard Mail, we expect total mail volume to grow about 1%. But despite favorable economic circumstances, we project First-Class Mail volume will continue to decline.

In 2004 we delivered to 1.8 million new addresses. That's like adding two cities, one the size of Philadelphia and one the size of Boston to our delivery system.

Mail volume is positively affected by economic growth. After a period of relative stagnation following the recession of 2001, economic growth picked up in 2003 and 2004, leading to 4.5% growth in the gross domestic product (GDP) for 2004, as projected by Global Insight Inc. We relied on Global Insight's August 2004 projection, which was the latest available when our 2005 Integrated Financial Plan was developed. Based on Global Insight's forecast, we expect GDP growth to moderate to an annualized rate of 3.5% in 2005.

Economy-wide retail sales, an economic indicator for Standard Mail and workshare First-Class Mail, grew 5.1% in 2004, but is expected to slacken, as a result of increased energy prices and interest rates. Increased energy prices are diverting consumer expenditures from other goods and services, and higher interest rates will dampen demand for mortgage refinancing and reduce the amount of cash consumers have available for large purchases. In addition, the stimulus from federal income tax cuts in 2003 caused a spike in retail sales during 2004 that will not be repeated in 2005. The projected 2005 retail sales slowdown leads us to project a lower growth rate for Standard Mail volume and to project a small volume decline in workshare First-Class Mail.

Employment is an indicator for our single-piece First-Class Mail volume. For many years now single-piece volume has declined. The moderate growth projected in employment by Global Insight is not sufficient to drive volume increases that overcome the negative impacts of electronic diversion.

Looking at single and workshare First-Class Mail volume together, we can see that economic growth has only attenuated the declines in First-Class Mail volume and revenue. We do not foresee a reversal of the multiyear downward trend in total First-Class Mail volume.

We also expect Priority Mail volume to decline slightly due to continued changes in the structure and competitive nature of the package services market. We think that Express Mail volume will stabilize after four years of decline because of higher prices charged by our competitors and the improvements we have made in this service. On the other hand, technological and demographic changes continue to cause declines in Periodicals. The growth we project in Package Services is based on projected increases in both Bound Printed Matter and Media Mail volumes, even though we expect a decline in Parcel Post.

While mail volume should grow in 2005, we have planned for revenues to fall. Total revenue in 2005 could be $700 million less than 2004 as we continue to lose our higher-revenue-and-contribution mail. As this mail declines, our margins are reduced, resulting in pressure on postal prices over and above the effect of inflation.

Network Growth

Historically, First-Class Mail volume and the growth in contribution it has produced have financed the cost of operating and expanding our delivery network. Over the last several years, however, the volume of First-Class Mail has declined while the number of delivery points in our network has continued to increase. Since 2001, First-Class Mail volume has decreased by over 5.7 billion pieces while our delivery network has expanded through the addition of 4.6 million new delivery points. Furthermore, we operate a retail network anchored by 37,159 Post Offices, stations, branches and contract units.

Delivering mail to individual delivery points six days a week is a major part of our work. Each year, we add between 1.6 million and 1.9 million delivery points to our network. From 2000 through 2004, the number of delivery points we serve has grown by 6.4 million. In 2004, we adjusted our reporting of rural and highway contract deliveries to customers who have their mail forwarded to a Post Office box as an alternative to a physical address. Prior to 2004 we included both addresses in our count of "possible" delivery points. We also no longer count a vacant delivery point on rural and highway routes as "possible" delivery points. These adjustments reduced our total delivery points by 824,388, and we have therefore adjusted our 2004 Operating Statistics in this report to reflect this change. Our actual growth in delivery points in 2004 was 1,782,900. We do not have the data to adjust the number of delivery points we reported for prior years.

We expect delivery point growth to continue for the indefinite future as a result of population growth and continuing demand for new housing. The Bureau of the Census reported housing starts in August 2004 at a seasonally adjusted rate of 2.0 million, up from 1.8 million in 2003. Also, Harvard University's Joint Center for Housing Studies reported that "household growth over the next ten years is expected to surpass that over the last ten years" and estimated "the total number of homes built in 2005–2015 could reach 18.5–19.5 million units" which "compares to the 16.4 million homes added in the 1990s."

This projected increase in household growth will translate into a continuing expansion of our delivery network. In the same period, First-Class Mail volume is projected to continue to decline. As the revenue and contribution produced by First-Class Mail decline, we will lose our primary historic means of financing our delivery and retail networks. This combination of trends will continue to challenge us at least through the next decade.

This challenge is best illustrated by the dramatic changes in the business environment we have witnessed in recent years. From 1997 to 2000, volume growth added $5.5 billion in annual revenues. From 2001 through 2003, declines in our volume reduced our revenues. In 2004, our volume and revenue increased only slightly. However, from 1996 to 2003, our delivery network grew by 12.1 million carrier delivery points, about 1.7 million a year.

Impact of Inflation and Changing Prices

The Postal Reorganization Act requires that the Postal Service provide universal mail service and operate on a financial breakeven basis. Therefore, the prices we charge in the form of postage rates and fees must, over time, reflect the changes in the cost and quantity of resources needed to effectively operate our business. The primary input resources are labor and the related cost of benefits, energy costs that impact the cost of transportation and utilities, material costs, and the cost of maintaining, replacing and expanding our distribution network.

We have maintained stable prices since the implementation of the last omnibus rate case recommendation in the summer of 2002, and we have committed to maintaining stable prices until 2006. We have achieved rate stability through continuous productivity improvement and from the benefit of reduced CSRS retirement costs of P.L.108-18. We plan to continue mitigating inflationary pressure with $1.4 billion of cost reductions planned for 2005. But these productivity improvements alone will not offset the continuing upward cost pressures resulting from resource cost inflation, the continuous expansion of our delivery network, or the loss of First-Class Mail volume and its high level of contribution to institutional costs. Also, we recognize that P.L.108-18 "savings" will be lost in 2006.

Expense Growth

We estimate that total expenses in 2005 will be $68.5 billion, a 3.9% increase over our 2004 expenses of $65.9 billion. We expect personnel costs, including contractual pay increases, employee benefits, and retiree benefits, to increase by $1.7 billion, or 3.2%. This increase will be driven by increased workload due to our expanding delivery network.This increase will also be driven by higher cost-of-living pay adjustments and health insurance premiums, coupled with an increase in our contributions to the Federal Employees Retirement System (FERS) from 10.7% of each FERS employee's salary to 11.2% as required by law.

We expect non-personnel costs excluding transportation expenses to increase approximately $600 million, or 6.9%, because of investments in programs to promote use of postal products, updates to and improvement of information technology capabilities, and improvements to customer access and service. Transportation costs will grow $150 million, or 3.0%, because of higher fuel costs and the impact of revised Department of Transportation requirements limiting the number of consecutive hours that drivers may spend behind the wheel.

Our 2005 projected expenses reflect cost reductions of $1.4 billion and include our plan to reduce workhours by 23 million. This workhour reduction is the equivalent of more than 10,000 full-time positions, even as we deliver mail to a projected additional 1.6 million new addresses. Without these cost reductions, our 2005 expenses would increase 5.9% instead of 3.9%. From 1971 through 1999 we had annual expense growth of less than 4.0% only three times. We expect that 2005 will be the fifth year out of the last six that expense growth will be less than 4.0%.

Item 7A. Quantitative and qualitative disclosures about market risk

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 on the following page, we do not use derivative financial instruments to manage market risks. Additionally, we do not purchase or hold derivative financial instruments for speculative purposes.

