

## Mail Delivers for America

Mail helps power the economic engine of the nation.

Mail is a \$1 trillion industry that employs more than 8 million Americans. You probably know at least one person who relies, directly or indirectly, on the mail for his or her livelihood. It could be your friend, family member, neighbor or colleague — or it could be the carrier who delivers your mail every day.

Every letter, catalog, newspaper and package we deliver represents a journey through the American workforce: the mill workers, truck drivers and engineers employed by a paper manufacturer. The sales force, call center operators and fulfillment staff who work for the retailer in a small town in Nebraska. The graphic designers, wordsmiths and account representatives for the big direct mail firm in Chicago. Small business owners — everywhere — who sell online but rely on the mail to reach their customers.

And when the economic engine of our nation sputters? We're still delivering to every address, six days a week — and even on Sundays if our customers need us to get it there.

Even when gas prices spike, we won't add a fuel surcharge on that package delivery.

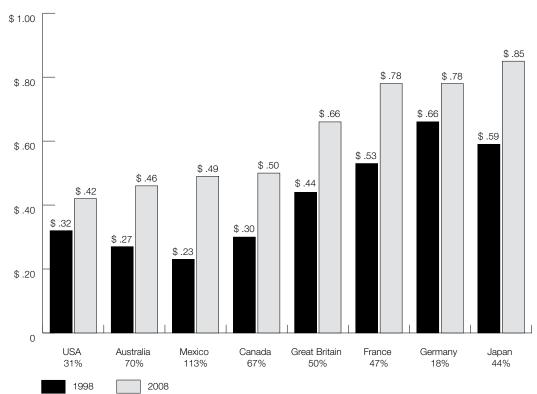
Americans depend on reliable delivery at reasonable prices, and that's our commitment.

For more than 230 years, the United States Postal Service has provided dependable service at a uniform price. Our products and services create jobs, strengthen relationships and connect businesses.

Mail continues to bind the nation together.

# 1998 to 2008 stamp prices

First-Class Mail Postage Rates 1998-2008 and Percentage Increase (CPI-U Increase 33%)



# 2008 Financial Highlights

#### Years Ended September 30

	2008	2007	2006
(Dollars in millions, audited)			
Operating revenue	\$ 74,932	\$ 74,778	\$ 72,650
Operating expenses	\$ 77,738	\$ 80,105	\$ 71,681
Income from Operations	\$ (2,806)	\$ (5,327)	\$ 969
Operating margin	(3.7%)	(7.1%)	1.3%
Net (loss) income	\$ (2,806)	\$ (5,142)	\$ 900
Purchase of capital property and equipment	\$ 1,995	\$ 2,715	\$ 2,630
Debt	\$ 7,200	\$ 4,200	\$ 2,100
Interest expense*	\$ 36	\$ 10	\$ 5
Capital contributions of U.S. government	\$ 3,034	\$ 3,034	\$ 3,034
Retained (deficit) earnings since reorganization	\$ (4,706)	\$ (1,900)	\$ 3,242
Total Net Capital	\$ (1,672)	\$ 1,134	\$ 6,276
(Unaudited)			
Number of career employees	663,238	684,762	696,138
Mail volume (pieces in millions)	202,703	212,234	213,138
New delivery points served	1,199,764	1,818,326	1,847,831

Percent Change From Preceding Year						
2008	2007	2006				
0.2%	2.9%	3.9%				
(3.0%)	11.8%	5.0%				
(26.5%)	3.2%	13.5%				
(3.1%)	(1.6%)	(1.2%)				

## Table of **Contents**

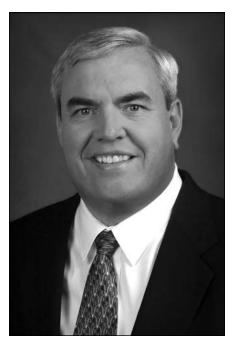
- **4** Letter from the Postmaster General, CEO and Chairman of the Board of Governors
- 6 2008 Year in Review
- 8 Value of the Mail
- 10 Board of Governors
- 12 Executive Committee
- **14** Message from the Audit and Finance Committee

- **16** Message from the Chief Financial Officer and Executive Vice President
- 19 Business
- 24 Risk Factors
- 27 Properties
- 28 Management's Discussion and Analysis of Financial Condition and Results of Operations

- 45 Controls & Procedures
- **46** Report of Independent Auditor
- **47** Financial Statements
- 52 Notes to the Financial Statements
- **62** Operating Statistics
- **66** Financial History Summary
- 67 Selected Quarterly Financial Data
- **68** Glossary

<sup>\*</sup> Excluding interest expense on deferred retirement obligations in 2006.

# Letter from the Postmaster General and CEO and the Chairman of the Board of Governors



o the President, Members of Congress, customers, employees, and the American people:

As the Postal Service entered fiscal year 2008, it became clear that the nation's economy was entering a period of increasing stress. The financial and housing sectors in particular — two key mail generators — were weakening. This was reflected in diminishing mail volumes, which accelerated as the nation experienced declines in retail sales, consumer confidence, and credit availability.

Because the mail remains an early indicator of larger economic trends, this signaled an increasingly difficult year for our business. The Board and management acted quickly to adjust our plans — cutting costs, reordering priorities, realigning resources to a reduced workload, and refocusing our growth initiatives to better address dramatically changing conditions.



One thing that did not change — and will not change — is our commitment to service excellence, and earning our customers' trust. This is the heart of our brand. Through a challenging year, the men and women of the Postal Service provided our customers with the most outstanding service ever, including a remarkable 97 percent on-time delivery rate for local First-Class Mail. And through a period marked by growing concern about the stability of many historic enterprises, the respected Ponemon Institute found that the Postal Service remained the most trusted government agency and among the 10 most trusted organizations public or private — in the nation.

We began 2008 with a goal of reducing costs by \$1 billion. We soon doubled that target, which we not only met, but exceeded by year end. Work hours were reduced significantly as overtime rates declined, and focused attrition activities helped bring career staffing down by more than 20,000 positions. New labor agreements contributed to our ability to better manage

growth in benefit costs. Throughout the organization, we took steps to eliminate activities that were simply not cost effective in today's changed business environment.

Although postage prices increased in May, the law places a cap on prices for the vast majority of our products: they cannot exceed the previous year's rate of growth in the Consumer Price Index. This, of course, coupled with high and steady volume losses of more than 4.5 percent — 9.5 billion pieces of mail — was insufficient to offset growth in costs that was led by the highest gasoline prices our nation has ever seen — prices that did not begin to moderate until near the close of the fiscal year.

Providers throughout the entire package and express delivery business, each heavily dependent on transportation, were affected by the steep increases in fuel prices and a softening of shipping demand by consumers and businesses. Like them, the Postal Service experienced more positive results in its international product lines, which continued to benefit from favorable foreign exchange rates.

We ended the year with a net loss of \$2.8 billion dollars. The effects of a dramatically declining economic environment on our revenue, and fuel prices that increased costs by over \$500 million, were magnified by other factors as well, including the shift of transactions and messages from the mail to electronic communications.

The Postal Law of 2006 required a payment of \$5.6 billion, part of an ongoing 10-year obligation for future retiree health benefits — this represents 7.5 percent of operating revenue. This payment was on top of a \$1.8 billion payment for the employer's 2008 portion of current retirees' health benefits costs.

Cost management remains a critical part of our strategy, as it must be, but growth is even more important to a successful future. That is why we took several major steps this year to build our business. Listening to our customers, we introduced new flexibility and choices to our shipping services products, with expanded choices, volume discounts, online discounts, customized services, and pricing that better reflects the cost differences between some long- and short-distance shipping. These have made our Express Mail and Priority Mail services better values than ever.

Realignment of several major elements of our business in June also was designed to support growth. These adjustments will help us bring new products and pricing to market more quickly and effectively. They are shaped by an aggressive new approach and a leadership team that reflects decades of customer experience both in consumer products and package delivery.

Experience tells us that when the economy stabilizes there will be a renewed demand for shipping and mailing services. That is why we are continuing our investment in the future. We simply cannot afford to defer the improvements necessary to support the needs of our customers until the business climate improves. Even in today's wired world, mail continues to be one of the most effective channels of communication available to American businesses and households. This is a clear competitive advantage.

To protect the advantages of mail, the deployment of the automated Flats Sequencing System is proceeding as scheduled. This will reduce even more costs as it increases sorting speed and accuracy.

Our commitment to the full implementation of the Intelligent Mail barcode also will provide mailers and the Postal Service with a rich source of real-time system data. This will increase the value of the mail and improve production, accounting, and operating processes. At the same time, we are making our networks more effective than ever. And by embracing a sustainable, green approach to doing business, we are creating long-term value for customers, employees, and the communities we serve.

The Postal Service has been a vibrant part of our nation through the highs and lows of every economic cycle for more than two centuries. We will keep it that way by pursuing innovative approaches that support our historic mission of delivering trusted, affordable, universal service to everyone in America.

John E. Potter Postmaster General/CEO

Alan C. Kessler Chairman, Board of Governors

#### 2008 Year in Review

#### New era for shipping services

We've entered a new world of competition. For the first time, as a result of legislation, we have the flexibility to introduce new products and adjust prices to respond to market conditions. Taking the first steps in this brave new shipping world, we're offering online savings and other pricing incentives for our shipping services. When customers use our Express Mail, Priority Mail, ground package, or international services, they get some of the best value in the marketplace. And, as always, they get the trust and reliability we've been delivering to Americans for more than two centuries.



# Record-breaking on-time performance

Our national on-time performance scores have never been better. We reached record levels in the third quarter for all three categories of First-Class Mail — overnight service at 97 percent on-time, two-day service at 95 percent on-time and three-day at 94 percent on-time. (First-Class Mail performance is measured independently by IBM Global Business Services.) These outstanding results reflect the dedication of our employees to

provide excellent service to every family and business in the nation.

#### Americans trust the Postal Service

Proudly, we continue to earn and keep the confidence and trust of our customers. For the fourth year in a row, the premier privacy trust study in America named the Postal Service the most-trusted government agency. More than 86 percent of those surveyed by the Ponemon Institute ranked us first among 74 agencies for keeping information safe and secure. And, according to an Associated Press-Ipsos poll, 89 percent of survey participants had a positive view of the Postal Service, highest out of a dozen federal agencies. We've always been a welcomed and trusted part of the communities we serve.

# Adapting to an evolving marketplace

We made changes to our organization to strengthen our position in an extremely competitive marketplace. With growth as a top priority, we brought together product development, product management and sales in a new Mailing and Shipping Services division.

Additionally, the new Customer Relations division will manage key consumer and business customer relationships as well as pricing.

And we continue to examine ways to make our networks work better for customers.

# Moving forward with new technologies

We're enthusiastic about two new technologies that promise to enhance the value of the mail and increase its effectiveness. Both the Postal Service and the mailing industry will benefit. Intelligent Mail services and the wealth of information they provide will become the foundation of mail value: printing logistics,

verification, acceptance, payment, processing, diagnostics, routing, transportation and delivery. The Flats Sequencing System is being deployed to automate the sorting of flat-size mail — magazines, catalogs and large envelopes — into delivery sequence, improving efficiency.



# Providing customers with choices online

The Post Office is always just a click away at usps.com. A redesign of the website makes it easier than ever to find the right solution for any mailing or shipping need. And the Brookings Institution named it one of the top five federal websites. We're always introducing new ways to make it quick, easy, and convenient to do business with us from your home or office. Many online features were introduced during the year customers now can find and pay for a new Post Office box, arrange for Carrier Pickup service for parcels being returned, and apply for a permit for Business Reply Mail. The Post Office is wherever you want it to be, around the clock.

# Fostering an inclusive work environment

"People are different — respect is universal." With that message, we continue to honor our commitment to diversity and respect in the workplace. Hispanic Business magazine again named the Postal Service one of the best companies for Hispanics and one of the country's top 10 companies for workforce diversity. We're developing tomorrow's leaders today through corporate succession planning and training opportunities. An online application process makes it easier to look for available postal positions and explore career advancement opportunities. For the fifth straight year, the Postal Service was named one of the best places to work in information technology by Computerworld magazine.

# Employees help connect with new business

We'll not only deliver and pick up that letter or package for you, we'll introduce you to our products and services and show you economical ways to mail and ship with the Postal Service. When we introduced our new shipping services pricing, we equipped employees with information they would need to spread the good word about our shipping to our customers. From carriers to retail associates at the Post Office to employees at the back dock, our workforce is dedicated to making the Postal Service the shipper of choice for America. In addition, we're broadening our outreach to Hispanic, Asian and other markets, including Spanish-language advertising.

#### Committed to a safe workplace

Federal officials praise the
Postal Service for its attention
to the health and safety of its
employees. More than 150 of our
worksites have achieved Voluntary
Protection Program status from the
Occupational Safety and Health
Administration. This program brings
management, employees and union
representatives together to work

to reduce injuries and illnesses. And we're also working to spread a safety message to the youngest generation of postal customers. Our drivers are trained to watch out for children. Through public service announcements and educational materials, we're raising awareness that children should never approach our delivery vehicles.

# Eco-friendly solutions and green innovation

Environmental responsibility is a corporate-wide priority. We created a vice president of sustainability to build on programs already under way as well as embrace new opportunities. As always, we're leading the way in advancing alternative-fuel vehicle technology, energy conservation, and recycling efforts. In 2008, the White House Council on Environmental Quality recognized five Postal Service environmental initiatives. From offering eco-friendly shipping boxes to promoting up-to-date address lists and targeted direct mail, we're encouraging our customers to "go green." Americans can learn more about our sustainability efforts by visiting usps.com/green.

# Corporate citizenship and community involvement

We give back to the communities we serve. We support programs like the National Association of Letter Carriers Food Drive, which collected a record-setting 73.1 million pounds of food donations. America's Looking For Its Missing Children program has resulted in the safe return of 148 children. More than 40,000 employees have joined the National Marrow Donor Program registry. Our semipostal stamps address important social concerns, raising more than \$62 million for breast cancer research. And in an election year, we worked with the Department of Defense to deliver absentee ballots to members of the armed forces serving abroad. Also, state and county election officials could go to *usps. com/electionmail* to find information on how to prepare and send mail as part of the election process.

# Delivering for Americans when disaster strikes

When an earthquake damaged the West Covina Post Office in Southern California, the Postmaster moved the lobby outside into mobile retail vans. When floodwaters spilled into the Fond du Lac Post Office in Wisconsin, employees reported to work at the county fairgrounds. In the aftermath of wildfires in the West and tornadoes in the South, we made sure residents got their mail. When a historic hurricane season's powerful storms pounded the Gulf Coast and moved up the Eastern seaboard, employees rose to the challenge and kept the mail moving. We kept customers informed about their mail service at usps.com. We promise to deliver for you, and we keep that promise.





#### Value of the Mail



#### Value

Mail is the great American equalizer.

No matter where you live, we'll deliver for you, six days a week. If it takes a pack mule or seaplane, we'll just do it. You can send a First-Class Mail letter from Maine to Alaska, from Detroit to Dallas, or from Brooklyn to the Bronx — all for the same price. We'll stop at the mailbox at the end of your driveway or drop off mail in the lobby of your high-rise apartment building. We'll also pick up your letters and packages at the same time we deliver.

Everyone can use the mail. There's no age limit, no special equipment needed, and feel free to use the level of technology to match your comfort level. If you want to mail and ship online, the Post Office is always open at *usps.com*. Or if you prefer to talk to a knowledgeable retail associate, stop by a Post Office. We make it quick, easy and convenient, as you like it.

We've been connecting people and businesses since the nation's founding. You might not think about the mechanics behind getting a piece of mail delivered to your home or office. But when you receive a package, important document, or birthday card through the mail, consider the online merchant who sold you the product inside that package, the government agency that sent you that important document, and the child who wishes you well as you celebrate another yearly milestone.

Mail is the economic engine that enables the Postal Service to deliver regular, dependable service to everyone.

We're all in the mail together.



#### Green

We're committed to environmental stewardship.

It doesn't get much "greener" than walking a delivery route. Nationwide, that's about 20 percent of all letter carrier routes. We also have carriers who ride bicycles or use flexible-fuel vehicles. And postal delivery and pickup reduces emissions and fuel use. Instead of customers driving multiple cars to the Post Office, one carrier stops at multiple homes. We also deliver packages for other shipping firms, minimizing delivery trips to neighborhoods.

Being green is not a new approach for us. We're a recognized innovator and leader in recycling, energy management, and exploring alternative-fuel technology. We are committed to actions that promote sustainability — meeting the needs of the present without compromising the future.

