United States Postal Service
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Washington, DC 20260
202-268-2000

Quarterly Report

For the Three Months Ended Dec. 31, 2003

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PART I. FINANCIAL INFORMATION

PART II. OTHER INFORMATION

INTRODUCTION

This report has been prepared consistent with relevant Securities and Exchange Commission interim financial reporting requirements. Certain of those reporting requirements are not applicable to this report because the Postal Service is a non-publicly traded, government-owned entity with a breakeven mandate. Therefore, this report excludes the following SEC reporting elements:

Part II – Other Information

- Item 2. Changes in Securities and Use of Proceeds
- Item 3. Defaults Upon Senior Securities
- Item 4. Submission of Matters to a Vote of Security Holders

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

United States Postal Service
Statements of Operations

(dollars in millions)	**Three Months Ended Dec. 31, 2003 (unaudited)**	Three Months Ended Dec. 31, 2002 (unaudited)
Operating revenue	**$ 18,209**	$ 18,384
Operating expenses:		
Compensation and benefits	**13,130**	12,656
Transportation	**1,177**	1,310
Other	**2,084**	2,042
Total operating expenses	**16,391**	16,008
Income from operations	**1,818**	2,376
Interest and investment income	**8**	14
Interest expense on borrowings	**(9)**	(121)
Net Income	**$ 1,817**	$ 2,269

See accompanying notes to financial statements.

United States Postal Service
Balance Sheets – Assets

(dollars in millions)	Dec. 31, 2003 (unaudited)	Sept. 30, 2003
Assets		
Current assets:		
Cash and cash equivalents	**$ 559**	$ 2,266
Receivables:		
Foreign countries	**777**	744
U.S. Government	**383**	359
Consignment	**50**	50
Other	**148**	144
Receivables before allowances	**1,358**	1,297
Less allowances	**106**	106
Total receivables, net	**1,252**	1,191
Supplies, advances and prepayments	**344**	366
Total current assets	**2,155**	3,823
Other assets, principally revenue forgone appropriations receivable	**365**	365
Property and equipment, at cost:		
Buildings	**19,800**	19,759
Equipment	**17,295**	17,166
Land	**2,814**	2,809
Leasehold Improvements	**1,072**	1,060
	40,981	40,794
Less allowances for depreciation and amortization	**19,199**	18,717
	21,782	22,077
Construction in progress	**1,083**	977
Total property and equipment, net	**22,865**	23,054
Total Assets	**$ 25,385**	$ 27,242

See accompanying notes to financial statements.

United States Postal Service
Balance Sheets - Liabilities & Net Capital

(dollars in millions)	Dec. 31, 2003 (unaudited)	Sept. 30, 2003
Liabilities and Net Capital		
Current liabilities:		
Compensation and benefits	**$ 3,061**	$ 2,518
Estimated prepaid postage	**1,349**	1,349
Payables and accrued expenses:		
Foreign countries	**963**	879
U.S. Government	**120**	112
Unexpended appropriations	**406**	406
Other	**2,101**	1,863
Total payables and accrued expenses	**3,590**	3,260
Prepaid box rentals, permit and metered mail	**1,973**	1,925
Outstanding postal money orders	**771**	768
Current portion of debt	**2,250**	7,273
Total current liabilities	**12,994**	17,093
Other liabilities:		
Workers' compensation	**6,697**	6,324
Employees' accumulated leave	**2,001**	1,932
Other	**1,010**	1,027
Total other liabilities	**9,708**	9,283
Commitments and contingencies - Note 2, 3		
Total Liabilities	**22,702**	26,376
Net capital:		
Capital contributions of the U.S. Government	**3,034**	3,034
Deficit since reorganization	**(351)**	(2,168)
Total net capital	**2,683**	866
Total Liabilities and Net Capital	**$ 25,385**	$ 27,242

See accompanying notes to financial statements.