General Inflation Risk

Each of our labor contracts with our largest unions includes provisions granting cost-of-living allowances (COLAs). COLAs are generally granted semi-annually and are linked to increases in the consumer price index (CPI). Nonbargaining employees do not receive COLAs. Because employee compensation represents a significant portion of our annual expenses, an increase in the CPI greater than had been incorporated into our financial plans could be a significant risk to our financial results. We estimate that an increase in the CPI of 0.5% would cause an annualized increase in our COLAs of about $100 million.

Each of our 290,902 letter carriers delivered an average of 43.46 tons of mail in 2004. That's equivalent to carrying almost 11 average-size male elephants.

Commodity Price Risk

We estimate that we purchase approximately 800 million gallons of fuel each year, thus fuel prices are a significant part of our expenses.

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 accounted for based on International Monetary Fund special drawing rights (SDR). The SDR exchange rate fluctuates daily based on a basket of currencies comprised of the euro, the 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. The actual currency used to settle accounts varies by country based on individual agreements.

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.

At year end, we adjust the reported receivable and payable balances to reflect the fair value based on the SDR rate published in the *Wall Street Journal* on the last day of September. This resulted in a $10 million gain from the revaluation in 2004 compared to a loss of $9 million in 2003. We do not use derivative financial instruments to manage the risk of changes in the value of the SDR.

Interest Rate Risk

As described in note 5 to the financial statements, we refinanced all 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.

We estimate that a 1% increase in interest rates would have an insignificant impact on our interest expense due to the structure of our debt portfolio. A 1% increase in interest rates would increase investment income by $15 million.

Item 8. Financial statements

Financial statements are on pages 39–51 of this report.

Item 9. Changes in and disagreements with accountants on accounting and financial disclosure

None.

Item 9A. Controls and procedures

Management is responsible for the preparation, integrity, and fair presentation of the financial statements of the Postal Service.

We maintain a system of internal control over financial reporting that is designed to provide reasonable assurance that transactions are executed as authorized and accurately recorded, that assets are safeguarded, and accounting records are sufficiently reliable to permit the preparation of financial statements that conform with accounting principles generally accepted in the United States. We maintain disclosure controls and procedures designed to ensure that information to be disclosed by us is recorded, processed, summarized, and reported within the time periods specified by our Board of Governors and the Office of Management and Budget. We are monitoring our internal controls over financial reporting and disclosure controls and procedures through internal self-assessments.

Code of Ethics

The Standards of Ethical Conduct for Employees of the Executive Branch at 5 Code of Federal Regulations (C.F.R.) §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 C.F.R. §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 internal ethics officials, and we publicize an ethics telephone line and e-mail address they can use for this purpose.

financial review

Part III

Item 10. Directors and executive officers
Stated on pages 12–13.

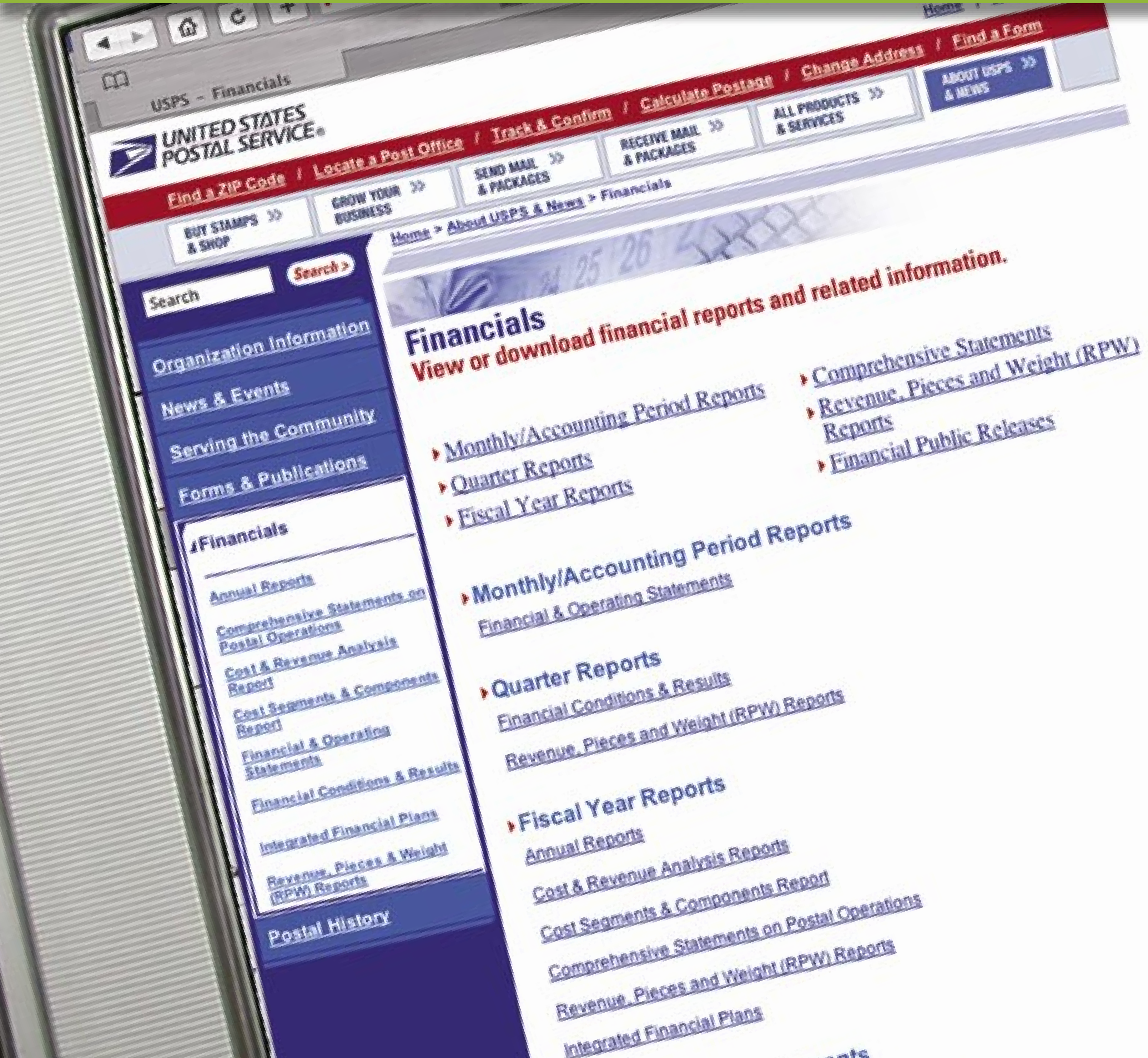
Item 11. Executive compensation
The Postal Service releases information concerning executive compensation to the extent required by the Freedom of Information Act (FOIA), 5 United States Code (U.S.C.) 552. Postal Service regulations implementing the FOIA are located at 39 C.F.R. 265. Information regarding how to submit a FOIA request can be found on our website *usps.com.*

Item 12. Security ownership of certain beneficial owners and management related stockholder matters
Not applicable to this report.

Item 13. Certain relationships and related transactions
As discussed in item 9A, every Postal Service officer, manager, and employee is required to comply with the Standards of Ethical Conduct for Employees of the Executive Branch and by the Supplemental Standards of Ethical Conduct for Employees of the United States Postal Service.

Item 14. Principal accountant fees and services
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 of 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.