We're helping consumers and businesses make environmentally friendly decisions about their mail. At usps.com/green, you can learn about green products and services as well as get recycling ideas and other information to improve environmental awareness. We're working with other companies, agencies and organizations in mail-back programs that recycle and dispose of small electronics, compact fluorescent lamps, and discarded or expired pharmaceuticals. And our packaging and envelopes are certified for ecologically smart product components.

We're working with customers, industry groups, suppliers, and environmental organizations to improve the environmental performance of mail, and we encourage marketers to make sure mail is properly addressed and targeted so consumers receive the mail they want.

Greening the mail is smart business.



#### Trust

Trust is the foundation of our service to the nation.

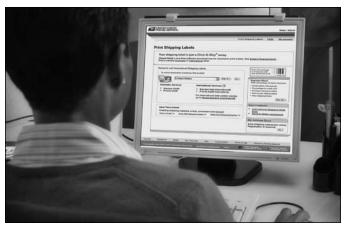
Americans depend on the security of the mail and they know we'll protect their privacy. This has been a fundamental principle of the Postal Service for more than 230 years. As the landscape of communications changes, we're leading the way in efforts to protect personal information, including ensuring online security. Our actions to protect consumers against mail fraud and theft have made us one of the most trusted organizations in the country.

We also keep our customers' trust through our performance. We get the mail where you want it, when you want it there, whether you're a consumer with a single letter or a large business with millions of mailpieces. You trust us to deliver for you, with high levels of service and dependability. We are continually working to build that trust. Through new technologies, such as Intelligent Mail services, more information about the mail is available than ever before, providing feedback that benefits everyone.

Our strength lies in the women and men who proudly represent the Postal Service. Our trusted carriers are welcomed in every community and show their care and concern by watching out for elderly customers and others on their routes, sometimes risking their own safety to help other citizens. At our Post Offices, we connect with the people in the communities we serve, building trusted relationships that endure.

Through times of prosperity and times of conflict, the Postal Service serves as the messenger that binds the nation together.

Our foundation of trust is rock solid.



#### Commitment

Our customers are at the center of everything we do.

With their needs in mind, we're making sure mail remains relevant, safe, and private — and continues to provide value for generations to come.

We always take the long view. As the nation has changed, so has the Postal Service. We're experts at adapting to the changing lifestyles of Americans and an evolving marketplace. From the Pony Express to mechanization to digital communications, we have always embraced new technologies, especially when they enable us to improve service and efficiency, and make the mail work better for our customers.

We'll keep innovating.

We're giving consumers and businesses convenient access and choices to manage their mail. We're working with mailers, marketers, and advertisers to improve the quality and relevancy of mail. We're adapting our products and pricing to market requirements. We're creating solutions that meet the needs — domestic and international — of a wide range of customers, including households and businesses, both small and large.

Our customers are diverse, and so are the ways they use the mail and how they do business with us. Ship online. Buy stamps at a grocery store or ATM. Save time and do it yourself at a kiosk.

After all, it's your Postal Service. Mail it your way.

Our mission is to provide trusted, affordable, universal service.

That's our commitment.

#### 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. No more than five Governors can 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.



Alan C. Kessler Chairman.

Appointed November 2000. Term expires December 2008. Partner at WolfBlock, LLP. Member of the Presidential Transition Team, 1992–93. Former Vice Chair of the Presidential/Congressional Commission on Risk Assessment and Risk Management. Member of Electoral College, 2000. Serves on Boards of the Greater Philadelphia Chamber of Commerce and the Philadelphia Industrial Development Corp. Former commissioner for Lower Merion Township, PA.



Carolyn Lewis Gallagher
Vice Chairman of the Board of
Governors since January 2008.
Chairman, Compensation and
Management Resources Committee
and Vice Chairman, Audit and
Finance Committee. Director of
Home Therapy Specialists, Inc.
Former President and CEO of
Texwood Furniture, Inc. Former
Trustee and Chairman, Texas
Employees' Retirement System.
Appointed by President Bush in
2003 to serve on the President's
Commission on the USPS.



Thurgood Marshall, Jr. Appointed December 2006. Term expires December 2011. Chairman, Government Relations and Regulatory Committee. Member, Audit and Finance Committee. Partner at Bingham McCutchen and principal with Bingham Consulting Group. Served President Clinton as former Assistant to the President and Cabinet Secretary. Former Director of Legislative Affairs and Deputy Counsel for Vice President Gore.



James C. Miller III Appointed April 2003. Term expires December 2010. Past Chairman of Board of Governors, 2005 through 2008. Chairman, Governance and Strategic Planning Committee and member, Audit and Finance Committee. Chairman emeritus, 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.



Mickey D. Barnett Appointed August 2006. Term expires December 2013. Vice Chairman, Government Relations and Regulatory Committee and member, Governance and Strategic Planning Committee. Attorney in Albuquerque, New Mexico. Former member, New Mexico State Senate. Former member, Appellate Nominating Commission for the New Mexico Supreme Court of Appeals. Former Legislative Assistant to Senator Pete Domenici of New Mexico.



James H. Bilbray Appointed August 2006. Term expires December 2015. Vice Chairman, Governance and Strategic Planning Committee and member, Government Relations and Regulatory Committee. Attorney in Las Vegas, Nevada. Former member, U.S. House of Representatives from Nevada. Former member, Nevada State Senate. Former Deputy District Attorney in Clark County, Nevada.



Louis J. Giuliano Appointed
November 2004. Term expires
December 2014. Chairman, Ad-Hoc
Committee on Operations. Member,
Compensation and Management
Resources Committee and
Governance and Strategic Planning
Committee. Former Chairman
of Board of Directors, President
and Chief Executive Officer of ITT
Corp. Director of the John McNeely
Company and Senior Advisor at the
Carlyle Group.



Katherine C. Tobin Appointed August 2006. Term expires December 2012. Chairman, Audit and Finance Committee and member, Compensation and Management Resources Committee. Member, Advisory Board, MentorNet, mentoring network for women in engineering and science. Former head of research teams at Hewlett-Packard Co. and Catalyst, a nonprofit organization for women in business.



Ellen C. Williams Appointed August 2006. Term expires December 2014. Vice Chairman, Compensation and Management Resources Committee and member, Government Relations and Regulatory Committee. Principal, government affairs and lobbying firm. Former Vice Chairman, Kentucky Public Services Commission. Former Commissioner, Governor's Office for Local Development. Former Chairman, Kentucky Republican Party. Staff assistant to former U.S. Representative Larry Hopkins.

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.

Patrick R. Donahoe Appointed 19th Deputy Postmaster General in April 2005. Donahoe is Chief Operating Officer and has served as Senior Vice President, Operations; Senior Vice President, Human Resources; and Vice President, Allegheny Area Operations.

## **Executive Committee**

The Executive Committee of the U.S. Postal Service 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
Chief Executive Officer



Ross Philo Chief Information Officer and Executive Vice President



Mary Anne Gibbons Senior Vice President, General Counsel



Patrick R. Donahoe
Deputy Postmaster General
and Chief Operating Officer



Anthony J. Vegliante
Chief Human Resources Officer
and Executive Vice President



**Stephen M. Kearney** Senior Vice President, Customer Relations



Robert F. Bernstock President, Mailing and Shipping Services



H. Glen Walker Chief Financial Officer and Executive Vice President



**Linda A. Kingsley**Senior Vice President,
Strategy and Transition

Kathleen Ainsworth

Vice President, Retail Operations

Mitzi R. Betman

Vice President, Corporate Communications

Sylvester Black

Vice President, Area Operations (Western)

Megan J. Brennan

Vice President, Area Operations (Eastern)

Susan M. Brownell

Vice President, Supply Management

Ellis A. Burgoyne

Vice President, Area Operations (Southwest)

William A. Campbell

Judicial Officer

James P. Cochrane

Vice President, Ground Shipping

Michael J. Daley

Vice President, Area Operations (Pacific)

Thomas G. Day

Senior Vice President, Intelligent Mail and Address Quality

Marie Therese Dominguez

Vice President, Government Relations and Public Policy

Jo Ann Feindt

Vice President, Area Operations (Great Lakes)

Steven J. Forte

Vice President, Area Operations (New York Metro)

William P. Galligan

Senior Vice President, Operations

Deborah Giannoni-Jackson

Vice President, Employee Resource Management

William R. Gilligan

Chief Postal Inspector (Acting)

Timothy C. Haney

Vice President, Area Operations (Northeast)

Delores J. Killette

Vice President, Consumer Advocate

Susan M. LaChance

Vice President, Employee Development and Diversity

Jerry D. Lane

Vice President, Area Operations (Capital Metro)

Lynn Malcolm

Vice President, Controller

Pritha N. Mehra

Vice President, Business Mail Entry and Payment Technologies

Julie S. Moore

Secretary of the Board of Governors

Walter F. O'Tormey

Vice President, Engineering

Anthony M. Pajunas

Vice President, Network Operations

Robert J. Pedersen

Vice President, Treasurer

Susan M. Plonkey

Vice President, Business **Customer Relations** 

Samuel M. Pulcrano

Vice President, Sustainability

Gary C. Reblin

Vice President, Expedited Shipping

Maura Robinson

Vice President, Pricing

Tom A. Samra

Vice President, Facilities

David B. Shoenfeld

Senior Vice President, Mailing Services

Jordan M. Small

Vice President, Delivery

Douglas A. Tulino

Vice President, Labor Relations

Paul Vogel

Senior Vice President and Managing Director, Global Business

Jerry W. Whalen

Vice President, Sales

Terry J. Wilson

Vice President, Area Operations (Southeast)

George W. Wright

Vice President, Information **Technology Operations** 

# Message from the Audit and Finance Committee



he Audit and Finance
Committee assists the full
Board of Governors in fulfilling
its fiduciary responsibilities. The
Chairman of the Board selects the
members of the Committee. This
year the Committee, whose members
included Governor Louis J. Giuliano,
Governor Carolyn Lewis Gallagher,
Governor Thurgood Marshall, Jr.,
Governor James C. Miller III, and I,
met eight times.

The Committee's primary responsibility is oversight of the integrity of Postal Service financial statements. The Committee reviews the soundness of internal accounting and control practices and major financial statement accounts involving management judgment. 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 Inspector General reports to the Governors and is represented at all Committee meetings.

During the year, the Committee heightened its focus on:

- Postal Service cost control efforts to respond to growing weakness in the U.S. economy,
- Effective transition to full compliance with Securities and Exchange Commission financial reporting rules,
- Progress toward 2010 compliance with section 404 of the Sarbanes-Oxley Act of 2002 (SOX),
- Monitoring efforts to increase the efficiency and effectiveness of internal controls,
- Enterprise Risk Management assessments.

The Committee strongly supported enterprise-wide, sustained actions to streamline work processes and reduce work-hour usage. The Committee also encouraged the Office of Inspector General (OIG) and outside auditors to look for similar process improvements and cost reduction opportunities in the conduct of their audits.

As part of its commitment to increased transparency and accountability, the Postal Service filed its first Form 10-Q with the Postal Regulatory Commission for Quarter I, ending December 31, 2007. The Committee was pleased to see a smooth adoption to the new format and continued improvements in subsequent quarterly 10-Q filings. These are positive developments and management is to be commended as the Postal Service transitioned to a new regulatory framework.

Preparation for SOX compliance featured prominently in the Committee's activities during the year. The Committee received a number of briefings on SOX requirements. We provided oversight on the strategic direction and guidance on decisions related to readiness, process improvement opportunities, and sustained compliance efforts.

In directing the conduct of the 2008 financial statement audit, the Committee met with Ernst & Young, LLP, and concurred with the scope and materiality levels they established in their work plan. The Committee met jointly and independently with Ernst & Young, LLP; the Inspector General; management; and the General Counsel throughout the year to discuss the progress of the audit and ensure independence and objectivity in the audit programs.

As a result, the Committee recommended, and the Board approved, the financial statements for 2008.

Katherine C. Tobin
Chairman, Audit and
Finance Committee

# Message from the Chief Financial Officer and Executive Vice President



nat a difference a year makes. At the start of the fiscal year, the Postal Service set ambitious goals to cut spending by \$1 billion, raise service to new record levels, improve customer satisfaction, and deliver solid business performance that would improve our bottom line by nearly \$5 billion from the prior year while essentially matching last year's record mail volume. By year's end, we met or exceeded all of the goals directly within, our control but saw customer demand and postal revenues decline at an unprecedented rate as the U.S. and global economies experienced serious deterioration.

While I believe it is necessary to focus this message on the Postal Service's immediate, extraordinary challenges, it is only appropriate to first recognize the achievements of postal managers and employees in fiscal year 2008. Service is the cornerstone of the postal franchise, and employees delivered better service across the board, including our best First-Class Mail service ever. We set new

performance records in three-day, two-day, and overnight committed First-Class Mail service, including a record 97 percent of local First-Class Mail delivered overnight in Quarter 3. Customer satisfaction also increased, with 93 percent of customers rating overall Postal Service performance as good to excellent in Quarter 4, the highest such score in three years.

The first decade of the 21st century has been marked by unusual economic and business volatility worldwide, which resulted in rapid swings in Postal Service mail volume, including the worst mail decline in our history. Mail volume fell by 9.5 billion pieces in FY 2008, reflecting weakness first in the housing and financial sectors and then spread throughout our domestic service portfolio, which comprises more than 99 percent of our total mail volume.

To put this in perspective, this one-year volume loss is 60 percent larger than the combined mail losses recorded from 2000 through 2003, during economic recession, the terrorist attacks of 2001 and the deposit of anthrax-laced letters into the mail system. It is, in fact, the single largest volume drop in our history, exceeding even the record 8 billion-piece loss recorded from 1929 to 1933 during the Great Depression. It also is troubling that the mail decline accelerated during the year, falling by a combined 3.4 billion pieces in Quarters 1 and 2, and by 6.1 billon pieces in the second half, a nearly 77 percent increase from the first two quarters.

At the same time that revenues were flattening, key costs were rising. During the course of the year, diesel fuel prices ranged from \$3.04 per gallon to \$4.76 per gallon. This increased costs by more than \$500 million. Fuel prices were not our

only significant cost increase — costof-living allowances for our bargaining employees, which are linked to inflation in the overall economy, were the highest ever in 2008.

Postal employees did a yeoman's job rallying to the unprecedented financial challenges, cutting costs by \$2 billion, and eliminating more than 50 million work hours compared to the prior year, even though the delivery network grew by 1.2 million new homes and businesses. Employees made important progress in transitioning to a new business model established by the Postal Accountability and Enhancement Act (PAEA) and implementing long-term strategic initiatives to further automate mail processing and advance the ongoing transformation of the Postal Service. This performance is a credit to the focus, discipline, and flexibility of postal employees at all levels to conserve resources, improve business processes, and adjust operations to respond to rapidly changing demands.

Despite efforts that far exceeded targets for both work-hour reductions and cost savings, the Postal Service finished the year with a \$2.8 billion loss. This includes \$5.6 billion that we paid into the Postal Service Retirees Health Benefits Fund (PSRHBF), as required by the new postal law.

Based on past experience, we expect mail volumes to rebound at least modestly when economic conditions improve. Under current economic conditions, however, there remains significant risk of further declines in mail volume. Therefore, in view of the rapid, year-end business deterioration experienced in FY 2008 and forecasts for continued economic difficulty in 2009, we have prepared ever more aggressive strategies to lower costs, reduce

the size of our workforce, and to adjust operations and resources. It will be difficult for the Postal Service to avoid further significant financial losses under current circumstances if present economic conditions persist or worsen. Extraordinary cost-saving efforts this year could not prevent a \$2.8 billion loss and inflationary pressures will increase the challenge in fiscal year 2009.

As we look to 2009, the Postal Service is committed to doing its part to keep mailing prices at or below the rate of inflation and to fulfill its legislative mandate to operate as a business fully funded by the revenues it earns and not by tax subsides. To do so, the Postal Service must realize every efficiency available, particularly in realigning its infrastructure, and matching resources and staffing to demand. The support of all stakeholders will be needed to make these necessary changes.

In addition, it is time to reexamine the accelerated 10-year payment schedule mandated by the PAEA for funding retiree health benefits. The Postal Service continues to support the sound business goal of fully funding retiree health benefits. However, the sizeable accelerated yearly outlays required under the law are growing increasingly untenable in the current, unstable economic environment. In the last 18 months. we have contributed over \$31 billion into the PSRHBF, either through direct payments or transfers from other over-funded obligations.