United States Postal Service
Statements of Cash Flows
Three Months Ended Dec. 31, 2003

(dollars in millions)	(unaudited)
Cash flows from operating activities:	
Net Income	$ 1,817
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization	566
Loss on disposals of property and equipment, net	8
Decrease in other assets	-
Increase in USPS workers' compensation	373
Decrease in Post Office Dept. workers' compensation	(24)
Increase in employees' accumulated leave	69
Decrease in other liabilities	(18)
Changes in current assets and liabilities:	
Increase in receivables, net	(61)
Decrease in supplies, advances and prepayments	22
Increase in compensation and benefits	567
Increase in estimated prepaid postage	-
Increase in payables and accrued expenses	330
Increase in prepaid box rentals, permit and metered mail	48
Increase in outstanding Postal Money Orders	3
Net cash provided by operating activities	3,700
Cash flows from investing activities:	
Purchase of property and equipment	(387)
Proceeds from sale of property and equipment	3
Net cash used in investing activities	(384)
Cash flows from financing activities:	
U.S. Government Appropriations Expended	-
Issuance of debt	-
Payments on debt	(5,023)
Net cash used in financing activities	(5,023)
Net decrease in cash and cash equivalents	(1,707)
Cash and cash equivalents at beginning of year	2,266
Cash and cash equivalents at end of period	**$ 559**

See accompanying notes to financial statements.

United States Postal Service
Statements of Changes in Net Capital
Three Months Ended Dec. 31, 2003 and the Year Ended Sept. 30, 2003

(dollars in millions)	Capital Contributions of U.S. Government	Deficit Since Reorganization	Total Net Capital
Balance, Sept. 30, 2002	$ 3,034	$ (6,036)	$ (3,002)
Net Income	-	3,868	3,868
Balance, Sept. 30, 2003	3,034	(2,168)	866
Net Income–Three Months Ended Dec. 31, 2003 (unaudited)	-	1,817	1,817
Balance, Dec. 31, 2003 (unaudited)	$ 3,034	$ (351)	$ 2,683

See accompanying notes to financial statements.

Notes to Financial Statements

Note 1. Basis of Presentation

General
This report reflects the operations of the United States Postal Service for the three months ended December 31, 2003, and the three months ended December 31, 2002. The interim statements for the three months ended December 31, 2003, have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and should be read in conjunction with our 2003 Annual Report. Accordingly, significant accounting policies and other disclosures normally provided have been omitted since such items are disclosed in our Annual Report.

On October 1, 2003, 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 Postal Reorganization. As a result of the conversion to the new reporting periods, prior year financial data is management's representation of results for the same period last year. In preparing the restated financial results, we have modified previously reported information to reflect the impact of Public Law 108-18 (see note 6 and 7, 2003 Annual Report).

In the opinion of management, the accompanying unaudited financial statements reflect all adjustments (including normal recurring adjustments) necessary to present fairly our financial position as of December 31, 2003, the results of our operations for the three months ended December 31, 2003, and our cash flows for the three months ended December 31, 2003. Operating results for the three months ended December 31, 2003, are not necessarily indicative of the results that may be expected for the year ending September 30, 2004.

Note 2. Commitments

Capital
At December 31, 2003, we estimate our financial commitment for approved capital projects in process to be approximately $2.2 billion.

Rents
Our total rental expense for the quarter ended December 31, 2003 and the year ended September 30, 2003 is summarized as follows:

(dollars in millions)	For the Three Months Ended Dec. 31, 2003	For the Year Ended Sept. 30, 2003
Non-cancelable real estate leases including related taxes	$ 233	$ 923
Facilities leased from General Services Administration subject to 120-day notice of cancellation	14	53
Equipment and other short-term Rentals	39	201
Total	$ 286	$ 1,177

At December 31, 2003, our future minimum lease payments for all non-cancelable leases are as follows:

	(dollars in millions)	
Year	**Operating**	**Capital**
2004	$ 818	$71
2005	785	71
2006	745	71
2007	698	71
2008	643	71
After 2008	5,948	637
	$ 9,637	992
Less: Interest at 4.5%		257
Total capital lease obligations		735
Less: Short-term portion of capital lease obligations		39
Long-term portion of capital lease obligations		$696

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

Capital leases included in buildings were $963 million at December 31, 2003, and $963 million at September 30, 2003. Total accumulated amortization was $271 million at December 31, 2003, and $259 million at September 30, 2003. Amortization expense for assets recorded under capital leases is included in depreciation expense.

