Postal Rate Commission
Submitted 6/9/2003 12:43 pm
Filing ID: 38381
Accepted 6/9/2003

CERTIFIED FINANCIAL STATEMENTS

The United States Postal Service Certified Financial Statements for the Years Ended September 30, 2002 and September 30, 2001, with report of independent auditors Ernst and Young, are reprinted in the following pages.

ASSURANCE AND ADVISORY
BUSINESS SERVICES

Copy for Bill Tayman

UNITED STATES POSTAL SERVICE

Financial Statements

Years ended September 30, 2002 and 2001 with Report of Independent Auditors

ERNST & YOUNG

ERNST & YOUNG LLP

UNITED STATES POSTAL SERVICE

Financial Statements

Years ended September 30, 2002 and 2001 with Report of Independent Auditors

0212-0376294-MCL

United States Postal Service

Financial Statements

Years ended September 30, 2002 and 2001

Contents

ERNST & YOUNG

Ernst & Young LLP
8484 Westpark Drive
McLean, VA 22102

Phone: (703) 747-1000
www.ey.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, 2002 and 2001, and the related statements of operations, changes in net capital deficiency and cash flows for each of the three years in the period ended September 30, 2002. These financial statements are the responsibility of the United States Postal Service's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

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

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

Ernst + Young LLP

November 8, 2002

United States Postal Service

Balance Sheets

	September 30 2002	2001
	(In Millions)	
Assets		
Current assets:		
Cash and cash equivalents *(Note 2)*	**$ 1,156**	$ 1,005
Receivables:		
Foreign countries	**592**	379
U.S. government	**125**	133
Consignment	**55**	55
Other	**137**	151
	909	718
Less allowances	**(112)**	(110)
Total receivables, net	**797**	608
Supplies, advances and prepayments	**327**	320
Total current assets	**2,280**	1,933
Other assets, principally revenue forgone appropriations receivable *(Note 7)*	**368**	372
Property and equipment, at cost:		
Buildings	**19,513**	18,808
Equipment	**16,421**	15,456
Land	**2,776**	2,684
Leasehold improvements	**1,098**	1,163
	39,808	38,111
Less allowances for depreciation and amortization	**(16,895)**	(15,317)
	22,913	22,794
Construction in progress	**1,223**	1,969
Total property and equipment, net	**24,136**	24,763
Deferred retirement costs *(Note 6)*	**32,231**	32,023
Total assets	**$ 59,015**	$ 59,091

0212-0376294-MCL

	September 30 2002	2001
	(In Millions)	
Liabilities and net capital deficiency		
Current liabilities:		
Compensation and benefits	**$ 5,113**	$ 5,810
Estimated prepaid postage	**1,500**	1,623
Payables and accrued expenses:		
Foreign countries	**748**	499
U.S. government	**246**	151
Emergency preparedness appropriations *(Note 10)*	**583**	–
Other	**584**	956
Total payables and accrued expenses	**2,161**	1,606
Prepaid box rentals, permit and metered mail	**2,011**	1,866
Outstanding postal money orders	**986**	988
Current portion of long-term debt	**3,815**	5,564
Total current liabilities	**15,586**	17,457
Long-term debt, less current portion *(Note 5)*	**7,300**	5,751
Other liabilities:		
Amounts payable for deferred retirement benefits *(Note 6)*	**30,046**	29,932
Workers' compensation *(Notes 2 and 3)*	**5,815**	5,167
Employees' accumulated leave	**2,088**	2,124
Other	**1,182**	986
Total other liabilities	**39,131**	38,209
Commitments and contingencies *(Notes 8 and 9)*		
Total liabilities	**62,017**	61,417
Net capital deficiency:		
Capital contributions of the U.S. government	**3,034**	3,034
Deficit since reorganization	**(6,036)**	(5,360)
Total net capital deficiency	**(3,002)**	(2,326)
Total liabilities and net capital deficiency	**$ 59,015**	$ 59,091

See accompanying notes.

United States Postal Service

Statements of Operations

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

See accompanying notes.

United States Postal Service

Statements of Changes in Net Capital Deficiency

	Capital Contributions of the U.S. Government	Deficit Since Reorganization	Total Net Capital Deficiency
		(In Millions)	
Balance, September 30, 1999	$ 3,034	$(3,481)	$ (447)
Net loss	–	(199)	(199)
Balance, September 30, 2000	3,034	(3,680)	(646)
Net loss	–	(1,680)	(1,680)
Balance, September 30, 2001	3,034	(5,360)	(2,326)
Net loss	–	**(676)**	**(676)**
Balance, September 30, 2002	**$ 3,034**	**$(6,036)**	**$(3,002)**

See accompanying notes.