Postal financial data can be easily viewed on usps.com



Report of Independent Auditors

Board of Governors
United States Postal Service

We have audited the accompanying balance sheets of the United States Postal Service as of September 30, 2004 and 2003, 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, 2004. 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 as of September 30, 2004 and 2003 and the results of its operations and its cash flows for each of the three years in the period ended September 30, 2004 in conformity with accounting principles generally accepted in the United States.

In accordance with *Government Auditing Standards,* we have also issued our report dated November 10, 2004 on our consideration of the United States Postal Service's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Ernst + Young LLP

McLean, VA
November 10, 2004

statements of operations

(Dollars in millions)	Year ended September 30, 2004	2003	2002
Operating revenue	**$68,996**	$68,529	$66,463
Operating expenses:			
Compensation and benefits	**52,134**	50,428	51,557
Transportation	**4,969**	4,989	5,132
Other	**8,748**	8,485	8,545
Total operating expenses	**65,851**	63,902	65,234
Income from operations	**3,145**	4,627	1,229
Interest and investment income	**33**	58	46
Interest expense on deferred retirement obligations	**(103)**	(116)	(1,601)
Other interest expense	**(10)**	(334)	(340)
Debt repurchase expense	-	(360)	-
Emergency preparedness appropriations	-	177	179
Emergency preparedness expenses	-	(184)	(189)
Net income (loss)	**$ 3,065**	$ 3,868	$ (676)

See accompanying notes to financial statements.

balance sheets

(Dollars in millions)	September 30, 2004	2003
Assets		
Current Assets:		
Cash and cash equivalents	$ 877	$ 2,266
Receivables:		
Foreign countries	621	744
U.S. government	327	359
Consignment	48	50
Other	139	144
Receivables before allowances	1,135	1,297
Less allowances	111	106
Total receivables, net	1,024	1,191
Supplies, advances and prepayments	220	366
Total Current Assets	2,121	3,823
Other Assets, Principally Revenue Forgone Appropriations Receivable	361	365
Property and Equipment, at Cost:		
Buildings	20,171	19,759
Equipment	17,277	17,166
Land	2,810	2,809
Leasehold improvements	1,103	1,060
	41,361	40,794
Less allowances for depreciation and amortization	20,656	18,717
	20,705	22,077
Construction in progress	1,792	977
Total Property and Equipment, Net	22,497	23,054
Total Assets	$24,979	$27,242

See accompanying notes to financial statements.

(Dollars in millions)	September 30, 2004	2003
Liabilities and Net Capital		
Current Liabilities:		
Compensation and benefits	$ 2,640	$ 2,518
Estimated prepaid postage	1,256	1,349
Payables and accrued expenses:		
Commercial vendors and accrued expenses	1,739	2,146
Foreign countries	778	879
U.S. government	87	83
Total payables and accrued expenses	2,604	3,108
Customer deposit accounts	1,606	1,566
Outstanding postal money orders	767	768
Prepaid box rentals and other deferred revenue	397	387
Debt	1,800	7,273
Total Current Liabilities	11,070	16,969
Non-Current Liabilities:		
Workers' compensation costs	6,651	6,324
Employees' accumulated leave	2,006	1,932
Other	1,321	1,151
Total Non-Current Liabilities	9,978	9,407
Total Liabilities	21,048	26,376
Net Capital:		
Capital contributions of the U.S. government	3,034	3,034
Retained earnings (deficit) since reorganization	897	(2,168)
Total Net Capital	3,931	866
Total Liabilities and Net Capital	$24,979	$27,242

See accompanying notes to financial statements.

statements of changes in net capital (deficiency)

Year ended September 30, 2004, 2003 and 2002

(Dollars in millions)	Capital Contributions of U.S. Government	Retained Earnings (Deficit) Since Reorganization	Total Net Capital (Deficiency)
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
Net income	-	3,065	3,065
Balance, September 30, 2004	**$3,034**	**$ 897**	**$ 3,931**

See accompanying notes to financial statements.

statements of cash flows

(Dollars in millions)	2004	2003	2002
	Year ended September 30,		
Cash flows from operating activities:			
Net income (loss)	**$3,065**	$3,868	$ (676)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	**2,145**	2,295	2,296
Loss on disposals of property and equipment, net	**71**	64	6
Decrease in other assets, principally revenue forgone appropriations receivable	**4**	3	4
Increase in workers' compensation liability	**343**	526	734
Increase (decrease) in employees' accumulated leave	**74**	(156)	(36)
Increase (decrease) in other non-current liabilities	**170**	(31)	196
Changes in current assets and liabilities:			
Decrease (increase) in receivables, net	**167**	(394)	(189)
Decrease (increase) in supplies, advances and prepayments	**146**	(39)	(7)
Increase (decrease) in compensation and benefits	**106**	(427)	(877)
Decrease in estimated prepaid postage	**(93)**	(151)	(123)
(Decrease) increase in payables and accrued expenses	**(412)**	1,201	(80)
Increase (decrease) in customer deposit accounts	**40**	(138)	145
Decrease in outstanding postal money orders	**(1)**	(218)	(2)
Increase in prepaid box rent and other deferred revenue	**10**	2	52
Net cash provided by operating activities	**5,835**	6,405	1,443
Cash flows from investing activities:			
Purchase of property and equipment	**(1,685)**	(1,314)	(1,705)
Proceeds from sale of property and equipment	**26**	37	30
Net cash used in investing activities	**(1,659)**	(1,277)	(1,675)
Cash flows from financing activities:			
U.S. government appropriations - Received	**—**	—	762
U.S. government appropriations - Expended	**(92)**	(177)	(179)
Issuance of debt	**—**	4,609	2,700
Payments on debt	**(5,473)**	(8,450)	(2,900)
Net cash (used in) provided by financing activities	**(5,565)**	(4,018)	383
Net (decrease) increase in cash and cash equivalents	**(1,389)**	1,110	151
Cash and cash equivalents at beginning of year	**2,266**	1,156	1,005
Cash and cash equivalents at end of year	**$ 877**	$2,266	$1,156

See accompanying notes to financial statements.

Notes to the financial statements

Note 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 undue discrimination among its many customers. This means that within each class of mail our price does not unreasonably vary by customer for the levels of service we provide. This fulfills our legal mandate to offer universal services at a fair and uniform price. Our primary lines of business are First-Class Mail, Standard Mail, Express 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, stations and branches, contract postal units and a large network of consignees. 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, 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, 2005, and November 20, 2006.

By law, we also consult with management organizations representing most of the employees not covered by collective bargaining agreements. These consultations provide an opportunity to participate directly in the planning, development, and implementation of programs and policies affecting the managerial employees in the field. The management organizations include the National Association of Postal Supervisors, National League of Postmasters, and National Association of Postmasters of the United States. We participate in federal employee benefit programs covering retirement, health benefits, and workers' compensation.

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 ratemaking process provides for the recovery of financial losses through future rate increases.

Note 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 make estimates and assumptions that affect the amounts we report in the financial statements and notes. Actual results may differ from our estimates.

Cash and 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, the 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 impact on the statement of operations from this revaluation was a gain of $10 million in 2004, a loss of $9 million in 2003, and a loss of $7 million in 2002. 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 $15 million in 2004, $12 million in 2003 and $7 million in 2002.

Supplies, Advances and Prepayments

Supplies, advances and prepayments are primarily composed of our inventories of supplies, motor vehicle parts and parts for mail processing equipment. We value our inventories at the lower of average cost or current market price. Total inventories amounted to $118 million at the end of 2004 and $123 million at the end of 2003.