Note 3. Contingent Liabilities

Each quarter we review pending litigation against us. We classify and adjust our contingencies for claims when we can reasonably estimate the amount of a probable, unfavorable outcome. These relate to labor claims, equal employment opportunity claims, environmental matters, traffic accidents, injuries sustained on postal properties, personal claims and claims to property damages, and suits and claims arising from postal contracts. We evaluate the materiality of cases determined to have a reasonable chance of adverse outcome. Management and General Counsel believe that we have made adequate provision for the amounts that may become due under the suits, claims and proceedings we have discussed here.

ITEM 2. Management Discussion and Analysis of Results of Operations and Financial Condition

OPERATIONS

Summary Results of Operations

For the first quarter our operating revenues of $18.2 billion were $175 million or 1.0% lower than the prior year period. Total operating expenses of $16.4 billion were $383 million or 2.4% greater than those of the prior year period. This resulted in net income of $1.8 billion which was $453 million lower than the prior year period. These results were due primarily to lower First-Class Mail, Priority Mail and Periodicals revenues, and higher personnel compensation expenses. Higher Civil Service Retirement System (CSRS) contributions and increased health benefit expenses for employees and retirees were the primary contributors to expense increases.

Revenue

Operating revenue was 1% less for the three months ended December 31, 2003, than for the three months ended December 31, 2002. With the exception of Package Services, revenue decreased in all other mail classes with the majority of the decline concentrated in First-Class Mail, Priority Mail and Periodicals. We expect volume and revenue will continue to be weak in the first half of the year, but we expect the economy to generate volume growth late in the fiscal year. We expect revenue to be flat for the year.

Following is a table comparing volume and revenue by class for the three months ending December 31, 2003, and the three months ended December 31, 2002.

	Volume (pieces in millions)			Operating Revenue (dollars in millions)		
	December 31, 2003	December 31, 2002	% Change	December 31, 2003	December 31, 2002	% Change
First-Class Mail	25,866	26,049	-0.7	$ 9,654	$ 9,770	-1.2
Priority Mail	234	235	-0.4	1,272	1,283	-0.9
Express Mail	13	14	-7.1	217	230	-5.7
Periodicals Mail	2,317	2,387	-2.9	562	582	-3.4
Standard Mail	24,891	24,840	0.2	4,686	4,694	-0.2
Package Services	318	310	2.6	656	654	0.3
Other	384	352	9.1	1,162	1,171	0.3
Total	54,023	54,187	-0.3	$ 18,209	$ 18,384	-1.0

First-Class Mail volume in the first quarter of 2004 was down compared to the same period last year, with continuing volume and revenue losses in the single piece and non-automation rate categories. We expect a continuing decline in single-piece mail due to the automation of business transactions and communications, and the substitution of electronic technologies for hard-copy correspondence and bill payments by consumers.

Standard Mail volume reached a new all-time high of 90.5 billion pieces in 2003. However, during the first quarter, Standard Mail volume was essentially flat. Increases in regular automation and enhanced carrier route services were offset by declines in the nonprofit volumes. Non-profit volume declines are normal in off-election years and are typically followed by solid increases in the following election year. Standard Mail volume growth depends on the rate of recovery in the general economy, and especially in the advertising market.

A shift of the parcel market from air to ground products boosted Package Services products in 2003, and we expect a continuation of this trend in 2004. For the first quarter, volume increased by 2.6% and revenue increased by 0.3% compared with last year as growth in the Bound Printed Matter and Media Mail subclasses exceeded declines in Parcel Post and Library Mail. Priority Mail and Express Mail continued their long-term declines, but declined at a reduced rate.