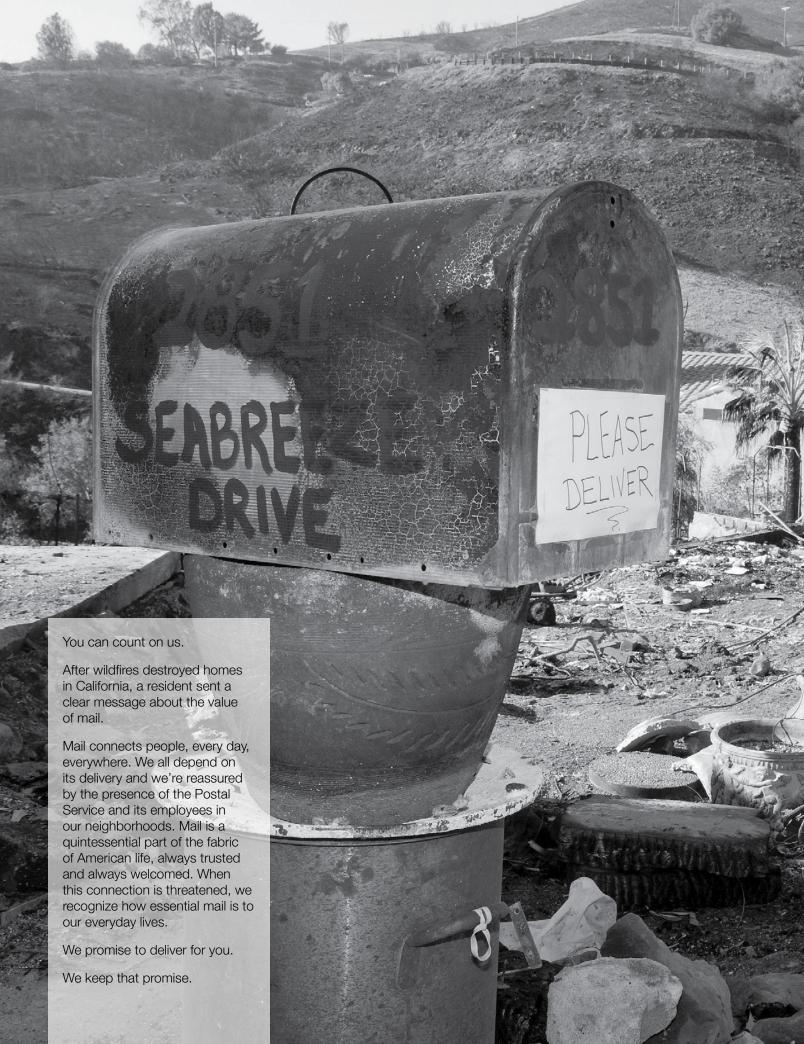
The average annual payment of \$5.6 billion represents 7.5% of total operating revenues, and it exceeds the highest net income ever achieved by the Postal Service. In the best of times, the size of the payments would present a considerable financial challenge due to the rigorous payment schedule. Under current economic conditions - which were not foreseen last year, let alone when the PAEA was drafted and enacted the current funding schedule all but guarantees that the Postal Service will record continued financial losses for the foreseeable future.

In congressional testimony last May, Inspector General David Williams suggested "indexing the payment to Postal Service revenue or economic factors, or extending the amortization period." Whatever mechanism may be used, it is essential that we be given the financial flexibility needed to address the imminent challenges and to preserve the health and viability of the Postal Service, while also fulfilling our long-range obligations. It simply is not prudent to borrow today to fund a future obligation while incurring large financial losses. All of our current debt is a direct result of making these accelerated payments.

Postal employees can take pride and confidence in their achievements over the past year. Although we face unusually tough economic times, we also have faith in the resilience of the American economy and hope for improving conditions worldwide. We look forward to working with all stakeholders to ensure our mutual success and the quickest possible return to profitable growth and success.

> H. Glen Walker Chief Financial Officer and **Executive Vice President**

H. Hen Walker



#### Business

#### Overview

The United States Postal Service (we) commenced operations on July 1, 1971, as an "independent establishment of the executive branch of the Government of the United States." We are governed by an 11-member Board of Governors. The Board is composed of nine Governors appointed by the President of the United States with the advice and consent of the Senate, plus the Postmaster General and the Deputy Postmaster General. Under the Postal Reorganization Act, and its successor, the Postal Accountability and Enhancement Act. Public Law 109-435 (P.L.109-435), we have a legal mandate to offer a "fundamental service" to the American people, "at fair and reasonable rates." We fulfill this legal mandate to provide universal service at a fair 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 provided.

We serve individual and commercial customers throughout the nation, competing for business in the communications, distribution, delivery, advertising, and retail markets.

Our Mailing and Shipping Services are sold through almost 37,000 Post Offices, stations, branches, contract postal units, our website www.usps.com, and a large network of consignees. We deliver mail to more than 149 million city, rural, Post Office box, and highway delivery points. We conduct our operations primarily in the domestic market, with international operations representing approximately 3% of total revenue.

All references to years, unless otherwise stated, refer to fiscal years beginning October 1 and ending September 30. All references to quarters, unless otherwise stated, refer to fiscal quarters within 2008.

We are not a reporting company under the Securities Exchange Act of 1934, as amended, and are not subject to regulation by the Securities and Exchange Commission (SEC). However, effective for reporting periods ending after September 30, 2007, we are required under P.L.109-435 to file with the Postal Regulatory Commission (PRC) certain financial reports containing information prescribed by the SEC under section 13 of the Securities Exchange Act of 1934. These reports are further described on the following page.

Additional disclosures on our organization and finances, including our Cost and Revenue Analysis reports, Revenue, Pieces, and Weight reports, Vision 2013 strategic plan and the Comprehensive Statement on Postal Operations may be found on our website at www.usps.com. Information on our website is not incorporated by reference in this document.

# Postal Accountability and Enhancement Act, Public Law 109-435 (P.L.109-435)

This law was signed by President Bush on December 20, 2006. It revises a number of provisions of the Postal Service's governing statute, codified in title 39, United States Code.

The law divides our services into two broad categories: market-dominant and competitive. Market-dominant services include, but are not limited to, First-Class Mail, Standard Mail, Periodicals, and Package Services. Price increases for these services are subject to a price cap based on the Consumer Price Index—All Urban Consumers (CPI-U). Competitive services, such as Priority Mail, Express Mail, Bulk Parcel Post, and Bulk International Mail have greater pricing flexibility. Throughout this document and in the day-to-day operation of the organization, we refer to market-dominant services as "Mailing Services" and competitive services as "Shipping Services".

For retail customers, the law anticipates that universal service can be preserved at affordable prices. For commercial mailers, the law is intended to provide price predictability. For employees, customers, and taxpayers, the law is designed to provide assurance that the employer portion of the Postal Service's health and retirement benefits becomes fully funded in the future.

P.L.109-435 also directs the U.S. Treasury to resume financial responsibility for the portion of the Civil Service Retirement System (CSRS) pensions of postal employees attributable to military service. This takes the financial burden added by P.L.108-18, estimated in 2003 at approximately \$27 billion by the Office of Personnel Management (OPM), away from the Postal Service. P.L.109-435 also abolished a federally mandated escrow requirement and directed that the money previously held in escrow be placed into a new Postal Service Retiree Health Benefits Fund (PSRHBF). Through 2017, we are required to make payments into the PSRHBF that average \$5.6 billion per year.

P.L.109-435 reconstituted the former Postal Rate Commission into a regulatory body, renamed the Postal Regulatory Commission (PRC). The regulations for the price-setting process released by the PRC on October 29, 2007, consist of three parts: (1) regulations related to price adjustments for market dominant products, including the formula for the calculation of the price cap; (2) regulations related to competitive products; and (3) establishment of a Mail Classification Schedule, which categorizes our products as either market dominant or competitive. These price-setting regulations are contained in 39 C.F.R. Parts 3001, 3010, 3015, and 3020.

The Mail Classification Schedule divides mail into Mailing Services or Shipping Services, establishes which types of mail constitute separate products, and presents a brief description of each product. The regulations allow us to make certain classification changes much more easily than under the previous system. This enhances overall pricing flexibility.

The regulations for Mailing Services, constituting almost 90% of all postal revenue, allow price changes every year with limited prior review, as long as the average increase for each class of mail is no greater than the rate of inflation as measured by CPI-U. The regulations permit price increases above the price cap in the event of extraordinary or exceptional circumstances.

The regulations for Shipping Services place no upper limit on price changes. The Governors of the Postal Service can adjust prices as necessary, as long as each product covers 100% of its attributable costs. No product may be cross-subsidized by Mailing Services. In addition, Shipping Services are required to cover 5.5% of the Postal Service's total institutional costs.

On September 11, 2008, the PRC issued Order No. 106 proposing rules on accounting practices and taxes on competitive products income. Comments from interested parties were due to the PRC on October 20, 2008; reply comments were due November 3. A final rule must be issued by December 19, 2008, unless otherwise agreed by the PRC and the Postal Service.

The PRC now has its own Office of Inspector General (OIG). The Postal Service will continue to be required to provide the funding for our Office of Inspector General, the PRC, and the PRC's OIG. Although the funding for these organizations is provided by the Postal Service, the amount of funding is determined by Congress. We are directed via the appropriations process, to provide funds to these organizations in specified amounts.

Additionally, P.L.109-435 requires us to file with the PRC a number of financial reports. These include quarterly reports containing information required by the SEC to be filed on Form 10-Q within 40 days after the end of each fiscal quarter, an annual report containing information required by the SEC on Form 10-K within 60 days after the end of each fiscal year, and current reports containing information required by the SEC on Form 8-K within the prescribed time frame. Our first filings were completed in 2008. Further, P.L.109-435 requires the Postal Service to comply with the rules prescribed by the SEC implementing Section 404 of the Sarbanes-Oxley Act of 2002, which pertain to reporting on the effectiveness of our financial internal controls. The requirement to comply with Section 404 is effective beginning with the 2010 annual report.

Since the law's enactment, we have been meeting its requirements by the applicable deadlines. We have successfully worked with the mailing community, the PRC, and our unions and management associations to make the transition as smooth as possible for all stakeholders.

# Strategy

The Government Performance and Results Act (GPRA) requires federal agencies to develop and publish a five-year strategic plan. The Postal Service updates its plan annually to accommodate ongoing business environment changes. This annual planning process incorporates an assessment of recent performance, refinement of strategies, and prioritization of objectives, programs, and budgets to optimize results.

In October 2008, we published Vision 2013, our five-year strategic plan, covering the period 2009-2013. Vision 2013 was designed to build upon the successes of the Postal Service's Strategic Transformation Plan, which helped guide multiple improvements in service, efficiency, and workplace conditions. With Vision 2013, the Postal Service commits to continuing this progress. It acknowledges that postal customers and the entire mailing industry are hardpressed by current economic conditions, and notes that continued service improvements and cost reductions are crucial. The Postal Service will continue to strengthen its core operations and services, balancing an immediate and urgent need to reduce costs with a continued commitment to strategies such as Intelligent Mail, that are essential to our future. However, in the long term, the Postal Service cannot survive on cost cutting alone; and service improvements will not, by themselves, halt revenue diversion or attract new customers. Growth is crucial to the future of affordable universal mail service. Vision 2013 also offers a broad perspective of what it will take to continue to provide affordable, universal service and sustain a strong, viable Postal Service for future generations. It describes strategies to grow the business by adapting to changing customer needs; to create new customer value by the Postal Service leveraging its strengths; and to embrace change — incorporating new technology and new approaches to respond more quickly to a rapidly evolving business environment.

Vision 2013 is available online at: www.usps.com/strategicplanning/vision2013.htm.

## Segments

We operate in one segment throughout the United States, its possessions, territories, and internationally.

#### Services

The Postal Service is the centerpiece of the U.S. mailing industry, providing a wide variety of services to meet almost any mailing need. Services include the Mailing Services and Shipping Services described below.

## Mailing Services

**First-Class Mail** — Includes domestic and international postcards, letters, or any other advertisement or merchandise up to 13 ounces. This service (or Express Mail or Priority Mail) is required for personal correspondence, handwritten or typewritten letters, and bills or statements of account.

**Standard Mail** — Is offered for any item, including advertisements and merchandise weighing less than 16 ounces, that is not required to be sent using First-Class Mail. Standard Mail is typically used for bulk advertising to multiple delivery addresses. Content restrictions apply for authorized nonprofit mailers.

**Periodicals** — Are offered for newspaper, magazine, and newsletter distribution and require prior authorization by the Postal Service.

**Package Services** — Are offered for any merchandise or printed matter weighing up to 70 pounds. These services include Single Piece Parcel Post, Bound Printed Matter, Library Mail, and Media Mail.

**Special Services** — Offer a variety of enhancements that add value to mail services. Many provide added security, proof of delivery, or loss recovery. Examples of these services include: Certified Mail, Registered Mail, Delivery Confirmation, Signature Confirmation, and insurance up to \$1,000.

Money Orders — Are a special service that offer a safe, convenient, and economical alternative to sending cash through the mail. They can be purchased at any Post Office or from any rural route carrier. Postal money orders are available for any amount up to \$1,000. Money orders can be cashed at any Post Office or can be deposited or negotiated at financial institutions. Money orders are replaced if damaged, lost, or stolen.

#### **Shipping Services**

**Priority Mail** — Priority Mail is offered in both the United States and abroad. The domestic offering is a 1–3 day non-guaranteed delivery service and is typically used to send documents, gifts, and merchandise. Priority Mail International provides customers with a reliable and economical means of sending correspondence and merchandise up to 70 pounds to over 190 countries and territories worldwide.

**Express Mail** — Includes Express Mail and Express Mail International. Express Mail is the domestic offering. This overnight, money-back guaranteed service includes tracking, proof of delivery, and insurance up to \$100. Delivery is offered to most destinations and is available 365 days a year. A surcharge is added to the price for Sunday and holiday delivery. Commercial prices and volume rebates are available to customers meeting certain volume thresholds. Express Mail International offers fast delivery service to over 190 countries with service guaranteed to select destinations.

Parcels — Parcel Select and Parcel Return Service are two programs designed to provide economical means of shipping packages. By taking advantage of the "first mile and last mile" aspect of the Postal Service, Parcel Select saves customers money by sorting packages closer to their ultimate destination; while Parcel Return Service is a workshare discount program where our customers go to selected sites to retrieve packages sent back to them from their customers. Parcel Select and Parcel Return Service allow us to partner with other companies to serve our respective customers' needs.

Details on our revenue by mailing, shipping, and other categories are found on the Operating Statistics Section, on page 62 of this report.

# **Pricing and Classification Activity**

P.L. 109-435 gave the Postal Service new flexibility in setting price and classification changes. Prices are set by the Governors and are approved by the PRC to be in compliance with the new regulations enacted as part of the law. We plan to adjust prices for our Mailing Services annually in May, with increases no higher than that of the rate of inflation. We plan to provide at least 90 days' notice of the new prices for Mailing Services.

On February 11, 2008, we announced a May 12, 2008 price adjustment for Mailing Services — First-Class Mail, Standard Mail, Periodicals, Package Services, and Special Services. The average increase by class of mail was at or below the 2.9% rate of inflation, calculated using the CPI-U for the past 12 months using an averaging method approved by the PRC. The First-Class Mail stamp price was increased from 41 cents to 42 cents. For the first time, customers could use the Forever Stamps they purchased before the price change, after the price change without adding additional postage.

Prices for Shipping Services must cover each product's attributable costs, as well as an appropriate share of the institutional costs of the Postal Service. For 2008, the institutional cost coverage percentage, determined by the PRC, was 5.5%. The new pricing flexibility provided by the law allows us for the first time to utilize contract prices, rebates, online price reductions, and other incentives to encourage growth. Prices must be announced at least 30 days prior to the implementation date. We provided 60 days notice prior to the May 12, 2008, price adjustment for Shipping Services.

Highlights of the Shipping Services price adjustments are described below. Express Mail was changed to a zone-based pricing system, with customers paying less for near-by destinations. Customers also receive a 3% price reduction for purchasing Express Mail online or through corporate accounts. Additional price reductions became available for those who ship quarterly minimum volumes. Priority Mail offers a 3.5% savings for customers who use electronic postage or meet other requirements. Parcel Select — our "last mile" delivery to every door — features pricing and volume incentives for large and medium shippers. Parcel Return Service moved entirely to a weight-based pricing system, resulting in significant price reductions for many lighter packages.