Property and Equipment

We record property and equipment at what it cost 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 $5 million in 2004, $1 million in 2003, and $23 million in 2002. Repairs and maintenance are charged to expense as incurred. This expense amounted to $744 million in 2004, $692 million in 2003 and $577 million in 2002.

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 Statement of Financial Accounting Standards (FAS) 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. In 2004 it was determined that an unused Post Office building in a major city was impaired. A contract granting a prospective buyer an option to buy this building has been signed. This option is contingent on the Postal Service making all necessary repairs to the building. An impairment loss of $24 million was recorded in 2004 in order to reduce the carrying value of the property to its estimated fair value, including the cost of necessary repairs. No material impairments were recorded in 2003 or 2002.

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

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

Segment Information

We operate in one segment throughout the United States and internationally. Our international operations are not significant.

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 type relationship. We account for our participation in the U.S. government sponsored retirement plans as a participant in a multi-employer plan arrangement in accordance with FAS 87, *Employers' Accounting For Pension Costs.* See notes 6 and 7 for additional information.

Notes to the financial statements

Retiree Health Benefits

We are required to pay a portion of the health insurance premiums of those retirees and their survivors who participate in the Federal Employees Health Benefits Program (FEHBP). We account for our participation in FEHBP as a participant in a multi-employer plan arrangement in accordance with FAS 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions.* Therefore, the costs of retiree health benefits are expensed as we incur them. See note 4 for additional information.

Workers' Compensation Costs

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

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 2004. 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. In our calculation of present value, a net discount rate of -0.8% for medical expenses and 3.3% for compensation claims is used. During 2004 we changed these discount rates in order to more accurately reflect our liability. 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 established a liability. In 2002 and 2003 we recognized these funds as non-operating revenue to the extent of the qualifying non-operating expenditure. Beginning in 2004 we are recognizing these funds as operating revenue to the extent they offset operating expenses. Appropriations utilized to purchase capital equipment will be offset against depreciation expense over the life of the equipment. See note 11 for additional information.

Reclassifications

Certain comparative prior year amounts in the financial statements and accompanying notes have been reclassified to conform to the current year presentation. These reclassifications had no effect on previously reported operating income and net income.

Note 3 - workers' compensation

At the end of 2004, we estimate our total liability for future workers' compensation costs at $7,579 million. At the end of 2003 this liability was $7,236 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. An increase of 1% in the assumptions would decrease our estimate of the liability by approximately $650 million. A decrease of 1% would increase our estimate of the liability by approximately $790 million.

In 2004, we recorded $1,239 million in workers' compensation expense, compared to the $1,473 million we recorded in 2003 and the $1,524 million we recorded in 2002.

In 2004, we changed the net discount rates used to determine the present value of estimated future workers' compensation payments, in consultation with an independent actuary. Our net discount rate is the estimated difference between what we expect to earn on investments compared to what we assume the inflation rate will be for medical costs and wage increases. Our net discount rate of -0.8% for medical claims means that our assumptions show that the average rate of inflation for medical claims (5.5%) will exceed our investment returns (4.7%) by 0.8% per year over the expected life of the medical claims. Conversely we believe that our assumed investment returns (5.5%) will exceed the rate of inflation on the consumer wages index (2.2%) by 3.3% over the expected life of the compensation claims.

The reduction in the medical claims net discount rate from 1.4% to -0.8% resulted in an increase in the medical claims liability and expense of $362 million. The compensation claims net discount rate was increased from 3.0% to 3.3%, thereby reducing the liability and expense by $148 million. The combined changes increased the total workers' compensation liability and expense by $214 million. The effect of the adoption of these changes is accounted for as a change in accounting estimate.

In addition to the cost of workers' compensation claims, OWCP charges us an administrative fee for processing claims. In 2004, the administrative fee was $44 million, compared to $45 million in 2003 and $37 million in 2002.

Note 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 16.7% of the cost in 2004, 2003 and 2002, 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 retiree health benefits as a participant in a multi-employer plan arrangement in accordance with FAS 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions.* Our annuitant health benefit expenses amounted to $1,313 million in 2004, $1,133 million in 2003 and $987 million in 2002. We include these costs in our compensation and benefits expense.

Note 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.

Cash outlays for interest (including the supplemental retirement obligations) were $242 million in 2004, $426 million in 2003 and $339 million in 2002.

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 was $1,800 million in 2004 and $7,283 million in 2003. Debt consists of $1,800 million in cash drawn on our line of credit with the FFB.

Our Note Purchase Agreements with the Federal Financing Bank, renewed this year, provide 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 these agreements we can also use a series of other notes with varying provisions to draw upon with two days' notice. The notes provide us the flexibility to borrow short-term or long-term, using fixed or floating rate debt, and can be either callable or non-callable.

Our Debt Consists of the following

(Dollars in millions)

Interest Rate %	Terms*	September 30, 2004	2003
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
1.731**	Short-term, floating rate, revolving credit facility, final maturity date of May 6, 2005	1,800	3,273
		$1,800	$7,273

* All debt repurchasable at any time at a price determined by the current FFB rates.
** Weighted average interest rate; prior year's interest rate was 1.026%.

Note 6 - retirement programs

Our employees, retirees and their survivors participate in a pension program of the U.S. government. We account for our involvement in these programs as participation in a multi-employer plan arrangement, in accordance with 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.

Notes to the financial statements

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 toward which we and the employee contribute. We do not match contributions to the Thrift Savings Plan for employees who participate in the CSRS.

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

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, which consists of a basic annuity and Social Security. We and the employee contribute to Social Security and the basic annuity at the rate prescribed by law. We do not match contributions to the Thrift Savings Plan for employees who participate in the Dual System.

Federal Employees Retirement System (FERS)

Effective January 1, 1987, officers and career employees hired since December 31, 1983, except for those covered by the Dual System, are covered by the Federal Employees Retirement System Act of 1986. In addition, employees hired before January 1, 1984, could choose during certain periods in 1987, 1988 and 1998 to participate in the FERS. This system consists of Social Security, a basic annuity plan, and a Thrift Savings Plan. We and the employee contribute to Social Security and the basic annuity plan at the rate prescribed by law. In addition, we are required to contribute to the Thrift Savings Plan a minimum of 1% per year of the basic pay of employees covered by this system. We also match a voluntary employee contribution up to 3% of the employee's basic pay, and 50% of a contribution between 3% and 5% of basic pay.

Employer and employee base contributions, as a percentage of employee basic pay, are as follows for each of the three plans for 2004, 2003 and 2002:

	2004	2003	2002
CSRS			
Employer	**17.4**	17.4*	7.0
Employee	**7.0**	7.0	7.0
Dual CSRS			
Employer	**18.0**	18.0*	7.0
Employee	**0.8**	0.8	0.8
FERS			
Employer	**10.7**	10.7	10.7
Employee	**0.8**	0.8	0.8

* As of May 2003, P.L.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 2004, 2003 and 2002 is as follows:

	2004	2003	2002
CSRS	**188,670**	211,913	230,632
Dual CSRS	**9,238**	10,122	10,828
FERS	**509,577**	505,728	510,237

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.

Our retirement expense payment in 2002 under the CSRS as a result of basic pay increases was $1,393 million plus interest of $1,242 million.

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 P.L.108-18 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.

Our retirement expense payment in 2002 for our retirees' COLAs was $879 million plus interest of $359 million.

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 2004, 2003 and 2002.