Periodical volume and revenue declined 2.9% and 3.4%, respectively, in this period. We project continued decline due to weakness in Periodical advertising revenues and the continued move from hard copy news and entertainment sources to the Internet. These trends affect both the weight and size of the pieces and the number of pieces sent, as circulation declines or titles cease to exist.

Expense Summary
For the three months ended December 31, 2003, total expenses are $272 million or 1.7% over the prior year period's $16,128 million. Personnel compensation costs were $475 million greater than in the first quarter of last year. This increase was offset by reductions of $91 million in non-personnel costs and interest expense of $112 million.

Compensation and Benefits
Compensation and benefits costs were $475 million or 3.7% over last year's first quarter. This increase was driven primarily by higher benefits expenses. Expense increases were due chiefly to the required increase in contribution to the CSRS retirement system, an increase from 7% of CSRS payroll to 17.4%, and by higher employee and annuitant health benefit costs. Offsetting this growth, the number of career employees was reduced by 8,471. These reductions were achieved through attrition and through voluntary early retirement opportunities offered to certain employee groups in selected locations. During the first quarter, over 3,600 employees accepted the voluntary retirement offer.

Retiree Health Benefits
Under the Federal Employees Health Benefits Program (FEHBP), the Office of Personnel Management (OPM) bills us for the cost of our retirees participating in the plan and we record this cost as a current compensation and benefits expense. Our expense related to retiree health benefits was $326 million during this quarter, compared to $269 million in the first quarter of 2003. This accounting treatment is consistent with our determination that our participation in the FEHBP most closely matches the characteristics of a participant in a multiemployer plan, as described in *Statement of Financial Accounting Standards No. 106, Employers' Accounting for Postemployment Benefits Other Than Pensions*.

Retirement Expense
The Postal Civil Service Retirement System Funding Reform Act of 2003 (Act) was signed by the President on April 23, 2003. This Act changed the way we fund our Civil Service Retirement System (CSRS) obligation, and transfers to us from the U. S. Treasury the responsibility for funding costs of CSRS benefits that current and former Postal Service employees have earned through military service. The Act also defines "savings" as the difference between contributions we would have made if the Act had not been enacted and the contributions we make under the Act. The Act requires "savings" after 2005 to be escrowed. According to a 2003 General Accounting Office (GAO) report, without this legislation, we were on course to over-fund our obligation by approximately $105 billion. Without considering the transfer of military service credits, we over-funded our retirement obligations by $10 billion as of September 30, 2002. See our Annual Report for a full discussion of the other provisions of the Act.

The Act provides an opportunity to reconsider the transfer of the CSRS military service obligation by requiring the Postal Service, Department of the Treasury, and the OPM to submit proposals "detailing whether and to what extent the Department of the Treasury or the Postal Service should be responsible for the funding of benefits attributable to the military service of current and former employees of the Postal Service." We recommended that the responsibility for these costs should be returned to the U. S. Treasury. The GAO prepared a written evaluation (Report Reference: GAO-04-281) of each proposal and submitted its report to the Committee on Government Reform of the House of Representatives and the Committee on Governmental Affairs of the Senate on November 26, 2003.

As of December 31, 2003, legislation has not been enacted either to reallocate responsibility for military service retirement credits or to define the use of the escrowed "savings" beyond 2005.

Separately, we have taken issue with the methodology OPM used to calculate our CSRS obligations. Specifically, we believe that OPM used an allocation methodology to attribute CSRS pension costs of the pre-July 1, 1971 service that assigns an unreasonably large share of the burden to us for payment. We requested OPM to consider an alternative allocation methodology that is consistent with the approach OPM previously used to allocate the increase in CSRS pension costs created by annual cost-of-living-adjustments granted to retirees. In accordance with the Act, on January 26, 2004, we filed a request for reconsideration of the method used by OPM to calculate Postal Service CSRS pension liability with the Board of Actuaries of the Civil Service Retirement System. The alternative allocation methodology endorsed in our appeal results as of September 30, 2002, in an estimated overfunding of Postal Service obligations of $81.6 billion, as opposed to OPM's estimate of $4.8 billion underfunding using its new allocation methodology.