The PRC reviewed the new pricing for both Mailing Services and Shipping Services and verified, with a small exception which was resolved, that our prices were consistent with P.L. 109-435.

In March 2008, we introduced the Priority Mail Large Flat-Rate Box, with pricing that included a military discount for the first time. The discount is intended to enhance good-will and reflect the unique economics of military care packages. We transferred Premium Forwarding Service to the Shipping Services grouping to facilitate future product and service enhancements. Repositionable Notes became a permanent offering.

Information about the PRC and their activities can be found on the PRC website at www.prc.gov.

## Intellectual Property

We own intellectual property that includes 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, services, and operations.

# Seasonal Operations

Our operations are seasonal. Mail volume and revenue tend to be greatest in our first fiscal quarter, which includes the fall holiday mailing season, and lowest during the summer, our fourth quarter.

#### Customers

We have a very diverse customer base and are not dependent upon a single customer or small group of customers. No single customer represents more than 3% of our operating revenue. The financial services sector, which includes real estate, represents approximately 15% of our operating revenues.

## **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 for design, development, and testing of postal equipment and operating systems. We also contract with independent suppliers to conduct research activities. While research and development activities are important to our business, these expenditures are not material.

#### **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 of possible future environmental legislation or regulations on our operations.

## **Employees**

At September 30, 2008, we had 663,238 career employees, substantially all of whom reside in the United States. We also had 101,850 non-career employees.

Our labor force is primarily represented by the American Postal Workers Union (APWU), National Association of Letter Carriers (NALC), National Postal Mail Handlers Union (NPMHU), and National Rural Letter Carriers Association (NRLCA). More than 85% 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 nonbargaining unit employees in the field an opportunity to participate directly in the planning, development, and implementation of programs and policies that affect them. Our 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 as required by statute, for retirement, health, and workers' compensation benefits.

#### Available Information

Financial and other information is available on www.usps. com; click on About USPS & News. Information on our website is not incorporated by reference in this document.

We make available on our website, free of charge, copies of our annual report and quarterly reports, as soon as reasonably practicable after they are filed with or provided to the PRC. Requests for copies may also be sent to the following address:

Corporate Communications United States Postal Service 475 L'Enfant Plaza, SW Washington, DC 20260-3100

#### Risk Factors

ur operations and financial results are subject to various risks and uncertainties, including those described below, that could adversely affect our business, financial condition, results of operations and cash flows. The remainder of this report, including sections entitled "Business" and "Management's Discussion and Analysis of Financial Condition and Results of Operations," will provide the reader with a more complete understanding of the risks and uncertainties we confront.

# Adverse changes in the economy directly impact our business, adversely affecting our results of operations.

The demand for postal services is heavily influenced by changes in the economy. A continuation of the slowdown in the economy is expected to impact nearly every class of mail negatively. The continual decline in employment, lasting since January 2008, has been indicative of this economic malaise. In recent months, turmoil in the financial markets has resulted in a worldwide credit crisis, which raises economic risk significantly. Moreover, a long run-up in commodities prices — including, most notably, energy prices — was followed by a rapid decline in energy prices beginning in mid-summer 2008. Volatile market conditions such as these are expected to have an adverse impact on retail sales, investment, consumer spending, and consumer confidence. Adverse trends in retail sales, investment spending, and employment are all likely to depress the demand for postal services.

Expanding use of electronic communications methods and other commercial services compete with some of our principal services. If we do not compete effectively with these services, our business and results of operations will be adversely affected.

The Internet continues to change the communications market. Within the next decade, further innovations in mobile commerce, broadband, interactive TV, data-mining software, and new printing technologies will continue to affect the way businesses and consumers interact. Of greatest impact on the Postal Service are electronic alternatives to correspondence and transactions, particularly for First-Class Mail and Standard Mail items such as business correspondence, bills, statements and customer payments and, increasingly, advertising. First-Class Mail volume has already been affected by the Internet, automatic deductions, direct deposit, telephone, fax machines, and other electronic communications.

In addition, major corporations now dominate the parcel and express markets, and the competitive landscape for postal services is becoming more global. Foreign postal operators are moving outside their geographic borders and expanding beyond their traditional postal services into express delivery, logistics, financial, and electronic services. Foreign posts have established significant nationwide sales forces and operations around the country. Currently, eight foreign operators maintain facilities in major metropolitan areas. In addition, many are partnering with international mail service providers to authorize use of their postal indicia for export from the United States. This has contributed to an increase in the outbound market share of our foreign competitors

While the majority of our prices are now linked directly to general inflation, our costs are not. Accordingly, we may not be able to increase prices sufficiently to offset increased costs, which would adversely affect our results of operations.

P.L.109-435 is intended to benefit both residential and business customers by providing predictable price increases tied to the rate of inflation for Mailing Services (primarily First-Class Mail, Standard Mail, certain Package Services, and Periodicals). These services represent about 90% of total revenues and about 87% of our attributable costs.

While the majority of our prices are now linked directly to general inflation, our costs are not. Postal costs are heavily concentrated in wages, employee and retiree benefits, and transportation. They are significantly impacted by wage inflation, health benefit premium increases, and by the continuous expansion of our delivery network. We believe that both volume and revenue growth, along with increasing productivity improvements, will be required to address the challenge presented by the regulatory price cap.

The contracts with our four largest unions currently include provisions granting cost of living allowances (COLAs). These contracts expire in 2010 and 2011. Under current contract provisions, COLAs are linked to the Consumer Price Index — Urban Wage Earners and Clerical Workers (CPI-W) and are granted semiannually. In 2008 CPI-W was 5.4%. Employee compensation represents a significant portion of our annual expenses; therefore, an increase in the CPI-W greater than had been incorporated into our financial plans could adversely affect financial results. We estimate that an increase in the CPI-W of 0.5% would cause an annualized increase in our COLAs of about \$124 million.

Adverse events may call into question our reputation for quality and reliability, which could diminish the value of the Postal Service brand and potentially adversely affect our business and results of operations.

We serve almost every American household and business nearly every day. For the fourth year in a row, the Ponemon Institute named the Postal Service the most trusted government agency and among the ten most trusted of all organizations. The Postal Service brand represents quality and reliable service and therefore is a valuable asset. We use our brand extensively in sales and marketing initiatives, and take care to defend and protect it. Any event that calls into question this quality and reliability could diminish the value of our brand and potentially adversely affect our business and reputation.

Fuel expenses are a material part of our operating costs. A significant increase in fuel prices could adversely affect our costs and results of operations.

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 mail, and natural gas for heating facilities. A 1.0% increase in fuel and natural gas costs would result in a \$29 million increase in expense. We did not use derivative commodity instruments to manage the risk of changes in energy prices during the periods covered by this report.

We are subject to Congressional oversight, regulation by other government agencies, and also oversight by various other organizations and the public. If we cannot successfully address their various, and sometimes competing, concerns, we may be subject to greater regulation, which could increase our costs or otherwise place additional burdens on our operations.

We are subject to a variety of forms of oversight and scrutiny by Congress, the PRC, mailer organizations, the media, and the general public. This is an outgrowth of our unique status as a provider of a fundamental service to the American people. We attempt to balance the interests of all groups with the need for operational efficiency. Our efforts to be responsive to these various stakeholders sometimes adversely impact the speed with which we are able to respond to changes in mail volumes, or other operational needs. Any limitations on our ability to take management action could adversely affect our operating and financial results.

#### We are potentially subject to various state legislative proposals that could reduce our revenues, increase our costs, or otherwise place additional burdens on our operations.

States continued to introduce Do Not Mail legislation in 2008, with approximately 16 Do Not Mail bills being considered in 13 state legislatures nationwide. (This includes nine bills that were carried over from 2007.) These bills, modeled after the Do Not Call registry, are designed to limit or stop advertising mail from being mailed to households. Currently, none of the state bills have passed; however, a few of the state legislatures may still be in session.

The Postal Service opposes legislation that would limit mailing, or that would interfere with the availability of an affordable, universal postal system. The Postal Service will continue to communicate the value of the mail by building upon its strong environmental record and its work with mailers on offering consumers choice on how to manage their mail. By working aggressively with mailers, marketers, and advertisers, the Postal Service can continue to improve the quality and relevancy of advertising mail.

Should a state pass Do Not Mail legislation, it would result in lost revenue for the Postal Service. A financial analysis conducted by the Postal Service determined that a national implementation of Do Not Mail legislation would place approximately \$6 billion of postal revenue at risk annually.

# We rely extensively on technology to operate our systems. A significant failure in a material system could impair our reputation for reliable service and adversely affect our results of operations.

We rely extensively on technology to operate our systems for processing and delivering mail. Our intranet is one of the largest maintained by any organization in the world. Any significant failure of these systems could cause delays in the processing and delivering of mail, which could damage our reputation, result in loss of business, and increase costs of operation.

#### A failure on our part to protect the privacy of information we obtain from our customers could damage our reputation and result in a loss of business.

We receive a variety of private information from our customers, such as address change data. We have implemented a number of safeguards intended to protect the confidentiality of data that we obtain. Any significant violation of the privacy of this data could damage our reputation and result in loss of business.

# We are subject to the risk of biohazards and other threats being placed in the mail.

Although we have implemented extensive emergency preparedness measures to keep the mail, postal employees, and postal customers safe from harm due to biohazards that could be introduced into the mailstream, there continues to be a risk of possible biohazard threats. If new biohazards were to arise and our measures were not sufficient to contain or mitigate the threat, our services could be disrupted. This could adversely affect our revenues, require substantial expenditures to address the threat, and could adversely affect our operations and financial condition.

In addition, the U.S. Transportation Security Administration ("TSA") has adopted new rules enhancing many of the security requirements for air cargo, and has proposed additional requirements. Until the requirements of these programs and their application to us are finalized, we cannot determine the effect that these new rules may have on our costs or our results of operations. These rules or other future security requirements for air cargo could impose material new costs on us.

# We are also subject to risks and uncertainties that affect many other businesses, including:

- Market acceptance of our new service and growth initiatives;
- Adverse weather conditions or natural disasters, such as hurricanes, which can damage our property and disrupt our operations;
- International conflicts or terrorist activities and the effects these events may have on our business or our results of operations; and
- Changes in interest rates and foreign currency exchange rates.

# **Properties**

#### **Real Estate**

Our facilities range in size from 60 square feet to 34 acres under one roof, and support retail, delivery, mail processing, maintenance, administrative, and support activities.

Real Estate Inventory	2008	2007
(Actual numbers)		
Leased Facilities	25,272	25,450
Owned Facilities	8,546	8,487
GSA/Other Government Facilities	357	381
Total Real Estate Inventory	34,175	34,318
Annual Rent Paid to Lessors (Dollars in millions)	\$1,011	\$ 973

The majority of our small and medium-sized facilities support the retail and delivery operations located in virtually every community across this country. Our retail and delivery operations are supported by 32,741 leased or owned facilities. We also provide retail services through 3,982 Contract Postal Units and community Post Offices where the facility is owned and maintained by the contractor.

Retail and Delivery Facilities	2008	2007
(Actual numbers)		
Post Offices	27,232	27,276
Classified Branches	1,493	1,508
Classified Stations	3,358	3,379
Carrier Annexes	658	532
Contract Postal Units	3,148	3,131
Community Post Offices	834	895
Total Retail and Delivery Facilities	36,723	36,721

Our larger facilities typically support mail processing operations, which process millions of pieces of mail on a daily basis, and prepare it for transportation across the country.

Processing Facilities	2008	2007
(Actual numbers)		
Processing and Distribution Centers	269	269
Customer Service Facilities	195	195
Bulk Mail Centers	21	21
Logistics and Distribution Centers	14	14
Annexes	64	66
Surface Transfer Centers	20	14
Airmail Processing Centers	20	29
Remote Encoding Centers	6	10
International Service Centers	5	5
Total Processing Facilities	614	623

We also have approximately 1,000 other facilities. These facilities include administrative, vehicle maintenance, and miscellaneous support facilities.

#### **Vehicles**

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

Vehicle Inventory	2008	2007
(Actual numbers)		
Delivery and Collection Vehicles (1/2 – 2 1/2 ton)	197,898	195,211
Mail Transport Vehicles (Tractors and Trailers)	6,455	6,824
Administrative Vehicles and Other Vehicles	5,906	6,169
Service Vehicles (Maintenance)	5,272	5,539
Inspection Service and Law Enforcement Vehicles	3,288	3,482
Mail Transport Vehicles (3 - 9 ton)	2,228	2,297
Total Vehicles	221,047	219,522

## Management's Discussion and Analysis of

# **Financial Condition and Results of Operations**

#### **Cautionary Statements**

Forward-looking statements contained in this report represent our best estimates of trends we know about, trends we anticipate, and trends we believe are relevant to our future operations. However, actual results may be different from our estimates. Certain forward-looking statements are included in this report and use such words as "may," "will," "could," "expect," "believe," "plan," or other similar terminology. These statements reflect our current expectations regarding future events and operating performance 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 service offerings by our competitors; consumer preferences or perceptions concerning our service 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; costs and delays associated with new regulations imposed by the PRC; and changes in applicable accounting policies and practices. The foregoing list of important factors is not all-inclusive. We have no obligation to publicly update or revise any forwardlooking statements, whether as a result of new information, future events, or otherwise.

#### **Critical Accounting Policies**

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make significant judgments and estimates to develop certain amounts reflected and disclosed in the financial statements. In many cases, there are alternative policies or estimation techniques that could be used. We maintain a thorough process to review the application of our accounting policies and to evaluate the appropriateness of the many estimates that are required to prepare the financial statements of a large organization. However, even under optimal circumstances, estimates routinely require adjustment based on changing circumstances and new or better information.

The three critical accounting policies that we believe are either the most judgmental or involve the selection or application of alternative accounting policies, and are material to our financial statements, are those relating to workers' compensation costs, deferred revenue for prepaid postage. and contingent liabilities. Workers' compensation costs are highly sensitive to the estimates of inflation and the length of time recipients stay on the compensation rolls. Deferred revenue for prepaid postage is challenging to estimate because of the difficulty in estimating stamp postage that has been purchased but has not yet been used. Contingent liabilities require significant judgment in estimating potential losses for legal claims. In addition, retirement and health benefits costs for our employees and retirees represent a significant portion of our expenses. Any changes in laws or regulations affecting the amounts, timing, or administration of these benefits could have a material effect on our financial position and results of operations. For additional information, see Note 2, Summary of significant accounting policies, in the Notes to the Financial Statements.

We recognize revenue when services are rendered. Because we collect payment in advance of services being performed, we defer the revenue as an estimated liability. This liability is classified as deferred revenue-prepaid postage on our balance sheets. In Quarter III of the current year, we improved the model used to estimate the deferred revenue for prepaid postage for stamps. This change was made necessary because the introduction of the Forever Stamp in April 2007, combined with the May 2008 price increase, resulted in a change in consumer behavior regarding the purchase and usage of stamps that was not measurable using our prior estimation techniques. This change more accurately captures trends in stamp usage. The change to a new estimation model is considered a change in accounting estimate under Generally Accepted Accounting Principles (GAAP).

As required by GAAP, the impact of the change was recorded in Quarter III, 2008. For the year-ended 2008, we increased the stamp portion of the deferred revenue-prepaid postage liability by \$477 million, \$230 million of which is considered a cumulative change in estimate and \$247 million of which is attributable to changes in consumer behavior during the last two quarters of the year. For further information, see Note 2 to the financial statements.

#### Results of Operations

In 2008, we had an operating loss of \$2,806 million, as compared to a \$5,327 million loss in 2007. Operating revenues of \$74,932 million for 2008 were 0.2%, or \$154 million greater than the \$74,778 million earned in 2007. Despite the May 2007 and May 2008 price increases, revenues were negatively impacted by a decline in volume of 9.5 billion pieces. The volume drop was mainly due to the deteriorating economy, which adversely impacted almost every category of mail.

Operating Statistics	2008	2007	2006
(Dollars in millions)			
Operating Revenue	\$ 74,932	\$ 74,778	\$ 72,650
Operating (Loss) / Income	\$ (2,806)	\$ (5,327)	\$ 969
Net (Loss) / Income	\$ (2,806)	\$ (5,142)	\$ 900
Operating Margin	(3.7%)	(7.1%)	1.3%
Avg Volume per Day (Pieces in millions)	667	705	703

Our 2008 expenses were impacted by high energy prices, COLAs, and the large percentage of our costs which are fixed. Operating expenses of \$77,738 million were \$2,367 million less than the \$80,105 million incurred in 2007. As discussed later in this section, operating expenses included a decrease in retiree health benefits of \$2,677 million and a decrease in compensation and benefits expense of \$601 million, which were partially offset by increases in transportation expenses of \$459 million and other expense, of \$452 million.