(Dollars in millions)	2004	2003	2002
CSRS	**$1,641**	$1,128	$ 740
FERS	**2,255**	2,172	2,121
FERS — Thrift Savings Plan	**877**	856	827
Dual CSRS	**76**	52	33
Social Security	**1,610**	1,544	1,511
Accrued Postal Supplemental Liability+	**12**	9	-
Interest expense on supplemental liability+	**103**	116	-
Amortization of deferred cost*:			
CSRS	-	-	1,393
Annuitant COLAs	-	-	879
Interest expense on deferred liabilities	-	-	1,601
Total retirement expense	**$6,574**	$5,877	$9,105

* Eliminated by P.L.108-18

\+ Required by P.L.108-18

Employer cash contributions to retirement plans were $4,827 million in 2004, $4,031 million in 2003 and $6,013 million in 2002. These amounts do not include Social Security contributions and interest expense on deferred retirement liabilities.

Note 7 – The Postal Civil Service Retirement System Funding Reform Act of 2003 — P.L.108-18

On April 23, 2003, the President signed into law the Postal Civil Service Retirement System Funding Reform Act of 2003 — P.L.108-18, which changed the way we contribute to the CSRS retirement plan. Although the law changed the funding of the plan, we 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.

We are required by P.L.108-18 to pay an additional annual amount, if necessary, each September, beginning in 2004, as determined by OPM. The additional amount is based on a calculation of any potential "supplemental liability", if one exists. The "supplemental liability", represents the excess of the actuarial present value of future benefits over the actuarial present value of plan assets, future contributions, earnings, and other actuarial factors related to postal participants in the CSRS plan.

During 2004, OPM estimated the present value of benefits at $191.1 billion, contributions at $15.9 billion, and plan assets at $171.7 billion. This resulted in a "supplemental liability" of $3.5 billion as of September 2003. This calculation assumed general salary increases of 4.0%, COLAs of 3.25% and interest of 6.25%, and is intended to provide for the "supplemental liability" over a 40-year period ending in September 30, 2043. Under the law OPM is not required to furnish the final actuarial calculation of the September 30, 2004, liability until June 30, 2005. OPM's calculation of the September 30, 2004, "supplemental liability" payment was $240 million.

OPM will recalculate the "supplemental liability", if any, on an annual basis. Each September 30, we will make any required payment resulting from this calculation.

Because the law went into effect in May 2003, we estimated the portion of the amount payable on September 30, 2004, attributable to 2003 and expensed that amount in 2003. This amounted to $125 million, of which $116 million was included as interest expense on our 2003 income statement. The 2004 portion of the supplemental retirement obligation was $115 million, of which $103 million is included as interest expense.

Note 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 appropriates money to reimburse us for the revenue that we have forgone in providing these services. We have included as operating revenue the amounts appropriated by Congress for revenue forgone of $36 million for 2004, $31 million for 2003 and $48 million for 2002. Legislation enacted in 2003 and 2002 delayed payment of the amount authorized for 2004 and 2003 until the first day of 2005 and 2004, respectively. Accordingly, we have 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.

Notes to the financial statements

The Revenue Forgone Reform Act of 1993 authorized a total of $1,218 million in payments. We calculated the present value of these future reimbursements, at 7% interest, to be approximately $390 million. We recognized the $390 million as revenue during fiscal years 1991 through 1998. The amounts receivable as of September 30, 2004 and 2003, were $364 million and $367 million, respectively.

Note 9 – commitments

At September 30, 2004, we estimate our financial commitment for approved capital projects in progress to be approximately $2,808 million.

Our total rental expense for the years ended September 30 is summarized as follows:

(Dollars in millions)	2004	2003	2002
Non-cancellable real estate leases including related taxes	$ 896	$ 923	$ 894
Facilities leased from General Services Administration subject to 120-day notice of cancellation	49	53	45
Equipment and other short-term rentals	213	201	214
Total	$1,158	$1,177	$1,153

At September 30, 2004, our future minimum lease payments for all non-cancellable leases are as follows:

Year (Dollars in millions)	Operating	Capital
2005	$ 823	$ 76
2006	799	76
2007	761	76
2008	712	76
2009	658	76
2010	605	76
After 2010	5,283	472
	$9,641	$928
Less: Interest		234
Total capital lease obligations		694
Less: Short-term portion of capital lease obligations		42
Long-term portion of capital lease obligations		$652

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

Capital leases included in buildings were $847 million in 2004 and $963 million in 2003. Total accumulated amortization is $259 million in 2004 and $259 million in 2003. Amortization expense for assets recorded under capital leases is included in depreciation expense.

Note 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 is 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 $104 million decrease in the contingent liabilities balance in 2004, compared to a decrease of $92 million in 2003 and a $187 million increase in 2002. 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 probable amounts due under the suits, claims and proceedings we have discussed here.

Note 11 – emergency preparedness funding

In FY 2002, the United States was subjected to biological terrorism, utilizing the mail as the delivery medium. In response, we implemented process changes and technology applications to reduce the risk to both our employees and our customers. The President of the United States and Congress authorized funding of $762 million in 2002 to assist in paying for some of these safety measures, and to replace or repair postal facilities damaged or destroyed on September 11, 2001.

In 2002 and 2003, the majority of our emergency preparedness expenses were for one-time activities, such as plant decontamination. We recognized these expenses as non-operating expenses and the corresponding revenue offset as non-operating revenue. Due to the ongoing nature of the remaining expenses, such as depreciation, supplies, and maintenance, beginning in 2004 all emergency preparedness items are treated as operating expenses and the associated revenue as operating revenue.

Our emergency preparedness expenditures are not all covered by the appropriations we received. The emergency preparedness expenses and capital equipment commitments for the years ended September 30 are as follows:

(Dollars in millions)	2004	2003	2002
Operating expenses:			
Personnel costs	$ 9	$ 12	$ 73
Non-Personnel Costs	123	-	-
Total operating expenses	132	12	73
Non-operating expenses	-	184	189
Total Expenses	$ 132	$196	$262
Capital Equipment Commitments	$ 222	$189	$ 38

As of September 30, 2004, all emergency preparedness appropriations have been fully expended or committed. We recognize these appropriations as revenue 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 were $92 million in 2004, $177 million in 2003 and $179 million in 2002. They are reflected in the 2004 and 2003 Statements of Cash Flows as a financing activity.

The capital funds spent in 2002 ($38 million) were spent on irradiation equipment that did not meet our needs. With the approval of OMB, the eight machines valued at $24 million were transferred to other government and public agencies, and the manufacturer provided us with a stronger machine at no additional cost. This new machine is valued at $14 million and is not yet deployed.