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). In the first quarter we accrued $372 million in workers' compensation expense, which is $16 million less than last year's first quarter accrual.

Transportation
Transportation expense of $1,177 million is $133 million, or 10.1%, under last year's first quarter total expense of $1,310 million. The major factors contributing to the reduction include network optimization efforts, such as shifting some transportation from air carriers to highway, initiatives to control fuel expenditures, and favorable settlements of prior year international terminal dues. Currently, we estimate that transportation costs for the year will be at or below last year's level. Rising fuel prices always present an expense risk but will be managed within the 2004 transportation operating plan.

Other Non-Personnel
Other non-personnel expenses of $2,038 million were $32 million over last year's comparable quarter. This category of expenses includes a wide variety of purchased supplies and services, and depreciation of property. The low variance to last year's expense levels is largely due to expense control measures, such as supply chain management, and to the deferral into later quarters of some expenses originally planned for first quarter.

Interest Expense
Interest expense was $112 million less than for the first quarter of last year. In late 2003 and during this quarter we reduced debt. Debt reduction combined with the lower interest rates obtained through the 2003 debt restructuring resulted in the reduced interest cost.

Cost Reduction Initiatives
Work hour reductions during the first quarter have given us momentum toward achieving the cost savings initiatives planned for 2004. These initiatives fall into two general categories: cost savings programs and increases in operational efficiency. We have developed plans to continue productivity increases and control expense growth using both types of initiatives, but the majority of our savings will come from increases in operational efficiency.

In the first quarter, we reduced the number of our career employees by almost 8,500. These reductions were achieved through attrition and through the offering of voluntary early retirement opportunities to certain employee groups in selected locations. During the first quarter, over 3,600 employees accepted the voluntary retirement offer.

Productivity
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 outputs are mail and special services and carrier services to an expanding delivery network. TFP calculations include inputs for all resources including labor, materials, transportation and capital investments.

During the first quarter, workload increased by 0.5%, and resource usage declined 1.2%, yielding a 1.7% increase in TFP. This productivity growth is equivalent to approximately $286 million in expense reductions. TFP growth has been positive in 17 of the last 18 quarters.

The workload increase was the first such increase in nine quarters, and was driven by the expanding delivery network. Mail volume, weighted for workload, declined for the eleventh straight quarter and resources usage declined for the eighteenth straight quarter. Management has been able to more than offset workload reductions with reductions in resource usage.

Capital Expenditures and Commitments
Capital commitments for the first quarter were $214 million compared to a plan of $372 million. During the first quarter, the Board of Governors approved funding for three projects: Cargo Vans, Automatic Flats Tray Lidder programs, and replacement of our Accounts Payable System. The capital cash outlays for the quarter were $384 million versus a plan of $448 million.

Financing Activities
We ended the first quarter of 2004 with a debt of $2.3 billion, a reduction of $5 billion over that period last year. We maintain two credit lines with the U.S. Treasury's Federal Financing Bank. One credit line enables us to draw up to $3.4 billion with two days' notice; the other up to $600 million on the same business day the funds are requested. No amounts were outstanding under these two credit lines as of December 31, 2003.

P.L. 108-18 requires all savings we realize under its provisions in 2004, estimated at $2.7 billion, to be applied to debt reduction this year. We ended 2003 with $7.3 billion in debt. Therefore, debt at September 30, 2004, cannot exceed an estimated $4.6 billion. Our Integrated Financial Plan (IRP) (see http://www.usps.com/financials/ifp/welcome.htm) includes repayment of between $4.2 and $4.7 billion of our debt this year, well beyond what is required by the statute.