The operating loss for 2007 was \$5,327 million, as compared to operating income of \$969 million in 2006, a decrease of \$6,296 million. This change was largely due to the additional retiree health benefit expenses incurred upon the enactment of P.L.109-435. On April 6, 2007, we transferred \$2,958 million, representing the entire amount of funds held in escrow, as required by P.L.108-18, to the Postal Service Retiree Health Benefits Fund (PSRHBF). Since we no longer held these funds, there was a 22% decrease in interest income for the second half of 2007 and this continued into 2008, where interest income declined 82% compared to 2007.

## Management's Discussion and Analysis of

# **Financial Condition and Results of Operations**

#### Revenue and Volume

On December 20, 2006, the President signed P.L.109-435. In accordance with that law, the categorization of our products has been updated to reflect the new Mailing Services and Shipping Services groupings. For example, First-Class Mail now also includes First-Class Mail International and is part of Mailing Services. Shipping Services include Express Mail and Priority Mail as well as certain services formerly included with international mail and package services. We have identified changes in categories in the discussion that follows.

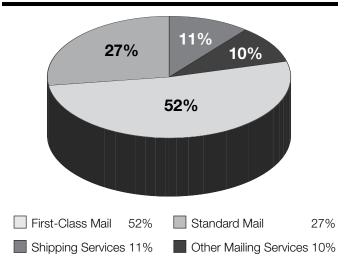
2008 was an extremely difficult year for both the U.S. economy and the Postal Service. Declining mail volume is a symptom of the ailing economy. The hard-hit financial sector of the U.S. economy led decliners not just in the stock market, but in the mailing arena as well. Operating revenue for 2008 was \$74,932 million, an increase of \$154 million from last year, while volume of 202.7 billion pieces declined by 9.5 billion pieces, or 4.5%. The volume decline accelerated as we progressed through 2008, reaching a peak decline of 3.2 billion pieces in the fourth quarter.

Revenue for the first seven and a half months of 2008 was affected by the May 2007 price increase of 5.4%. The remainder of the year was affected by the May 2008 price increase of 2.9%. Although the volume decrease in 2008 was significant, the price increase held revenue flat compared to 2007.

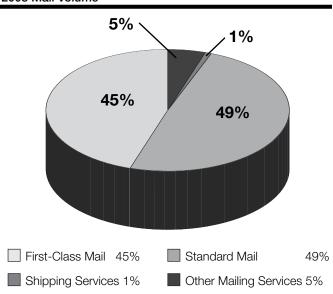
Operating Revenue	2008	2007	2006
(Dollars in millions)			
First-Class Mail	\$ 38,179	\$ 38,405	\$ 37,605
Standard Mail	20,586	20,779	19,876
Periodicals	2,295	2,188	2,215
Package Services	1,845	1,812	1,751
Other Mailing Services*	3,645	3,720	3,715
Total Mailing Services	66,550	66,904	65,162
<b>Total Shipping Services</b>	8,382	7,874	7,488
Total Operating Revenue	\$ 74,932	\$ 74,778	\$ 72,650

 $<sup>^{\</sup>star}$  Special services revenue and other income included in "Other" category.





#### 2008 Mail Volume



The current recession has had an adverse effect on advertising mail, particularly with regard to credit card, mortgage, and home equity solicitations. While the trouble in the financial services sector is routinely making headlines, we have also experienced noteworthy declines from mail order catalogue retailers, printing and publishing businesses, and the services sector.

#### MAILING SERVICES

While Standard Mail volume exceeds First-Class Mail volume, First-Class Mail remains, by far, the largest revenue generator, as illustrated by the two previous charts.

The First-Class Mail category now includes First-Class Mail International. First-Class Mail revenue decreased \$226 million, or 0.6%, while volume decreased by 4.6 billion pieces, or 4.8%, in 2008. The revenue decrease occurred in spite of two price increases. Only non-automation presort and First-Class International letters experienced increases in volume. The most significant decline was in single-piece First-Class letters, with a decrease of over 3 billion pieces of mail. The long-term continued decline in single-piece volume reflects the impact of electronic diversion as businesses, nonprofit organizations, governments, and households continue to move their correspondence and transactions to electronic alternatives, such as Internet bill payment, automatic deduction, and direct deposit. The rate of decline accelerated significantly in 2008 as the economy weakened. Presorted First-Class Mail also decreased. This is a reflection of the general curtailment of advertising spending. This curtailment of advertising has significantly impacted both First-Class Mail and Standard Mail.

Mail Volume By Type	2008	2007	2006
(Pieces in millions)			
First-Class Mail	91,697	96,297	98,016
Standard Mail	99,084	103,516	102,460
Periodicals	8,605	8,796	9,023
Package Services	846	914	919
Other Mailing Services*	896	1,081	1,084
Total Mailing Services	201,128	210,604	211,502
Total Shipping Services	1,575	1,630	1,636
Total Mail Volume by Type	202,703	212,234	213,138

<sup>\*</sup> Free mail for the blind included in the "Other" category.

In 2007, First-Class Mail revenue increased \$800 million, or 2.1%, as volume decreased by 1.7 billion pieces, or 1.8%. First-Class Mail represented 51% of total operating revenues and 45% of total volume in 2007.

First-Class Mail Changes from Prior Year

2008	Quarter 1	Quarter 2 Quarter 3		Quarter 4	Total
(Dollars & Pieces in	millions)				
Revenue Change	\$ 193	\$ 264	\$ (180)	\$ (503)	\$ (226)
Percentage	1.9%	2.8%	-1.9%	-5.4%	-0.6%
Volume Change	(993)	(760)	(1,282)	(1,565)	(4,600)
Percentage	-3.9%	-3.1%	-5.4%	-6.9%	-4.8%

#### Standard Mail Changes from Prior Year

2008	Quar	ter 1	Quarter 2 Quarter 3		Quarter 3	(	Quarter 4	Total	
(Dollars & Pieces in	millions	:)							
Revenue Change	\$	201	\$	101	\$	(161)	\$	(334)	\$ (193)
Percentage	3	.6%		2.0%		-3.2%		-6.3%	-0.9%
Volume Change	(7	776)		(760)		(1,368)		(1,528)	(4,432)
Percentage	-2	.7%		-3.0%		-5.6%		-6.1%	-4.3%

Standard Mail revenue decreased almost \$200 million, or 0.9%, in 2008, while volume decreased 4.4 billion pieces or 4.3%. Standard Mail items are primarily advertising materials and is particularly sensitive to economic contractions. The drop in Standard Mail volume is a direct reflection of the poor state of the economy, as we experienced accelerated declines in volume as the year progressed. The decline of 1.5 billion pieces in Quarter IV was only topped in severity by the 2.2 billion piece decline in Standard Mail in Quarter I of 2002 following the anthrax attacks and the terrorism of September 11, 2001. The decline is primarily due to the curtailment of advertising, which is expected to continue through 2009, before rebounding beginning in 2010.

In 2007, Standard Mail revenue increased \$903 million, or 4.5%, compared with 2006 on 1.0% volume growth. The first quarter was favorably impacted by the carryover effect of the January 2006 price increase. A portion of the third quarter and all of the fourth quarter benefited from the May 2007 price increase. Standard Mail represented 28% of total operating revenues and 49% of total volume in 2007.

# Management's Discussion and Analysis of

# **Financial Condition and Results of Operations**

Periodicals volume decreased 191 million pieces, or 2.2%, in 2008. Price increases resulted in a revenue increase of \$107 million, or 4.9%. Total periodicals volume has fallen by 16.6% over the last ten years. This long-term, steady decline is the result of the ongoing trend in reading preferences rather than the current economic downturn.

Periodicals volume decreased 227 million pieces, or 2.5% in 2007, driven by the same long-term trend noted above. This resulted in a revenue decrease of \$27 million, or 1.2%, in spite of the price increase.

Package Services under the new law now includes singlepiece Parcel Post, International Inbound Surface Parcel Post, Bound Printed Matter, Media Mail, and Library Mail. Parcel Select and Parcel Return Service are now part of the Shipping Services group. Price increases resulted in a revenue increase of \$33 million, or 1.8%, compared to 2007. Package Services volume decreased 68 million pieces, or 7.4%, in 2008. Revenue increased despite volume decreases, due to the May 2007 and May 2008 price increases.

In 2007, Package Services revenues of \$1,812 million increased \$61 million or 3.5% on a volume decline of 5 million pieces or 0.5%.

#### **Shipping Services**

Under the new law, Shipping Services includes Priority Mail, Express Mail, destination entry Parcel Post, Parcel Select Return Service, and International Mail, excluding single-piece First-Class International Mail. Collectively these products earned \$8,382 million in revenue, a \$508 million increase, or 6.5%, while volume declined 55 million pieces, or 3.4%. The pricing structure of this service group does not have the CPI price cap restrictions of Mailing Services as outlined in P.L. 109-435.

Shipping Services revenue in 2007 of \$7,874 million was \$386 million, or 5.2% greater than 2006 revenues of \$7,488 million, despite a volume decline of 6 million pieces, or 0.4%.

#### **Operating Expenses**

Operating expenses are comprised of Compensation and Benefits, Retiree Health Benefits, Transportation, and Other Expenses.

In 2008, total operating expenses of \$77,738 million were \$2,367 million, or 3.0%, less than 2007, mainly due to the decrease of \$2,677 million in retiree health benefits. Retiree health benefits were \$7,407 million in 2008, compared to \$10,084 million in 2007. The decrease is primarily due to a 2007 one-time charge in addition to the annual amounts

required by P.L. 109-435. See Note 4, *Postal Accountability and Enhancement Act*, *Public Law* 109-435 (P.L. 109-435), in the Notes to the Financial Statements for more information. Despite the decrease, compensation and benefits, along with retiree health benefits were \$60,992 million, or 78.5%, of our operating expenses compared to \$64,270 million or 80.2% in 2007. Transportation expenses increased \$459 million, or 7.1%, while other expenses increased \$452 million or 4.8%.

In 2007, total operating expenses of \$80,105 million were \$8,424 million, or 11.8%, more than 2006. Retiree health benefits increased \$8,447 million in 2007, driven by requirements of P.L. 109-435. The law also suspended our retirement payments to the CSRS fund which, along with a reduction in the estimate of our workers' compensation liability, led to a \$479 million, or 0.9%, decrease in total compensation and benefit expenses compared to 2006. A \$457 million, or 7.6%, increase in transportation expenses also contributed to the increase in expenses.

Operating Expenses	2008	2007	2006
(Dollars in millions)			
Compensation and Benefits	\$ 53,585	\$ 54,186	\$ 54,665
Retiree Health Benefits	7,407	10,084	1,637
Transportation	6,961	6,502	6,045
Other Expenses	9,785	9,333	9,334
Total Operating Expenses	\$ 77,738	\$ 80,105	\$ 71,681

#### Compensation and Benefits

Personnel compensation and benefits were \$601 million, or 1.1%, less than 2007, mainly due to reductions in workhours. The average annual COLA increase per employee in 2008 was \$469 in March and \$1,487 in September. The total impact of COLAs in 2008 was \$562 million.

Despite these large COLAs, which increased the 2008 average hourly labor cost 2.5%, we were able to decrease compensation costs by \$1,062 million, or 2.5%, by reducing workhours. However, this was partially offset by increases of \$162 million, or 2.8%, in retirement expenses and \$347 million, or 39.4%, in worker's compensation expense. Decreases in health benefits and other expenses accounted for the remainder of the decrease. Additional information on workhours, retirement, health benefits, and workers' compensation expenses are provided on the following pages.

Total	\$ 53,585	\$ 54,186	\$ 54,665
Other	450	473	458
Workers' Compensation	1,227	880	1,279
Health Benefits	5,376	5,401	5,345
Retirement	5,899	5,737	7,006
Compensation	\$ 40,633	\$ 41,695	\$ 40,577
(Dollars in millions)			
Compensation and Benefits Expenses	2008	2007	2006

In 2007, personnel compensation and benefits costs of \$54,186 million were \$479 million, or 0.9%, less than 2006. The decrease was due to elimination of the employer's share of the CSRS contribution resulting from the enactment of the new law and reductions in workhours, complement, and workers' compensation costs.

Although total compensation and benefits were lower in 2007, our labor costs increased by \$1,118 million, or 2.8%. COLA increases in 2007 added \$871 million to our compensation expenses. These increases were offset somewhat by a decrease of 36 million labor hours. Our 2007 average hourly labor cost increased by 1.6%, compared to an increase of 4.5% in 2006. In 2007, workers' compensation decreased by \$399 million. See Workers' Compensation later in this section and Note 11, *Workers' compensation*, in Notes to the Financial Statements for additional information.

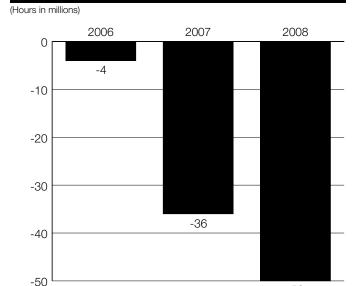
#### Workhours

In addition to labor and benefits rates, workhours are a major driver of our compensation and benefits expense. In 2008, mail processing, customer service, city delivery, and other workhours decreased by 50 million compared to 2007 offsetting the higher labor rates. The reduction in workhours was in part an outcome of lower mail volumes, which reduced workload. As mail volume fell throughout the year, management initiated a number of efforts to reduce workhours, especially overtime.

Workhours by Function	2008	2007	2006
(Workhours in thousands)			
City Delivery	452,288	462,040	468,918
Mail Processing	293,108	315,825	332,269
Customer Services & Retail	217,236	233,791	246,538
Rural Delivery	189,950	189,709	186,164
Other, including Plant, Operational Support, and Administrative	220,772	221,636	224,840
Total Workhours	1,373,354	1,423,001	1,458,729

Rural delivery increased 0.2 million workhours in 2008. The rural delivery workhour growth was driven by the addition of almost 710,000 new rural delivery points.

#### **Workhour Reductions**



In 2007, total workhours decreased by 36 million hours compared to 2006, partially offsetting the higher labor rates. Mail processing, customer service, and city delivery workhours decreased 36 million hours.

-50

Rural delivery increased 3.5 million workhours in 2007. The rural delivery workhour growth was driven by the addition of more than one million new rural delivery points. Other workhours decreased by three million compared to 2006.

Workhours have been reduced in eight of the last nine years with only 2005 showing a slight increase. Since 2002, workhour reductions have been the single biggest contributor to the ongoing achievement of our savings targets.

## Management's Discussion and Analysis of

# **Financial Condition and Results of Operations**

In 2007, we entered into new agreements with our four largest labor unions. The APWU and the NRLCA agreed to new four-year contracts, while the NPMHU and NALC entered into five-year agreements. COLA-based changes were included in the agreements.

Our non-bargaining employees receive pay increases 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**

Our employees participate in one of three retirement programs of the U.S. government, based on the starting date of their employment with the federal government. These programs are the Civil Service Retirement System (CSRS), the Dual CSRS/Social Security System (Dual CSRS), and the Federal Employees Retirement System (FERS). The programs are administered by the OPM. See Note 10, Retirement programs, in the Notes to the Financial Statements for additional information.

The expenses of all of our retirement programs, except for retiree health benefits, are included in compensation and benefits expense. These expenses represented 7.6% of our total operating expenses in 2008, 7.2% in 2007, and 9.8% in 2006. Retirement expense for current employees of \$5,899 million was \$162 million, or 2.8%, greater than in 2007. The 2008 increase is largely attributable to the higher employer contributions resulting from higher average wage rates in 2008, largely due to COLAs. The decrease in 2007, as compared to 2006, is mainly due to the enactment of P.L. 109-435, which suspended our CSRS retirement contribution as of October 14, 2006, but increased our contributions into the PSRHBF.

As described in Note 2, Summary of significant accounting policies, in the Notes to the Financial Statements, we account for our participation in the retirement programs of the U.S. government under multiemployer plan accounting rules, in accordance with Financial Accounting Standard Board Statement 87, Employers' Accounting for Pensions. Although the Civil Service Retirement and Disability Fund (CSRDF) is a single fund and does not maintain separate accounts for individual agencies, P.L. 109-435 requires us to make certain disclosures regarding the obligations

and changes in net assets as if the funds were separate. All of the following information is provided from OPM and represents the most recent data available (i.e., actual data as of September 30, 2007) with projections to September 30, 2008.