Appropriations that had not been recognized as revenue as of September 30, 2004 and 2003, were $314 million and $406 million, respectively. The balance was recorded as an accrued expense until spent. Amounts spent on capital equipment are deferred as a non-current liability and amortized to offset depreciation expense of the related equipment.

operating statistics

(In millions of units indicated) Class of Mail	2004	2003	2002	2001	2000
First-Class Mail					
Pieces, number	**97,926.4**	99,058.7	102,378.6	103,655.6	103,525.7
Weight, pounds	**4,389.9**	4,236.3	4,283.6	4,362.8	4,392.0
Revenue	**$36,376.8**	$37,048.3	$36,483.2	$35,876.0	$35,515.9
Priority Mail					
Pieces, number	**848.6**	859.6	998.2	1,117.8	1,222.5
Weight, pounds	**1,623.3**	1,622.9	1,875.1	2,149.7	2,352.3
Revenue	**$ 4,421.4**	$ 4,494.3	$ 4,722.5	$ 4,916.4	$ 4,837.1
Express Mail					
Pieces, number	**54.1**	55.8	61.3	69.4	70.9
Weight, pounds	**50.6**	53.2	59.1	72.1	80.0
Revenue	**$ 852.8**	$ 888.1	$ 910.5	$ 995.7	$ 996.1
Mailgrams					
Pieces, number	**1.6**	2.8	2.8	3.3	3.7
Revenue	**$ 0.7**	$ 1.2	$ 1.4	$ 1.4	$ 1.5
Periodicals					
Pieces, number	**9,135.3**	9,319.9	9,689.8	10,077.4	10,364.8
Weight, pounds	**4,067.5**	3,995.0	4,006.1	4,408.3	4,720.3
Revenue	**$ 2,191.8**	$ 2,234.8	$ 2,164.9	$ 2,205.2	$ 2,170.7
Standard Mail* **					
Pieces, number	**95,563.5**	90,492.2	87,230.6	89,938.4	90,057.1
Weight, pounds	**11,148.3**	10,827.6	10,315.5	10,822.2	11,142.6
Revenue	**$18,122.5**	$17,231.3	$15,818.8	$15,704.9	$15,193.3
Package Services					
Pieces, number	**1,131.9**	1,128.5	1,075.1	1,093.0	1,128.4
Weight, pounds	**3,632.6**	3,793.8	3,690.6	3,801.7	3,773.8
Revenue	**$ 2,206.9**	$ 2,215.7	$ 2,080.1	$ 1,993.9	$ 1,912.3
International Economy Mail					
Pieces, number	**25.9**	29.9	38.6	60.4	78.7
Weight, pounds	**60.3**	60.5	65.3	80.3	89.4
Revenue	**$ 145.2**	$ 145.9	$ 150.4	$ 177.7	$ 180.3
International Airmail* **					
Pieces, number	**817.9**	775.3	865.2	1,022.1	1,020.7
Weight, pounds	**168.4**	152.6	151.8	171.6	169.7
Revenue****	**$ 1,550.6**	$ 1,441.0	$ 1,429.4	$ 1,554.0	$ 1,477.2
U.S. Postal Service					
Pieces, number	**529.3**	391.6	424.9	380.6	362.9
Weight, pounds	**105.4**	80.1	87.5	82.3	95.3
Free Matter for the Blind					
Pieces, number	**71.1**	70.4	56.8	44.6	46.6
Weight, pounds	**34.6**	29.8	28.1	24.9	25.1
Totals*****					
Pieces, number	**206,105.6**	202,184.7	202,821.9	207,462.6	207,882.2
Weight, pounds	**25,280.9**	24,851.9	24,562.7	25,975.9	26,840.6
Revenue	**$65,868.7**	$65,700.7	$63,761.1	$63,425.2	$62,284.3

operating statistics

(In millions of units indicated)

Class of Mail	2004	2003	2002	2001	2000
Registered Mail*					
Number of Mail articles	7.4	8.2	9.1	11.4	13.3
Revenue	$ 75.0	$ 82.1	$ 86.6	$ 98.4	$ 98.4
Certified Mail*					
Number of Mail articles	273.7	271.4	283.5	269.0	270.5
Revenue	$ 629.5	$ 624.2	$ 605.9	$ 494.8	$ 385.4
Insurance*					
Number of articles	53.2	59.1	59.8	60.0	58.0
Revenue	$ 127.8	$ 138.3	$ 135.2	$ 123.1	$ 108.9
Delivery Receipt Services**					
Number of articles	840.6	748.8	535.5	421.1	356.9
Revenue	$ 538.0	$ 503.1	$ 460.4	$ 370.8	$ 316.8
Collect on Delivery					
Number of articles	1.9	1.9	2.3	2.7	4.1
Revenue	$ 11.4	$ 11.1	$ 13.8	$ 15.3	$ 21.5
Money Orders					
Number issued	188.0	202.5	218.0	227.2	232.8
Revenue	$ 230.7	$ 230.7	$ 239.4	$ 225.4	$ 234.7
Face value of issues (non-add)***	$28,782.2	$ 29,151.7	$29,721.2	$30,770.3	$29,945.2
Other					
Box rent revenue	$ 779.9	$ 788.1	$ 750.6	$ 699.0	$ 684.2
Stamped envelope and card revenue	$ 21.9	$ 24.4	$ 29.3	$ 27.1	$ 15.4
Other revenue, net	$ 676.8	$ 395.8	$ 333.3	$ 287.5	$ 326.0
Totals					
Special Services revenue	$ 3,091.0	$ 2,797.8	$ 2,654.5	$ 2,341.4	$ 2,191.2
Mail revenue	$65,868.7	$ 65,700.7	$63,761.1	$63,425.2	$62,284.3
Revenue forgone	$ 36.3	$ 30.7	$ 47.6	$ 67.1	$ 64.4
Operating revenue	$68,996.0	$ 68,529.2	$66,463.2	$65,833.7	$64,539.9

* Return receipts have been broken out from Registered, Certified Mail and insurance special service categories.
** Delivery Receipt Services contains Return Receipts, Return Receipts for Merchandise and Delivery Confirmation Service.
*** Certain reclassifications have been made to previously reported amounts.
**** Includes foreign postal transaction revenue.
***** Agency and franked mailed are included in their classes of mail, when using official mail.

Some totals may not add exactly due to rounding.

operating statistics

	2004	2003	2002	2001	2000
Headquarters Career Employees*					
Headquarters	2,708	1,867	1,712	1,836	2,279
Headquarters-Field Support Units	3,396	3,971	3,848	5,653	5,566
Inspection Service (field)	3,648	3,903	3,875	4,047	4,190
Inspector General	782	723	722	713	664
Total HQ and Related Employees**	10,534	10,464	10,157	12,249	12,699
Field Career Employees*					
Area Offices	2,196	2,205	2,107	1,377	1,597
Postmasters/Installation Heads	25,519	25,509	25,771	26,113	26,121
Supervisors/Managers	33,635	35,360	37,829	38,754	38,797
Prof. Admin. Tech. Personnel	9,168	9,436	9,661	9,764	9,959
Clerks	226,183	242,276	256,656	269,792	281,956
Nurses	167	171	173	180	191
Mail Handlers	54,769	56,776	59,259	60,102	60,851
City Delivery Carriers	228,140	229,404	233,639	240,295	241,079
Motor Vehicle Operators	8,628	8,778	9,092	9,325	9,347
Rural Delivery Carriers-Full Time	62,762	61,611	60,817	59,790	57,111
Bldg. and Equip. Maintenance Personnel	40,263	41,469	42,275	42,604	42,284
Vehicle Maintenance Personnel	5,521	5,576	5,513	5,558	5,546
Total Field Career Employees*	696,951	718,571	742,792	763,654	774,839
Total Career Employees*	707,485	729,035	752,949	775,903	787,538
Non-Career Employees*					
Casuals	20,529	17,373	19,065	30,317	29,572
NonBargaining Temporary	1,138	910	807	761	712
Rural Subs/RCA/RCR/AUX	56,403	56,451	56,474	58,134	57,532
PM Relief/Leave Replacements	12,157	12,161	12,234	12,313	12,423
Transitional Employees	9,884	11,025	12,847	13,577	13,461
Total Non-Career Employees*	100,111	97,920	101,427	115,102	113,700
Total Employees*	807,596	826,955	854,376	891,005	901,238
Post Offices, Stations and Branches					
Post Offices	27,505	27,556	27,791	27,876	27,876
Classified stations and branches	5,623	5,796	5,900	5,835	5,802
Contract stations and branches	2,889	2,777	2,500	2,876	2,833
Community Post Offices	1,142	1,450	1,492	1,536	1,549
Total Post Offices, Stations and Branches	37,159	37,579	37,683	38,123	38,060
Residential Delivery Points******					
City	77,967,046	77,490,203	77,014,294	76,578,169	76,131,249
Rural	33,817,615	33,324,799	32,141,581	31,004,518	29,915,385
PO Box	15,634,610	15,730,694	15,772,964	15,818,625	15,904,400
Highway Contract	2,162,772	2,153,056	2,073,145	2,004,837	1,938,395
Total Residential	129,582,043	128,698,752	127,001,984	125,406,149	123,889,429
Business Delivery Points******					
City	7,185,300	7,208,608	7,197,207	7,183,431	7,197,776
Rural	1,172,499	1,192,144	1,132,049	1,071,201	1,013,269
PO Box	4,321,862	4,203,433	4,065,877	3,969,279	3,796,343
Highway Contract	58,084	58,339	55,362	52,247	49,234
Total Business	12,737,745	12,662,524	12,450,495	12,276,158	12,056,622
Total Delivery Points****	142,319,788	141,361,276	139,452,479	137,682,307	135,946,051
Change in Delivery Points***	958,512	1,908,797	1,770,172	1,736,256	1,893,377