In 2003 we refinanced our debt portfolio, retiring all long-term debt. Accordingly, all current debt is classified as short-term debt and has a weighted average interest rate of 1.2% compared to 4.9% on our debt portfolio one year prior. Total interest expense for the first quarter 2004 was $9 million compared to $121 million during the first quarter of 2003, reflecting both lower average of debt balances and lower interest rates. This amount of interest expense was in line with expectations. Without the debt refinancing in 2003, interest expense for the first quarter of 2004 would have been $92 million.

Liquidity
The first quarter of our fiscal year typically produces strong cash flow. We used this cash flow and our year-end cash balance to reduce debt. Cash and cash equivalents amounted to $559 million on December 31, 2003, compared to $2.3 billion on September 30, 2003.

Emergency Preparedness Funding
In October 2001 the United States became the target of biological terrorism. These activities affected us directly as the public was exposed to infectious biological agents sent by mail. Our viability and our value to the American people are dependent upon an open and accessible system, and it is critical to put in place process changes and technology applications that can reduce risks for both employees and customers.

The President of the United States authorized an initial funding of $175 million for 2002 to assist in paying for such safety measures. Congress approved two additional appropriations totaling $587 million for emergency expenditures to protect postal employees and customers from exposure to biohazardous material, sanitize and screen the mail, and to repair or replace postal facilities destroyed or damaged in New York City as a result of September 11, 2001 terrorist attacks. Through December 31, 2003, we have spent or committed $584 million of the $762 million appropriated.

For the three months ended December 31, 2003, emergency preparedness expenses were $50 million. $4 million were included in operating expense. None of these expenses were covered by appropriations.

OUTLOOK
Our mail volume and revenue growth is influenced by business cycle fluctuations. First quarter volumes and revenues are consistent with our IFP and suggest that the 2004 plan remains valid. We will, however, be particularly vigilant for negative volume and revenue plan variances as the year progresses because the plan calls for a ramp-up in growth in the latter half of the year. In light of the uneven recovery from the last recession and indications that mail volume growth is a lagging indicator, we have projected total volume growth of 1.3% in 2004.

We expect First-Class Mail volume to decline for the third straight year, reflecting the continued impact of electronic diversion. Standard Mail volume may benefit from the telemarketing regulations known as the “do not call” list that the Federal Trade Commission implemented in the fall of 2003. Standard Mail volume will also benefit from economic growth and should grow faster in 2004 than in 2003 because the 2002 rate increase will have been fully absorbed. As in 2003 lower contribution Standard Mail is expected to be our only significant source of volume growth. We expect Priority and Express Mail volume to continue to decline as the market moves to lower-priced ground shipment alternatives. This trend should favor our destination-entered Parcel Post products, pushing up the volume in the Package Services category. United Parcel Service and Federal Express have announced new service options that will use our destination-entry delivery service. We expect the long-term decline in Periodicals and International Mail to continue. We do not plan to increase domestic postage rates in 2004 or 2005.

Historically, the growth of First-Class Mail volume has financed the cost of expanding our delivery network. However, over the last several years, the volume of First-Class Mail and the number of delivery points have moved in opposite directions. From 2001 to 2003, First-Class Mail volumes decreased by over four billion pieces while our delivery network expanded by 3.7 million new delivery points. We expect delivery point growth to continue for the indefinite future.

Our total expense plan in 2004 is $66.8 billion, which is 2.9% more than our 2003 total expenses. This planned expense increase is driven primarily by higher wages and benefit costs, partially offset by decreases in employee complement and work hours. We are continuing our efforts not just to control costs but to reduce them. For 2004, we plan $1.4 billion in cost reductions. We will reduce operating costs by continuing our Breakthrough Productivity Initiative, as outlined in our Transformation Plan. We plan a reduction of 25 million work hours in 2004, even with the additional work hours from an extra delivery and retail day due to the extra calendar day of the year. We continue to reduce our total work hours even as we deliver to 1.8 million new addresses each year.