#### **Funding Status**

The following table provides OPM's estimation of the funding status of the CSRS and FERS programs for Postal Service participants as of September 30, 2007, and 2006, and the projected obligation as of September 30, 2008.

# Present Value Analysis of Retirement Programs as calculated by OPM (9/30/07 latest data available)

calculated by OPIVI (9/30/07 I	ales	i uala a	ıvaı	iable)		
(Dollars in billions)						
	Pro	ojected				
CSRS		2008		2007		2006
Actuarial Accrued Liability 9/30	\$	200.0	\$	196.9	\$	190.5
Current Fund Balance		196.7		193.8		207.6
(Unfunded) / Surplus	\$	(3.3)	\$	(3.1)	\$	17.1
	Pro	ojected				
FERS		2008		2007		2006
Actuarial Accrued Liability 9/30	\$	61.1	\$	55.1	\$	49.3
Current Fund Balance		69.9		63.5		58.0
Surplus	\$	8.8	\$	8.4	\$	8.7
Projected						
TOTAL CSRS and FERS		2008		2007		2006
Actuarial Accrued Liability 9/30	\$	261.1	\$	252.0	\$	239.8
Current Fund Balance		266.6		257.3		265.6
Surplus	\$	5.5	\$	5.3	\$	25.8

In June 2007, the \$17.1 billion surplus attributed to the CSRS plan on September 30, 2006, was transferred to the newly created PSRHBF.

#### **Net Periodic Costs**

Information about the net periodic costs for the CSRS and FERS pension plans, which are prepared by OPM, is as follows:

Components of Net Periodic Costs as calculated by OPM (9/30/07 latest actual data available)

(Dollars in billions)	CSF	RS	FERS		
	Projected 2008	2007	Projected 2008	2007	
Actuarial Liability as of October 1	\$ 196.9	\$ 193.7	\$ 55.1	\$ 49.3	
+ Expected Contributions*	0.5	0.5	3.2	3.0	
<ul><li>Expected Benefit Disbursements</li></ul>	(9.4)	(8.9)	(0.8)	(0.7)	
+ Interest Expense	12.0	11.8	3.6	3.2	
<ul> <li>Actuarial Gain due to Actual Experience during FY</li> </ul>	_	(4.4)	_	(0.6)	
+ Actuarial Loss Due to Change in Assumptions	_	4.2	_	0.9	
Actuarial Liability as of September 30	\$ 200.0	\$ 196.9	\$ 61.1	\$ 55.1	

<sup>\*</sup> Expected contribution for CSRS consists of employee contributions only. Expected contribution for FERS includes both employee and employer amounts.

#### **Cost Methods and Assumptions**

OPM made the following assumptions in completing its analysis:

- The actuarial cost method is Entry Age Normal
- Long-term economic assumptions are as follows:
  - Rate of inflation 3.5%
  - FERS COLA 2.8%
  - Annual general salary increases 4.25%
  - Interest rate 6.25%
  - The Postal Service is not required to make any agency contributions to CSRS
  - Postal Service contributions to FERS will not change; contributions will continue at the current rate of 11.2% of pay (the employee contribution is 0.8% of pay)

The OPM Board of Actuaries decided to incorporate an assumption of future mortality improvement into the actuarial valuation as of September 30, 2007. This caused the dynamic normal cost of CSRS to increase from 25.2% of pay to 25.8% and the FERS normal cost to increase from 12.0% to 12.3%.

#### Components of Net Change in Plan Assets

The following table prepared by OPM shows the components of the net change in plan assets for the CSRS and FERS programs.

Analysis of Change in Pension Net Assets during FY 2007 as calculated by OPM (9/30/07 latest actual data available)

calculated by Of W (9/00/07 latest actual data available)					
(Dollars in billions)	CSRS Actual	FERS Actual			
Net Assets as of 9/30/2006*	\$ 207.9	\$ 58.0			
+ Contributions	0.6	3.0			
- Benefit Disbursements	(8.9)	(0.7)			
- Transfer to Health Benefits Fund	(17.1)	0.0			
+ Investment Income	11.3	3.2			
Net Assets as of 9/30/2007	\$ 193.8	\$ 63.5			

\*OPM restated September 30, 2006 CSRS net assets from \$207.6 to \$207.9.

As stated previously, CSRDF is a single fund and does not maintain separate accounts for individual agencies. The actual securities of the CSRDF are not allocated separately to CSRS or FERS, or to Postal Service and non-Postal Service beneficiaries. The assets of the CSRDF are composed entirely of special issue Treasury securities with maturities ranging up to 15 years. The long-term securities bear interest rates ranging from 4% to 5%, while the short-term securities have an interest rate of 3.75%.

The assumed rate of return on the CSRS fund balance for both 2006 and 2007 was 6.25% while the actual rates of return were 5.42% and 5.51%, respectively. For the FERS fund, the assumed rate of return for both 2007 and 2006 was 6.25%, while the actual rates of return were 5.63% and 5.73% respectively. The projected rate of return on both the CSRS and FERS fund balance for 2008 is 6.25%.

## Management's Discussion and Analysis of

# **Financial Condition and Results of Operations**

OPM estimates the contributions and benefit payments for the next five years as follows:

# Projection of CSRS and FERS Contributions and Benefit Payments\* as calculated by OPM

(Dollars in billions)	CS	RS	FEF	RS
	Total	Total Benefit	Total	Total Benefit
	Contributions	Payments	Contributions	Payments
2008	\$ 0.5	\$ 9.4	\$ 3.1	\$ 0.8
2009	0.4	10.0	3.4	0.9
2010	0.4	10.6	3.7	1.1
2011	0.4	11.2	4.1	1.3
2012	0.3	11.8	4.4	1.5

<sup>\*</sup> Assumes total employee population remains constant

#### **Health Benefits**

Postal employees and retirees may participate in the Federal Employees' Health Benefits Program (FEHBP), which is administered by OPM. We account for our employee and retiree health benefit costs as an expense in the period our contribution is due and payable to FEHBP, using multiemployer plan accounting rules in accordance with Financial Accounting Standards Board Statement 106 (FAS 106), Employers' Accounting for Postretirement Benefits Other Than Pensions.

The drivers of our active employee health care costs are the number of employees electing coverage and the premium costs of the plans they select. In 2008, health benefit expenses for active employees were \$5,376 million, a decrease of \$25 million compared to 2007. This was 6.9% of our total operating expenses. The 2007 expense of \$5,401 million was 6.7% of our total operating expenses and increased by \$56 million, or 1.0%, over 2006.

Premiums for each plan participating in FEHBP are determined annually by OPM. OPM announced average premium increases effective in January 2008 were 2.0%, 1.8% in January 2007 and 6.6% in January 2006. The low level of premium increases in 2007 and 2008 are the result of lower plan costs and the application of plan reserves to lower premiums. However, in September 2008, OPM announced an average premium increase of 7.0% for January 2009.

#### **Retiree Health Benefits**

Eligible postal employees, those with at least five consecutive years participation in the FEHBP immediately preceding retirement, are entitled to continue to participate in FEHBP postretirement. As outlined in FAS 106, the amount we pay into the PSRHBF, plus our portion of the current premium expense, is recognized as an expense when due. See Note 4, *Postal Accountability and Enhancement Act, Public Law* 109-435 (P.L. 109-435) and Note 9, *Health benefit programs*, in Notes to the Financial Statements, for further discussion of this accounting treatment.

P.L. 109-435 made several changes to the way we fund and report our obligations for postretirement health benefits. The law established the PSRHBF and directed OPM to determine any Postal Service surplus in the Civil Service Retirement and Disability Fund as of September 30, 2006. and to deposit the surplus into the PSRHBF by June 30, 2007. OPM attributed to the Postal Service a surplus of \$17.1 billion in the CSRS fund as of September 30, 2006. and transferred the funds as required on June 29, 2007. P.L. 109-435 also required that we begin to fund the OPMdetermined obligation for retiree health benefits by paying into the PSRHBF the 2006 escrow resulting from P.L. 108-18 (\$2.958 billion) and by making additional annual payments averaging \$5.6 billion per year through 2016. Beginning in 2017, the PSRHBF will begin to pay our portion of the premium payments. Payment to the PSRHBF was \$5.6 billion in 2008 and \$5.4 billion in 2007.

Under P.L. 109-435, OPM will continue to charge us for our portion of the premiums for postal retirees currently participating in FEHBP, and we will continue to expense these payments as they become due until 2017. The major drivers of our retiree health benefits premium costs are the number of current participants on the rolls, the mix of plans selected by retirees, the premium costs of those plans, and the apportionment of premium costs to the federal government for retiree service prior to 1971. Retiree health benefit premium expense, exclusive of the expense for the PSRHBF, has increased every year. Retiree health benefits employee premium expense increased 4.7% in 2008 and 5.4% in 2007. The number of Postal Service annuitants and survivors has grown to approximately 452,000 in 2008 compared to 450,000 in 2007, and 448,000 in 2006. The average monthly apportionment, the percentage of retiree premiums charged to the Postal Service, has increased from 66.4% in 2006 to 69.9% in 2008. A summary of the retiree health benefits expense for 2008, 2007, and 2006 is included in the table below.

#### Retiree Health Benefits

Expense	2008	2007	2006
(Dollars in millions)			
Employer Premium Expense \$	1,807	\$ 1,726	\$ 1,637
Transfer of 2006 Escrow to PSRHBF	_	2,958	_
P.L. 109-435 Scheduled Payment	5,600	5,400	
Total \$	7,407	\$ 10,084	\$ 1,637

#### **PSRHBF**

P.L. 109-435 requires that OPM provide, and that we report, certain information concerning the obligations, costs, and funding status of the PSRHBF. The following table shows the funded status and components of net periodic costs.

Postal Service Retiree Health Benefit **Fund Funded Status and Components** of Net Periodic Costs as calculated

by OPM*	2008	2007
(Dollars in millions)		
Beginning Actuarial Liability at October 1	\$ 80,786	\$ 74,815
- Actuarial Gain	(1,136)	_
+ Normal Costs	3,389	3,175
+ Interest @ 6.25%	4,977	4,676
Subtotal Net Periodic Costs	7,230	7,851
- Premium Payments	(1,934)	(1,880)
Actuarial Liability at September 30	86,082	80,786
- Fund Balance at September 30	(32,610)	(25,745)
Unfunded Obligations at September 30	\$ 53,472	\$ 55,041

<sup>\*</sup>Medical Inflation Assumption = 7%

The OPM valuation of Post Retirement Health Liabilities and Normal Costs were prepared in accordance with Federal Accounting Standards Advisory Board (FASAB) Statement of Federal Financial Accounting Standards (SFFAS) No. 5. SFFAS 5 requires the use of the aggregate Entry Age Normal actuarial cost method.

Demographic assumptions and an interest rate assumption of 6.25% are consistent with the pension valuation assumptions, and decrements are based upon counts or numbers rather than dollars.

The normal cost, which is on a per-participant basis, is computed to increase annually by a constant medical inflation rate which is assumed to be 7% per annum. Normal costs are derived from the current FEHBP on-roll population with an accrual period from entry into FEHBP to assumed retirement. Entry into the FEHBP is generally later than entry into the retirement systems.

The accrued liability is equal to the total liability less future normal payments. The liabilities and normal costs that appear in the OPM financial statements and are used in agency reporting are based upon annuitant medical costs (including administration costs) less annuitant premium payments. The values used in these valuations are based upon the same methodology and assumptions as for the financial statements except the average government share of premium payments for annuitants is substituted for annuitant medical costs less annuitant premium payments. The government share of premium payments has been adjusted to reflect premium payment levels that correspond to actual costs. This amount is assumed to increase at 7% per annum. For current Postal annuitants, this government share of premium payments is adjusted to reflect the prorata share of civilian service to total service for which the Postal Service is responsible. Postal annuitant counts include contracts for which the Postal Service makes no payment. The pro-rata adjustment is made by applying calculated factors based upon actual payments that vary by age and Medicare status of the enrollments. For active postal employees, the pro-rata share in retirement is assumed to be 93% of the total.

The following table shows the net assets of the PSHRBF.

#### Net Assets of Retiree Health Benefit Fund as calculated

by OPM	2008	2007
(Dollars in millions)	"	
Beginning Balance at October 1	\$ 25,745	\$ _
Contributions and Transfers	5,600	25,458
Earnings @ 4.8% and 5.0%, respectively	1,265	287
Net increase	6,865	25,745
Fund Balance at September 30	\$ 32,610	\$ 25,745

#### Management's Discussion and Analysis of

#### **Financial Condition and Results of Operations**

The assets of the PSRHBF are composed entirely of special issue Treasury securities with maturities ranging up to 15 years. The long-term securities bear interest rates ranging from 4% to 5%, while the short-term securities have an interest rate of 3.75%. The expected rate of return was 6.25% for both 2008 and 2007, while the actual rates of return were 4.8% for 2008 and 5.0% for 2007.

Because there are several areas of judgment involved in calculating this obligation, estimates could vary widely depending on the assumptions used. Utilizing the same underlying data that was used in preparing the estimate in the *Postal Service Retiree Health Benefit Fund Funded Status and Components of Net Periodic Costs* chart, the September 30, 2008 obligation could range from \$40 billion to \$70 billion, solely by varying the inflation rate by plus or minus 1% while the 2007 unfunded obligation would range from \$49 billion to \$69 billion using the same assumption.

# Projection of PSRHBF Contributions and

Benefit Payments	Con	tributions	Payments
(Dollars in millions)			
2009	\$	5,400	\$ _
2010		5,500	_
2011		5,500	_
2012		5,600	_
2013		5,600	_

#### 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 from postal funds.

We record as a liability the present value of all future payments we expect to make for those employees receiving workers' compensation. At the end of 2008, we estimate our total liability for future workers' compensation costs at \$7,968 million, an increase of \$197 million, or 2.5%, from 2007. In 2007, our liability decreased \$92 million, or 1.2%, from 2006. Our workers' compensation expense was \$1,227 million for 2008, \$880 million for 2007, and \$1,279 million for 2006.

As discussed in Note 11, Workers' compensation, in the Notes to the Financial Statements, we implemented an improved model for estimating our liability for workers compensation in 2008, with the assistance of an independent actuary. The revised model is similar to that used in the independent actuarial valuation, which formed the basis for the recorded liability in 2007. The revised model combines four generally accepted actuarial valuation techniques to project our future claim payments based upon our currently open claims and our past claim payment experience. In addition, we refined our estimation in 2008 by taking a longer period of claim payment experience into consideration in the projection. The cumulative impact of the changes in estimate reduced our 2007 liability and expense by \$685 million and our 2008 liability and expense by \$154 million.

In 2008, we experienced a 1.5% increase in the number of medical claims receiving payments and a 3.8% increase in the number of compensation claims receiving payments. The actual claim payments increased \$56 million, or 6.2%, over 2007. A factor in this increase was COLAs of 2.4% granted to all compensation claimants in March 2007 and 4.3% granted in March 2008, which raised the payments to all compensation claimants on the rolls. Medical claims payments during the year grew by 8.9%.

In 2007, we experienced a 4.6% decrease in the number of medical claims receiving payments and a 0.2% decrease in the number of compensation claims receiving payments. Although the number of claims receiving payments decreased, the actual cost of claims increased \$41 million, or 4.7%, over 2006. A factor in this increase was the 2.4% March 2007 COLA, which raised the payments to all compensation claimants on the rolls.

#### **Transportation Expenses**

Transportation expenses for 2008 were \$6,961 million, an increase of \$459 million, or 7.1%, compared to 2007. Compared to 2006, 2007 transportation expenses increased \$457 million or 7.6%. Transportation costs are largely made up of air and highway transportation.

Transportation Expense	2008	2007	2006
(Dollars in millions)			
Highway Transportation	\$ 3,499	\$ 3,150	\$ 2,977
Air Transportation	3,047	2,990	2,771
Other Transportation	415	362	297
Total Transportation Expense	\$ 6 961	\$ 6 502	\$ 6.045

#### **Highway Transportation**

Highway transportation expenses for 2008 were \$3,499 million, an increase of \$349 million, or 11.1% over 2007. In 2008, the increase was attributed to higher fuel prices, contract labor rates, and contract CPI rates. In addition, some mail that was previously transported via air was moved to surface transportation during the year. In 2008, the average price of gasoline increased approximately 30.4% compared to 2007. Diesel fuel, which makes up 93% of the fuel purchased for highway contracts, was an average of \$3.87 per gallon in 2008, compared to \$2.70 per gallon in 2007, an increase of 43.3%.