* *Complement data from On-Rolls and Paid Employees Statistics database as of end of September 2004 and 2003 and early September 2000–2002.*

** *Beginning 2004 employees located outside the Headquarters location, but performing Headquarters functions are counted as Headquarters employees.*

*** *The table above shows delivery growth of 958,512 in 2004. The absolute growth of 1,782,900 deliveries in 2004 was adjusted to reflect the current reporting procedure as implemented in 2004. For a more detailed discussion of the current reporting procedure, see the "Network Growth" section of the "Management Discussion and Analysis."*

**** *2004 and 2003 delivery points are reported as of September 30 while 2000–2002 reflect delivery points as reported in early to mid-September.*

Mail *this* cool really works.

Who says mail has to be square? Or round? I can really make my message pop with Customized MarketMail. You've never seen anything like it.

financial history summary

	2004	2003*	2002*
Statements of Operations			
(Dollars in billions)			
Total revenue	**$ 69.0**	$ 68.8	$ 66.7
Total expense	**65.9**	64.9	67.4
Net income (loss)	**$ 3.1**	$ 3.9	$ (0.7)
(Dollars in millions)			
Operating revenue	**$68,960**	$68,498	$66,415
Revenue forgone appropriation	**36**	31	48
Total operating revenue	**68,996**	68,529	66,463
Compensation and benefits	**52,134**	50,428	51,557
Other expenses	**13,717**	13,474	13,677
Total operating expenses	**65,851**	63,902	65,234
Income from operations	**3,145**	4,627	1,229
Interest and investment income	**33**	58	46
Interest expense on deferred retirement obligations	**(103)**	(116)	(1,601)
Other interest expense	**(10)**	(694)**	(340)
Emergency preparedness, net	**—**	(7)	(10)
Net income (loss)	**$ 3,065**	$ 3,868	$ (676)
Balance Sheets			
Assets			
Current assets	**$ 2,121**	$ 3,823	$ 2,280
Property and equipment, deferred retirement costs and other assets	**22,858**	23,419	56,735
Total assets	**$24,979**	$27,242	$59,015
Liabilities and net capital (deficiency)			
Current liabilities	**$11,070**	$16,969	$15,586
Other liabilities	**9,978**	9,407	39,131
Long-term debt	**—**	—	7,300
Net capital (deficiency)	**3,931**	866	(3,002)
Total liabilities and net capital (deficiency)	**$24,979**	$27,242	$59,015
Changes in Net Capital (Deficiency)			
Beginning balances			
Capital contributions of the U.S. government	**$ 3,034**	$ 3,034	$ 3,034
Deficit since reorganization	**(2,168)**	(6,036)	(5,360)
Total beginning balance net capital (deficiency)	**866**	(3,002)	(2,326)
Net income (loss)	**3,065**	3,868	(676)
Ending balance	**$ 3,931**	$ 866	$ (3,002)

* Certain reclassifications have been made to previously reported amounts.
** Includes $360 million in debt repurchase expense.

financial history summary

2001*	2000*	1999*	1998*	1997*	1996*	1995*	1994*
$ 65.9	$ 64.6	$ 62.7	$ 60.1	$ 58.3	$ 56.6	$ 54.5	$ 49.6
67.6	64.8	62.4	59.5	57.0	55.0	52.7	50.5
$ (1.7)	$ (0.2)	$ 0.4	$ 0.6	$ 1.3	$ 1.6	$ 1.8	$ (0.9)
$65,767	$64,476	$62,655	$60,005	$58,133	$56,309	$54,176	$49,252
67	64	71	67	83	93	117	131
65,834	64,540	62,726	60,072	58,216	56,402	54,293	49,383
51,351	49,532	47,333	45,596	44,093	42,676	41,931	39,609
14,289	13,460	13,309	12,190	11,038	10,437	8,799	8,846
65,640	62,992	60,642	57,786	55,131	53,113	50,730	48,455
194	1,548	2,084	2,286	3,085	3,289	3,563	928
35	41	29	44	115	142	216	193
(1,603)	(1,568)	(1,592)	(1,613)	(1,629)	(1,496)	(1,443)	(1,433)
(306)	(220)	(158)	(167)	(307)	(368)	(566)	(601)
—	—	—	—	—	—	—	—
$ (1,680)	$ (199)	$ 363	$ 550	$ 1,264	$ 1,567	$ 1,770	$ (913)
$ 1,933	$ 1,655	$ 1,296	$ 1,893	$ 1,736	$ 1,670	$ 2,975	$ 2,683
57,158	56,628	54,713	53,015	51,675	50,157	46,146	43,733
$59,091	$58,283	$56,009	$54,908	$53,411	$51,827	$49,121	$46,416
$17,457	$18,277	$15,436	$15,278	$14,107	$12,796	$11,499	$11,665
38,209	38,150	37,466	37,652	37,439	37,746	34,794	32,985
5,751	2,502	3,554	2,788	3,225	3,909	7,019	7,727
(2,326)	(646)	(447)	(810)	(1,360)	(2,624)	(4,191)	(5,961)
$59,091	$58,283	$56,009	$54,908	$53,411	$51,827	$49,121	$46,416
$ 3,034	$ 3,034	$ 3,034	$ 3,034	$ 3,034	$ 3,034	$ 3,034	$ 3,034
(3,680)	(3,481)	(3,844)	(4,394)	(5,658)	(7,225)	(8,995)	(8,082)
(646)	(447)	(810)	(1,360)	(2,624)	(4,191)	(5,961)	(5,048)
(1,680)	(199)	363	550	1,264	1,567	1,770	(913)
$ (2,326)	$ (646)	$ (447)	$ (810)	$ (1,360)	$ (2,624)	$ (4,191)	$ (5,961)

* Certain reclassifications have been made to previously reported amounts.

selected quarterly financial data

(Dollars in millions)

(unaudited)

2004	Quarter I	Quarter II	Quarter III	Quarter IV
Operating revenue	$18,209	$17,292	$16,591	$16,904
Total operating expenses	16,391	16,556	16,288	16,616
Income from operations	1,818	736	303	288
Other revenue (expense)	(1)	5	(44)	(40)
Net Income	$ 1,817	$ 741	$ 259	$ 248

2003	Quarter I	Quarter II	Quarter III	Quarter IV
Operating revenue	$18,384	$17,083	$16,670	$16,392
Total operating expenses	16,008	15,692	15,922	16,280
Income from operations	2,376	1,391	748	112
Other revenue (expense)	(107)	(71)	(119)	(462)
Net Income (loss)	$ 2,269	$ 1,320	$ 629	$ (350)

glossary

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.