As discussed in the Operations section and in our 2003 Annual Report, the Postal Civil Service Retirement System Funding Reform Act of 2003 changed our funding requirements for CSRS retiree benefits. As required by the Act, we have submitted reports giving our recommendations on two issues. First, we recommended that the obligation to fund the military service costs of postal employees' CSRS retirement benefits revert to the Department of the Treasury. Second, we recommended that the escrow provisions of the Act be eliminated and that those "savings" be used to fund retiree health care benefits, retire debt or fund capital expenditures. We do not know what actions, if any, will be taken by Congress regarding these proposals. Any of these issues could materially affect our financial results in 2004 and beyond.

In accordance with our Emergency Preparedness Plan, the Board of Governors approved the Biohazard Detection System and the Ventilation and Filtration System, which totaled $573 million. We have scheduled deployment of these systems to begin in 2004 and to be completed by mid-2005. We requested a $350 million appropriation for 2004 to fund these costs. When no legislative action was taken on that request, we submitted a revised request of $779 million to fund Emergency Preparedness Costs through 2005. This $779 million request was not included in the proposed 2005 U.S. Government Budget transmitted by the President to the Congress on February 2, 2004. Failure to receive this appropriation will impact our financial results.

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.

ITEM 3. Qualitative Disclosures about Market Risk

In the normal course of business, we are exposed to market risks from changes in commodity prices, certain foreign currency exchange rate fluctuations, and interest rates. Our commodity price risk is primarily exposure to changes in prices for diesel fuel, unleaded gasoline and aircraft fuel for transportation of the mail, and natural gas for heating facilities. We have foreign currency exchange rate risk related to the settlement of terminal dues and transit fees and other transportation and delivery arrangements with foreign postal administrations and/or their affiliates for international mail.

We did not use derivative commodity or financial instruments to manage market risk related to commodities, foreign currency exchange or interest rate fluctuations for debt instruments. Additionally, we do not purchase or hold derivative financial instruments for speculative purposes.

ITEM 4. Controls and Procedures

We are voluntarily complying with selected sections of the Sarbanes-Oxley Act of 2002, primarily Section 404 relating to the documentation and testing of controls. This activity was recommended by the Board of Governor's Audit and Finance Committee and is being reported to that Committee.

During the next quarter, we will report to the Audit and Finance Committee the recognized internal control framework we selected as suitable for our evaluation of internal controls. Over the past year, we began updating our financial process and control documentation. During the course of this fiscal year, we will begin formalized testing of our internal controls for processes relating to the financial statements.

No material control weaknesses were identified or reported during the quarter ending December 31, 2003.

Part II OTHER INFORMATION

ITEM 1. Legal Proceedings

See foot note 3, Contingent Liabilities, December 31, 2003 financial statements.

ITEM 5. Other Information

Board of Governors Matters
The President of the United States made a second recess appointment of Governor Albert V. Casey to the Board of Governors on December 23, 2003. The recess appointment will expire in late 2004. Governor Casey is Chairman, Audit and Finance Committee.

On December 9, 2003, S. David Fineman, Chairman, Board of Governors, appointed Governor James C. Miller III to the Audit and Finance Committee.

On December 8, 2003, Governor Ned R. McWherter's term ended.

ITEM 6. Exhibits and Reports

Reports
The following announcements are available online at http://www.usps.com/financials/welcome.htm Financial Public Releases.

1. December 2, 2003: Postal Service Revises FY 2003 Q III Balance Sheet -- Reports supplemental Pension Liability Footnotes.

2. December 9, 2003: Postal Service announces FY 2003 financial results.

3. December 8, 2003: Postal Service appeals method for determining international mail transportation rates Docket Number 1629.

4. January 26, 2004: Postal Service requests the Board of Actuaries of the Civil Service Retirement System to review and adjust the method used to allocate Civil Service Retirement System liabilities to the Postal Service for employees first employed before July 1, 1971, the date of Postal Reorganization.