In 2007, our highway transportation expenses were \$3,150 million, an increase of \$173 million, or 5.8%, over 2006. This was driven by an increase in the number of miles driven, contractual rate increases for the contract drivers, and delivery growth. The increase in fuel prices was somewhat neutralized through leveraging our buying power to obtain favorable pricing by consolidating fueling points and bulk purchasing.

#### Air Transportation

Air transportation expenses for 2008 were \$3,047 million, an increase of \$57 million, or 1.9%, compared to the same period last year. Domestic air transportation expenses for 2008 were \$2,336 million, a decrease of \$57 million or 2.4%, compared to 2007. International air expenses increased \$114 million primarily due to the shift from surface to air delivery, resulting from the elimination of the Global Economy service offering.

Air transportation expenses for 2007 were \$2,990 million, an increase of \$219 million, or 7.9%, from 2006. In 2007, the increase was driven by growth in mail volume on our cargo carriers and the expansion of peak season operations, which provided improved service to our customers. Additional contributing factors were increases in contract rates for the offshore networks and an increase in fuel expenditures. With the 5% growth in international volume, we also saw a corresponding increase in international air expense compared to 2006.

#### Other Transportation

Other transportation expenses for 2008 were \$415 million, an increase of \$53 million, or 14.6%, mainly driven by an increased number of international terminal dues settlements to foreign postal administrations compared to 2007. Terminal dues settlements are the fees we pay to foreign postal administrations for the outbound international mail that they deliver for us.

In 2007, other transportation expenses were \$362 million, an increase of \$65 million, or 21.9%, caused by increased international terminal dues settlements to foreign postal administrations and expedited mail delivery transactions as compared to 2006.

#### Other Expenses

In 2008, other operating expenses of \$9,785 million increased \$452 million, or 4.8%, from the comparable 2007 amount. The increase was primarily driven by Depreciation and Vehicle Maintenance Services. Vehicle Maintenance Services increased \$166 million and includes the fuel used by our carrier fleet. Depreciation and amortization expense increased \$167 million, compared to 2007, as a number of equipment projects were completed during the last half of 2007 and the early part of 2008.

Other Operating Expenses	2008	2007	2006
(Dollars in millions)			
Supplies and Services	\$ 2,597 \$	2,594 \$	2,643
Depreciation and Amortization	2,319	2,152	2,149
Rent and Utilities	1,779	1,700	1,721
Vehicle Maintenance Service	926	760	709
Information Technology and Communications	658	630	649
Rural Carrier Equipment Maint. Allowance	545	495	485
Other	961	1,002	978
Total	\$ 9,785 \$	9,333 \$	9,334

In 2007, other operating expenses decreased \$1 million from 2006 comparable amounts, as shown in the table above.

#### **Productivity**

We use a single indicator called total factor productivity (TFP) to measure productivity. TFP measures the change in the relationship between outputs (workload processed) and inputs (resource usage). Workload consists of weighted mail volume, miscellaneous output, and our expanding delivery network. Resources consist of labor, materials (including transportation), and deployed capital assets. Workload minus resources used equals TFP.

During FY 2008, TFP declined 0.5%. This marks the first year since 1999 that the Postal Service registered negative annual TFP growth. Despite efforts to manage workforce utilization (reduction of 50 million workhours), utilize material such as supplies and services efficiently, and maximize the

#### Management's Discussion and Analysis of

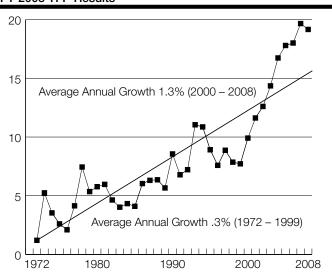
### **Financial Condition and Results of Operations**

return on capital investments (mainly automation), the worsening conditions across most sectors of the U.S. economy during this fiscal year, resulted in a 4.5% decline in mail volume, which we were unable to completely offset.

Aggregate workload for FY 2008 declined 3.0%. This was mainly due to a sharp decline in weighted mail volume, driven by the 8.5% decline in First-Class single-piece mail volume. In response to the workload decrease, we reduced resource usage 2.4% compared to last year. Labor usage, in particular, fell 3.6% compared to 2007.

The following graph shows the cumulative TFP trend from 1972 through 2008.

#### FY 2008 TFP Results



#### Service And Performance

Management monitors several key statistics to determine performance against our service standards. The major indicators we monitor are the External First-Class (EXFC) on-time mail delivery scores and the Customer Satisfaction Measurement (CSM) scores.

EXFC is an independently administered system that provides an external measure of delivery performance from collection box to mailbox. Although not a system-wide measurement of all First-Class Mail performance, EXFC continuously tests a panel of 463 3-digit ZIP Code areas selected on the basis of geographic area and volume density, thereby providing a measure of service performance from the customer's point of view. Results of these measures for the last four quarters are listed below.

**EXFC Service Performance Scores** 

	Quarter 1	Quarter 2	Quarter 3	Quarter 4
(Percentage delivered on time)				
Overnight Delivery	96	96	97	97
2-Day Delivery	93	94	95	94
3-Day Delivery	88	92	94	93

As required by P.L. 109-435, we worked with the PRC to create a set of modern service standards for our Mailing Services products. These standards were issued on December 19, 2007, and will be reflected in the service performance measurements published in 2009. The 2008 service scores do not reflect the new service standards.

CSM is an independently-administered survey of customer opinions about key areas of service to residential customers. The following table displays the residential satisfaction results for the last four quarters.

#### **Customer Satisfaction Measurement**

	Quarter 1	Quarter 2	Quarter 3	Quarter 4
(Percentage)		'		
Service rated excellent, very good or good	92	92	92	93

#### CAPITAL RESOURCES AND LIQUIDITY

#### Capital Investments

At the beginning of 2008, there were 30 Board-approved projects in progress, representing \$6.8 billion in approved capital funding. During the year, the Board approved 11 new projects, which totaled \$0.9 billion in additional capital funding. A total of 14 projects representing \$1.8 billion in approved capital funding were completed. The year ended with 27 open projects that amount to \$5.9 billion in approved capital.

While the funding for a project is authorized in one year, the commitment or contract to purchase or build may take place over several years. By year-end, approximately \$5.0 billion had been committed to these 27 open projects. Actual capital cash outlays will occur over several years. Through the end of 2008, approximately \$3.4 billion has been paid for the 27 projects.

In 2008, capital commitments for all projects were \$2.3 billion. See Note 7, Leases and other commitments, in the Notes to the Financial Statements for additional information.

Noteworthy projects approved in 2008 include:

The Advance Facer Canceller 200 (AFCS 200) project will deploy 550 AFCS 200 machines. This purchase will address end-of-life issues with existing cancellation equipment initially placed in service over 16 years ago. The new AFCS 200 will include features that improve mail processing operations and enhance service.

The Carrier Route Vehicles project purchased 1,352 vehicles. These vehicles will be used to initiate the next planned phase of providing postal-owned right-hand drive vehicles to rural routes per agreement with the National Rural Letter Carrier's Association.

The purchase of 739 additional Delivery Barcode Sorter Stacker Modules will provide a greater depth-of-sort to existing letter mail processing operations. These units will be installed in 110 postal facilities. The labor savings generated by this program are expected to produce a strong return on investment.

#### Liquidity

Liquidity is the cash we have with the U.S. Treasury and the amount of money we can borrow on short notice if needed. Our note purchase agreement with the Federal Financing Bank, renewed in 2008 and expiring in 2009, provides for revolving credit lines of \$4.0 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. This arrangement provides us the flexibility to borrow short-term or long-term, using fixed- or floating-rate debt that is either callable or noncallable. These arrangements with the Federal Financing Bank provide us with adequate tools to effectively fund our cash requirements and manage our interest expense and risk. See Note 5, Debt and related interest, in Notes to the Financial Statements for additional information about our debt obligations.

The amount we can borrow is limited by statute. Our total debt outstanding cannot exceed \$15 billion, and the net increase in debt at year-end for any fiscal year cannot exceed \$3 billion.

Looking forward, our liquidity will be comprised of the approximately \$1.4 billion of cash that we have entering 2009, the cash flow that we generate from operations, and the \$3 billion that we can borrow if necessary. As was the case in 2008, for 2009 we do not expect cash flow from operations to supply adequate cash to fund our capital investments and the \$5.4 billion payment into the PSRHBF required by P.L. 109-435. Consequently, the increase in debt next year could be similar to this year's \$3 billion increase.

The majority of our revenue is earned in cash and the majority of our cash outflow is to support our biweekly payroll. Generally, cash flow from operations is at a seasonal peak in our first quarter and seasonal low in our fourth quarter. The first quarter includes the fall mailing and holiday season. In the fourth quarter we make significant cash payments for workers' compensation and retiree health benefits. A large portion of the \$7.2 billion in debt we incurred at the end of 2008 was to fund the \$6.6 billion in year-end PSRHBF and Workers' Compensation payments. It should also be noted that \$4.3 billion of the current liabilities on our balance sheet at September 30, 2008, represents items for which we have already collected cash, but have a remaining obligation to perform a future service.

The following table illustrates our scheduled cash flow obligations in future years.

#### Schedule of Commitments

	Retiree Health Benefits	Leases
(Dollars in millions)		
2009	\$ 5,400	\$ 882
2010	5,500	861
2011	5,500	806
2012	5,600	738
2013	5,600	671
After 2013	17,200	5,387
Total	\$ 44,800	\$ 9,345

#### Management's Discussion and Analysis of

### **Financial Condition and Results of Operations**

#### **CASH FLOW**

#### **Cash Flows From Operating Activities**

Net cash used in operating activities was \$0.4 billion in 2008 compared to \$2.6 billion used by operating activities in 2007. The year-to-year change of \$2.2 billion was driven mainly by the reduction in the net loss of \$2.3 billion. This, in turn, was largely due to the absence in 2008 of the onetime transfer of \$3.0 billion formerly held in escrow to the PSRHBF in 2007. Additional cash was provided in 2008 by an increase of \$547 million in prepaid postage. This is due to changes in consumer buying behavior, largely driven by the introduction of the Forever Stamp (See Note 2 to the Financial Statements, Summary of significant accounting policies — Revenue Recognition/Deferred Revenue — Prepaid Postage). This increase was partially offset by decreases in payables and accrued expenses of \$324 million, other noncurrent liabilities of \$167 million, money orders outstanding of \$127 million, and a decrease in accrued compensation and benefits of \$105 million.

Net cash used in operating activities was \$2.6 billion in 2007 compared to \$3.8 billion provided by operating activities in 2006. The year-to-year decrease of \$6.4 billion was driven mainly by the \$8.4 billion in payments to the PSRHBF in 2007, as required by P.L. 109-435, partially offset by the \$1.6 billion in CSRS payments that we are no longer required to make. This is also reflected in our 2007 net loss of \$5.1 billion compared to 2006 net income of \$900 million. Additional cash was provided in 2007 by an increase in other noncurrent liabilities of \$281 million, primarily contingent liabilities, an increase in compensation and benefits liabilities of \$347 million, and increased collections of accounts receivable of \$80 million. These cash flow increases were partially offset by decreases in payables and accrued expenses of \$93 million, and customer deposit accounts and outstanding money orders of \$186 million.

#### **Cash Flows From Investing Activities**

Net cash used by investing activities was \$1.9 billion in 2008 compared to \$500 million provided in 2007. Purchases of property and equipment of \$2.0 billion decreased \$700 million from the \$2.7 billion purchased in 2007. Proceeds from building sales and the sale of property and equipment totaled \$57 million in 2008 compared to \$257 million in 2007. The remainder of the change was due to the absence, in 2008, of the one time 2007 transfer of funds from the escrow restricted cash into operating cash. Excluding this one time item, cash used by investing activities would have decreased \$520 million in 2008.

Net cash provided by investing activities was \$500 million in 2007 compared to \$5.5 billion used in 2006. Nearly all of the year-over-year change can be attributed to the almost \$3.0 billion that was placed in escrow as restricted cash in 2006, and then was removed from restricted cash when transferred to the new PSRHBF in 2007. Capital cash outlays of \$2.7 billion increased slightly from the \$2.6 billion in 2006. Proceeds from the sale of property were \$39 million in 2007 compared to \$114 million in 2006. In 2007, the sale of the James A. Farley Building and several Philadelphia properties resulted in proceeds from deferred building sales of \$218 million. Excluding the escrow, net cash flow used in investing activities would have been virtually unchanged at \$2.5 billion for both 2007 and 2006, rather than the \$500 million and \$5.5 billion reported.

#### **Cash Flows From Financing Activities**

Net cash provided by financing activities was \$2.9 billion, \$2.0 billion, and \$2.0 billion for 2008, 2007, and 2006 respectively. Our borrowing from the Federal Financing Bank increased \$3.0 billion, \$2.1 billion, and \$2.1 billion in 2008, 2007, and 2006 respectively.

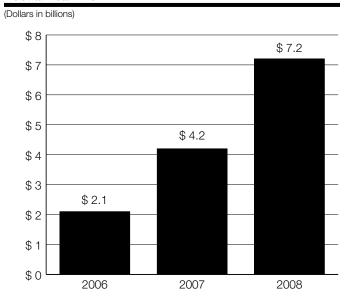
#### FINANCING ACTIVITIES

#### Debt

As an "independent establishment of the executive branch of the Government of the United States," we receive no tax dollars for ongoing operations. We are self-supporting, and have not received an appropriation for operational costs since 1982. We fund our operations chiefly through cash generated from operations and by borrowing from the Federal Financing Bank.

The amount we borrow is largely determined by the difference between our cash flow from operations, which includes the end-of-year payout of \$6.6 billion for retiree health benefits and workers' compensation, and our capital cash outlays. Our capital cash outlays consist of the funds invested for new facilities, new automation equipment, and new services. On September 30, 2008, we had \$7.2 billion in debt outstanding, a \$3.0 billion increase from last year.

#### Debt at Year End



#### Other Interest Expense

In 2008, interest expense was \$36 million, an increase of \$26 million compared to 2007. The net loss of \$2.8 billion in 2008 decreased the number of days we were debt free in 2008 compared to 2007, and resulted in the increase in interest expense. In 2007 and 2006, with less debt to repay, and increased cash on hand, other interest expense was \$10 million and \$5 million respectively.

#### Interest and Investment Income

When we determine that our available funds exceed our current needs, we invest those funds with the U.S. Treasury's Bureau of Public Debt in overnight securities issued by the U.S. Treasury. Due to increased levels of debt in 2008, excess cash was mostly used to repay debt, resulting in investment income of \$10 million.

In 2007 and 2006, with less debt to repay, and increased cash on hand, we earned investment income of \$169 million in 2007 and \$140 million in 2006.

We also recognize imputed interest on the funds owed to us under the Revenue Forgone Reform Act of 1993. Under the Act, Congress agreed to reimburse the Postal Service \$29 million annually through 2035 for services performed in prior vears. See Note 12, Revenue forgone, in the Notes to the Financial Statements for additional information.

#### Interest and Investment

Income	2008	2007	2006
(Dollars in millions)			
Investment Income	\$ 10	\$ 169	\$ 140
Imputed Interest on Accounts Receivable from the	0.5	0.5	0.5
U.S. Government	25	25	25
Other Interest	1	1	2
Total	\$ 36	\$ 195	\$ 167

#### LEGISLATIVE UPDATE

#### Appropriations

Although the Postal Service is self-funded and does not receive any Congressional appropriations to support its operations, some funding is provided to cover the costs of certain statutorily mandated services. In September 2008, the President signed into law P.L. 110-329, to fund the federal government until March 6, 2009. The Postal Service received the October 2008 - March 2009 portion of its \$29 million revenue foregone reimbursement. On October 1, 2008, the Postal Service received \$88.9 million, to cover cost associated with free mail for the blind and overseas voters mailed in previous years.

#### **International Air Transportation Bill**

In October 2008, the President signed the Air Carriage of International Mail Act (P.L. 110-405), which eliminated the authority of the Department of Transportation (DOT) to set the prices paid by the Postal Service for the air transport of international mail. Under the new provision, the Postal Service is permitted to competitively negotiate the terms of international air mail transportation contracts directly with air carriers, just as we do with our domestic transportation. We will benefit by paying international mail transportation rates set by negotiation, not regulatory procedures.