United States Postal Service

Statements of Cash Flows

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

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

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

See accompanying notes.

1. Description of Business

Nature of Operations

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

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

Postal Reorganization

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

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

1. Description of Business (continued)

Price-Setting Process

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

2. Summary of Significant Accounting Policies

Basis of Accounting and Use of Estimates

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

Cash Equivalents

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

Current Values of Financial Instruments

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

Supplies, Advances and Prepayments

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

2. Summary of Significant Accounting Policies (continued)

Property and Equipment

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

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

Impaired Assets

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

Revenue Recognition/Estimated Prepaid Postage

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

Compensation and Benefits Payable

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

2. Summary of Significant Accounting Policies (continued)

Deferred Retirement Benefits and Costs

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

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

Post-Retirement Health Benefits

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

Workers' Compensation Costs

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

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

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

2. Summary of Significant Accounting Policies (continued)

Emergency Preparedness Appropriations

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

New Accounting Pronouncements

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

3. Workers' Compensation

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

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

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

3. Workers' Compensation (continued)

of our liability for future outlays on behalf of Postal Service workers' compensation claimants. The effect of the refinements was a reduction of $423 million in the 2000 compensation and benefits expense.

4. Post-Retirement Health Benefit Programs

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

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

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

5. Debt and Related Interest Costs

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

5. Debt and Related Interest Costs (continued)

Debt is due as follows (dollars in millions):

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

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

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

5. Debt and Related Interest Costs (continued)

Our debt consists of the following (dollars in millions):

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

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

** Prior year rate was 2.521%.

*** Prior year rate was 2.501%.

6. Retirement Programs

We account for retirement benefits as a participant in a multi-employer plan arrangement, in accordance with FAS Statement No. 87, *Employers' Accounting for Pensions*. With certain exceptions, employees participate in one of the following three retirement programs based upon the starting date of their employment with the Postal Service. Employee and employer contributions are made to the Civil Service Retirement System, the Dual System or the Federal Employees Retirement System, which are administered by the Office of Personnel Management. Employees may also participate in the Thrift Savings Plan, which is a defined contribution retirement savings and investment plan. Postal Service employees are authorized to participate in the Thrift Savings Plan by the Federal Employees Retirement System Act of 1986. The Plan is administered by the Federal Retirement Thrift Investment Board. We and all employees also contribute to Medicare at the rate prescribed by law.

Civil Service Retirement System (CSRS)

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

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

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

Federal Employees Retirement System (FERS)

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

6. Retirement Programs (continued)

Federal Employees Retirement System (FERS) (continued)

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

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

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

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

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

6. Retirement Programs (continued)

Deferred Retirement Costs

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

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

There are no deferred retirement costs associated with FERS.

Deferred Retirement Liability—Civil Service Retirement System

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

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

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

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

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

6. Retirement Programs (continued)

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

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

Future Minimum Payments

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

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

6. Retirement Programs (continued)

Expense Components

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

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

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

7. Revenue Forgone

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

7. Revenue Forgone (continued)

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

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

8. Commitments

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

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

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

8. Commitments (continued)

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

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

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

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

9. Contingent Liabilities

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

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

9. Contingent Liabilities (continued)

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

10. Emergency Preparedness Funding

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

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

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

All three appropriations are to remain available until expended for purposes approved by Congress. We are required to submit quarterly expenditure plans on the obligation of all 2002 supplemental appropriations, as well as annual updates of the Emergency

10. Emergency Preparedness Funding (continued)

Preparedness Plan. Unspent funds that are not reallocated with Congressional approval are required to be returned to the United States Treasury. As a result, the funds that have not been spent or reallocated as of September 30, 2002 of $583 million are reflected in our 2002 Balance Sheet as a non-interest bearing liability and have been reflected in the 2002 Statement of Cash Flows as a financing activity.

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

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

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

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

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

10. Emergency Preparedness Funding (continued)

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

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

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

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

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

11. Subsequent Event

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

As discussed in Note 6, we participate in retirement programs administered by OPM. As required by law, each year OPM determines the estimated liability of the CSRDF for both management-granted increases in CSRS employees' current basic pay and for COLAs the government grants retirees. We amortize and pay this liability amount in 30 equal annual installments for management-granted increases and 15 years for government-granted COLAs, both of which include interest computed at a rate of 5% per year. The liability is

11. Subsequent Event (continued)

calculated as part of a multiemployer plan of the U.S. government. Nothing in current legislation permits determining our liability separately.

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

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