Appropriation Public funds set aside by Congress for a specific purpose.

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 A special service that provides 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.

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.

Government Accountability 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.

Leasehold 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.

Operating Margin A financial indication calculated by dividing income from operations by operating revenue.

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.

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% 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.

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

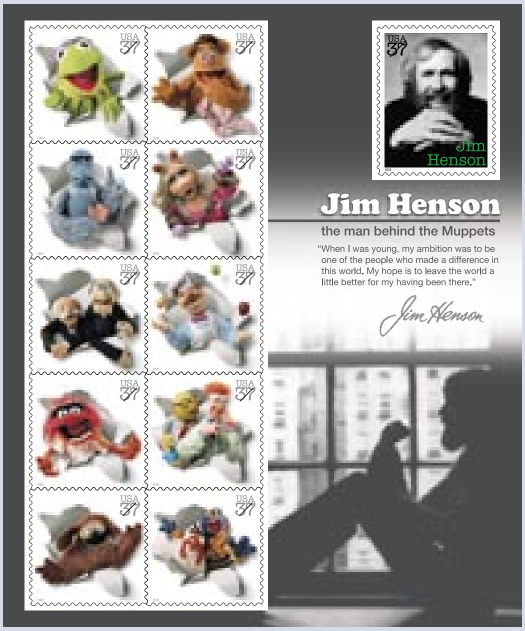
Universal Service The Postal Service's mandate and commitment to the nation to provide mail delivery service at uniform and reasonable rates to everyone, everywhere.

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

2005 Postage Stamps

Lunar New Year Souvenir Sheet ▪ Marian Anderson ▪ Love Bouquet Ronald Reagan ▪ Northeast Deciduous Forest ▪ Spring Flowers ▪ Jim Henson and the Muppets ▪ American Scientists ▪ Robert Penn Warren ▪ Yip Harburg Henry Fonda ▪ Distinguished Marines ▪ Masterworks of Modern American Architecture ▪ Arthur Ashe ▪ American Advances in Aviation ▪ To Form A More Perfect Union ▪ 50s Sporty Cars ▪ Rio Grande Blankets ▪ Greta Garbo Constellations ▪ Child Health ▪ Holiday Cookies

Lunar New Year Souvenir Sheet
Issue Date: January 2005
Format: double-sided-pane of 24



Jim Henson and the Muppets
Issue Date: March 2005
Format: souvenir sheet of 11

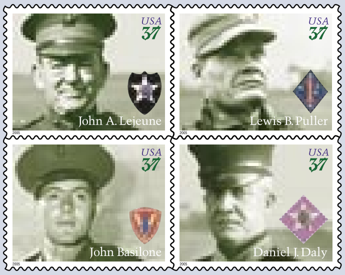
Ronald Reagan
Issue Date: February 2005
Format: pane of 20

American Scientists
Issue Date: To Be Determined
Format: pane of 20

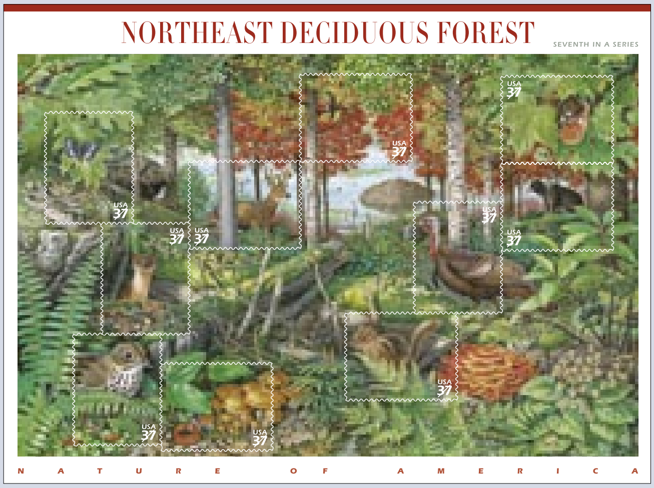
Marian Anderson
Issue Date: January 2005
Format: pane of 20

Love Bouquet
Issue Date: February 2005
Format: pane of 20

Spring Flowers
Issue Date: March 2005
Format: book of 20



Distinguished Marines
Issue Date: May 2005
Format: pane of 20



Northeast Deciduous Forest
Issue Date: March 2005
Format: pane of 10

Robert Penn Warren
Issue Date: April 2005
Format: pane of 20

Yip Harburg
Issue Date: April 2005
Format: pane of 20

Masterworks of Modern American Architecture
Issue Date: May 2005
Format: pane of 12

Arthur Ashe
Issue Date: July 2005
Format: pane of 20

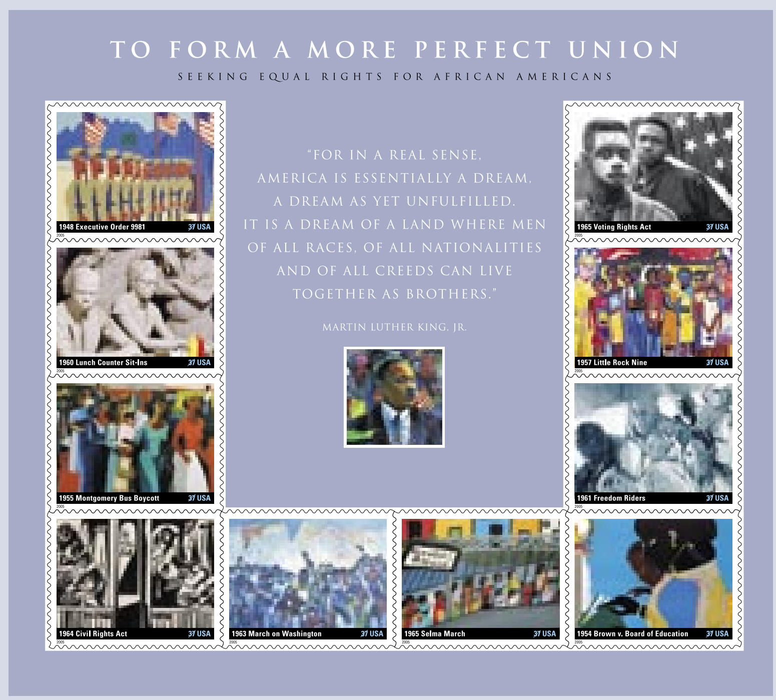
Henry Fonda
Issue Date: May 2005
Format: pane of 20

American Advances in Aviation
Issue Date: July 2005
Format: pane of 20

50s Sporty Cars
Issue Date: August 2005
Format: doublesided book of 20

Greta Garbo
Issue Date: September 2005
Format: pane of 20

Rio Grande Blankets
Issue Date: August 2005
Format: doublesided book of 20



To Form A More Perfect Union
Issue Date: August 2005
Format: pane of 10

Constellations
Issue Date: October 2005
Format: pane of 20

Child Health
Issue Date: October 2005
Format: pane of 20

Holiday Cookies
Issue Date: October 2005
Format: pane of 20

Fort Pierce, FL, Rural Letter Carrier Doug Latshaw delivers in spite of hurricane flood waters.

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