#### **Medicare Improvements for Patients** and Providers Act

The Medicare Improvements for Patients and Providers Act, (P.L. 110-275) was signed into law July 15, 2008. The law reduces the Medicare reimbursement rate for mail order of durable medical equipment, but does not make a similar reduction for retail suppliers of such equipment. These changes could have a potential annual negative revenue impact of approximately \$40 million.

#### Management's Discussion and Analysis of

#### **Financial Condition and Results of Operations**

#### **Tobacco Legislation**

On September 10, 2008, H.R. 4081, The *Prevent All Cigarette Trafficking Act of 2008* (PACT Act), passed the House by a 379 to 12 vote. The bill would make cigarettes and smokeless tobacco nonmailable under the criminal provisions of Title 18 of the U.S. Code. The bill would also place shipping and record-keeping requirements on those selling cigarettes and smokeless tobacco over the phone, through the mail, or via the Internet. Sellers would be required to verify the age and identity of purchasers to reduce sales to minors. In addition, the bill would make failure to comply with state tobacco tax laws a felony. The Postal Service estimates that shipping tobacco constitutes approximately \$35–\$40 million of revenue annually. A companion bill has been awaiting Senate floor action for over a year.

#### Outlook

The U.S. economy had experienced a year of slow growth before experiencing an actual contraction of GDP, which began in Quarter IV. Most economists agree that the contraction in GDP will be more serious during the first half of 2009. Global Insight, an economic forecasting and consulting firm, expects real GDP to decline for three quarters in a row beginning with Quarter IV of 2008.

The U.S. economy had slumped long before the current credit crisis began. The housing market, sub-prime mortgage issues, and energy price fluctuations resulted in a year of slow economic growth, causing a major downturn in both First-Class Mail and Standard Mail advertising.

A financially healthy Postal Service is dependent upon a healthy U.S. economy. Retail sales, employment, and investment spending are all significant indicators of mail demand. All three of these indicators are projected to significantly decrease in 2009. Outright declines in consumer spending are anticipated during the final quarter of calendar year 2008 and the first quarter of 2009. These would be the first declines in consumer spending since 1991. Non-farm employment has been in steady decline since February, and is expected to continue to decline throughout 2009. Finally, investment spending should see a sharp decrease in 2009.

#### **Revenue Outlook**

We project revenue to increase between 1.0% and 2.0% in 2009 on a volume decrease of 3.0% to 4.0%. This expected revenue increase is due primarily to anticipated price increases.

First-Class Mail volume is expected to decline about 2.0% during 2009. Electronic alternatives to mail will continue to decrease First-Class Mail volume. Prior to 2008, this was offset to some degree by growth in First-Class Mail workshare letters and flats.

Standard Mail revenue is expected to decline in 2009.

Periodicals revenue and volume are both projected to decrease in 2009. We expect the modest year-over-year declines in Periodicals volume to continue. While the declines in Periodicals are not dramatic, they are part of a long-term trend.

Both volume and revenue are expected to grow in 2009 for Package Services.

Our Shipping Services products revenues and volumes are expected to grow modestly in 2009. This entire group is influenced by competitor's prices, which may include fuel surcharges. P.L. 109-435 has provided an opportunity for greater competition by the Postal Service in this area of services.

Pricing for shipping services will change in January 2009, with new prices announced in November 2008. The move to a January implementation for shipping services is consistent with industry standards, and provides a clearer picture of the competitive, affordable rates the Postal Service offers. P.L. 109-435 changed the way we operate and conduct business. It provides new flexibility, especially in competitive pricing for shipping services, enabling us to respond to dynamic market conditions and changing customer needs. Prices will change in January for Express Mail, Priority Mail, Parcel Select, Parcel Return Service, and some international shipping products. It will be the first time we will separate price adjustment and implementation dates for our shipping and packaging business from the dates for our mailing services and products.

#### **Expense Outlook**

Total expenses for 2009 are estimated to increase between 1.0% and 2.0%. Personnel costs increases in 2009 will be driven primarily by cost-of-living adjustments, contractual pay increases, and increases in health benefits. This will be offset by planned cost reductions. We are offering voluntary early retirement opportunities to almost 25% of our workforce in 2009. The total number of employees who accept the early retirement offer will impact the savings for FY 2009.

#### Controls and **Procedures**

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

#### Disclosure Controls

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our quarterly and annual reports is recorded, processed, summarized, and reported within the time frames specified by P.L. 109-435, and that this information is accumulated and communicated to our management, including the Postmaster General and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, we recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and we were required to apply our judgment in evaluating the cost-benefit relationship of possible controls and procedures.

We carried out an evaluation, under the supervision and with the participation of management, including the Postmaster General and Chief Financial Officer, of the effectiveness of the design and operation of disclosure controls and procedures as of September 30, 2008. Based on the foregoing, the Postmaster General and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of September 30, 2008.

#### Internal Controls

There have been no changes during the year covered by this report in our internal control over financial reporting or in other factors that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

#### Report of Independent Auditors



Ernst & Young LLP 8484 Westpark Drive McLean, Virginia 22102 Tel: 703 747 1000 www.ev.com

#### Report of Independent Registered Public Accounting Firm

The Board of Governors of the United States Postal Service

We have audited the accompanying balance sheets of the United States Postal Service as of September 30, 2008 and 2007, and the related statements of operations, changes in net capital, and cash flows for each of the three years in the period ended September 30, 2008. 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 the standards of the Public Company Accounting Oversight Board (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. We were not engaged to perform an audit of the United States Postal Service's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the United States Postal Service's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and 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, 2008 and 2007, and the results of its operations and its cash flows for each of the three years in the period ended September 30, 2008, in conformity with U.S. generally accepted accounting principles.

In accordance with Government Auditing Standards, we have also issued our report dated November 14, 2008 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 other matters. 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 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

November 14, 2008

A member firm of Ernst & Young Global Limited

# Statements of **Operations**

		Years En	ded Sep	otember 30,	
		2008	2007		2006
(Dollars in millions)					
Operating revenue	\$	74,932	\$ 74,778	\$	72,650
Operating expenses:					
Compensation and benefits		53,585	54,186		54,665
Retiree health benefits		7,407	10,084		1,637
Transportation		6,961	6,502		6,045
Other		9,785	9,333		9,334
Total operating expenses		77,738	80,105		71,681
(Loss) Income from operations		(2,806)	(5,327)		969
Interest and investment income		36	195		167
Interest expense on deferred retirement obligations		_	_		(231)
Other interest expense		(36)	(10)		(5)
Net (Loss) Income	\$	(2,806)	\$ (5,142)	\$	900

# Balance sheets — **Assets**

	Sep	tember 30,
	2008	2007
(Dollars in millions)		
Assets		
Current Assets:		
Cash and cash equivalents	\$ 1,432	\$ 899
Receivables:		
Foreign countries	450	425
U.S. government	133	155
Other	187	223
Receivables before allowances	770	803
Less allowances	41	44
Total receivables, net	729	759
Supplies, advances and prepayments	193	201
Total Current Assets	2,354	1,859
Property and Equipment, at Cost:		
Buildings	22,269	21,591
Equipment	21,544	21,060
Land	2,971	2,914
Leasehold improvements	914	842
	47,698	46,407
Less allowances for depreciation and amortization	25,886	24,688
	21,812	21,719
Construction in progress	1,381	1,877
Total Property and Equipment, Net	23,193	23,596
Other Assets — Principally Revenue Forgone Receivable	439	392
Total Assets	\$ 25,986	\$ 25,847

# Balance sheets — Liabilities and

# Net (Deficiency) Capital

	Sep	otember 30,
	2008	2007
(Dollars in millions)		
Liabilities and Net (Deficiency) Capital		
Current Liabilities:		
Compensation and benefits	\$ 3,466	\$ 3,571
Payables and accrued expenses:		
Trade payables and accrued expenses	1,246	1,503
Foreign countries	413	452
U.S. government	85	111
Total payables and accrued expenses	1,744	2,066
Customer deposit accounts	1,449	1,499
Deferred revenue-prepaid postage	1,689	1,142
Outstanding postal money orders	720	847
Prepaid box rent and other deferred revenue	461	479
Debt	7,200	4,200
Total Current Liabilities	16,729	13,804
Noncurrent Liabilities:		
Workers' compensation costs	7,003	6,800
Employees' accumulated leave	2,208	2,129
Deferred appropriation and other revenue	525	591
Long-term portion capital lease obligations	587	618
Deferred gains on sales of property	312	310
Contingent liabilities and other	294	461
Total Noncurrent Liabilities	10,929	10,909
Total Liabilities	27,658	24,713
Net Capital		
Capital contributions of the U.S. government	3,034	3,034
Deficit since 1971 reorganization	(4,706)	(1,900)
Total Net (Deficiency) Capital	(1,672)	1,134
	\$ 25,986	\$ 25,847
Total Liabilities and Net (Deficiency) Capital	\$ 20,980	φ 25,64 <i>i</i>

# Statements of Changes in Net (Deficiency) Capital

	Capital Contri U.S. Go	butions of overnment	Retained (Deficit) Earnings Since Reorganization		Total Ne (Deficiency) Capita	
(Dollars in millions)						
Balance, September 30, 2005	\$	3,034	\$	2,342	\$	5,376
Net Income				900		900
Balance, September 30, 2006		3,034		3,242		6,276
Net (Loss)				(5,142)		(5,142)
Balance, September 30, 2007		3,034		(1,900)		1,134
Net (Loss)				(2,806)		(2,806)
Balance, September 30, 2008	\$	3,034	\$	(4,706)	\$	(1,672)

# Statements of Cash Flows

	Years Ended Sepetember 3				mber 30,	
		2008		2007		2006
(Dollars in millions)						
Cash flows from operating activities:						
Net (Loss) Income	\$	(2,806)	\$	(5,142)	\$	900
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:						
Depreciation and amortization		2,319		2,152		2,149
(Gain) loss on disposals of property and equipment, net		(16)		23		(40)
(Increase) decrease in appropriations receivable revenue forgone		(47)		2		(18)
Increase (decrease) in noncurrent workers' compensation liability		203		(69)		342
Increase in employees' accumulated leave		79		13		100
(Decrease) increase in noncurrent deferred appropriations and other revenue		(5)		(7)		21
(Decrease) increase in other noncurrent liabilities		(167)		281		(67)
Changes in current assets and liabilities:						
Receivables, net		30		80		169
Supplies, advances and prepayments		8		4		(5)
Compensation and benefits		(105)		347		204
Payables and accrued expenses		(324)		(93)		64
Customer deposit accounts		(50)		(148)		(73)
Deferred revenue-prepaid postage		547		(45)		(13)
Outstanding postal money orders		(127)		(38)		55
Prepaid box rent and other deferred revenue		22		37		(20)
Net cash (used in) provided by operating activities		(439)		(2,603)		3,768
Cash flows from investing activities:						
Decrease (increase) in restricted cash		_		2,958		(2,958)
Purchase of property and equipment		(1,995)		(2,715)		(2,630)
Proceeds from deferred building sale		4		218		_
Proceeds from sales of property and equipment		53		39		114
Net cash (used in) provided by investing activities		(1,938)		500		(5,474)
Cash flows from financing activities:						
Issuance of notes payable		4,500		1,000		_
Payments on notes payable		(1,000)		_		_
Net change in revolving credit line		(500)		1,100		2,100
Payments on capital lease obligations, net		(29)		(19)		(37)
U.S. government appropriations - expensed		(61)		(76)		(85)
Net cash provided by financing activities		2,910		2,005		1,978
Net increase (decrease) in cash and cash equivalents		533		(98)		272
Cash and cash equivalents at beginning of year		899		997		725
Cash and cash equivalents at end of year	\$	1,432	\$	899	\$	997

#### Notes to the Financial Statements

#### Note 1 — Description of business

#### **Nature of Operations**

The United States Postal Service (we) provides a variety of classes of mail service to the public, 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. This fulfills our legal mandate to offer universal service at a fair price. We conduct our operations primarily in the domestic market, with international operations representing approximately 3% of our total revenue.

Our services are divided into two broad categories: mailing and shipping, which account for 89% and 11% of our revenue, respectively. Two lines, First-Class Mail and Standard Mail, account for about 94% of our mail volume, while Priority Mail and Express Mail represent significant services we provide in our shipping category. The principal markets for our services are the communications, distribution, delivery, advertising, and retail markets. Our services are sold and distributed through almost 37,000 Post Offices, stations, branches, contract postal units, and a large network of consignees.

Our labor force is primarily represented by the American Postal Workers Union (APWU), National Association of Letter Carriers (NALC), National Postal Mail Handlers Union (NPMHU), and National Rural Letter Carriers Association (NRLCA). More than 85% of our career employees are covered by collective bargaining agreements.

By law, we also consult with management organizations representing most of the employees not covered by collective bargaining agreements. These consultations provide an opportunity for nonbargaining unit employees in the field to participate directly in the planning, development, and implementation of programs and policies affecting managerial employees in the field.

#### Postal Reorganization

We commenced operations on July 1, 1971, in accordance with the provisions of the Postal Reorganization Act. We are an "independent establishment of the executive branch of the Government of the United States." Governing decisions are made by a Board of Governors, which consists of nine members who are appointed by the President with the advice and consent of the Senate, plus the Postmaster General and Deputy Postmaster General.

The equity that the U.S. government held in the former Post Office Department became our initial capital. We 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 1972 and 1982 totaled approximately \$1.3 billion, resulting in total government contributions of \$3.034 billion. The U.S. government remains responsible for all of the liabilities attributable to operations of the former Post Office Department. However, under the Balanced Budget Act of 1997, the liability for Post Office Department workers' compensation costs was transferred to us.

The Postal Accountability and Enhancement Act (P.L.109-435), enacted December 20, 2006, made significant reforms in the governance of the Postal Service and significantly altered some of our financial responsibilities, particularly with respect to the funding of Civil Service Retirement System (CSRS) benefits and retiree health benefits. See Note 4, Postal Accountability and Enhancement Act, Public Law 109-435 (P.L. 109-435), in the Notes to the Financial Statements for additional information.

We enter into significant transactions with other U.S. government agencies, as disclosed throughout these financial statements.

# Note 2 — Summary of significant accounting policies

#### Basis of Accounting and Use of Estimates

We conform to accounting principles generally accepted in the United States (GAAP) and maintain our accounting records and prepare financial statements on the accrual basis of accounting. Following these principles, we make estimates and assumptions that affect the amounts reported in the Financial Statements and Notes. Actual results may differ from estimates.

#### Segment Information

We operate in one segment throughout the United States, its possessions and territories, and internationally.

#### Reclassifications

Certain comparative prior year amounts related to deferred gains that we have determined are immaterial to 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.

#### Cash and Cash Equivalents

We consider securities that mature within 90 days or less from the date that we buy them to be cash equivalents.

#### Allowance for Doubtful Accounts

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

Allowance for Doubtful Accounts	2008 2007		2006	
(Dollars in millions)				
Beginning Balance	\$	44	\$ 48	\$ 50
Provision for Doubtful Accounts		7	12	3
Writeoffs		10	16	5
Ending Balance	\$	41	\$ 44	\$ 48

#### **Supplies and Repair Parts**

Supplies and repair parts consist of repair parts for mail processing equipment. We value these at average cost. Total supplies and repair parts amounted to \$112 million at the end of 2008 and \$119 million at the end of 2007. A majority of our motor vehicle spare parts are supplied through consignment agreements.

#### **Property and Equipment**

We record property and equipment at cost, including interest paid on the money we borrow to pay for the construction of major capital additions. See Note 6, *Property and equipment*, in the Notes to the Financial Statements for additional information.

We depreciate buildings and equipment over their estimated useful lives, which range from 3 to 40 years, except buildings with historic status, which are depreciated over 75 years, using the straight-line method.

#### **Impaired Assets**

We record losses on long-lived assets when events and circumstances indicate that the assets might be impaired. In accordance with Financial Accounting Standards Board Statement 144, Accounting for the Impairment or Disposal of Long-Lived Assets, we write down impaired assets to the lower of cost or fair value. See Note 6, Property and equipment, in the Notes to the Financial Statements for additional information.

#### **Asset Retirement Obligations**

We account for asset retirement obligations in accordance with Financial Accounting Standards Board Interpretation 47, *Accounting for Conditional Asset Removal* (FIN 47). Accruals are recorded under "Noncurrent Liabilities, Contingent liabilities, and other" on our balance sheets.

#### Notes to the Financial Statements

#### **Amortization of Leasehold Improvements**

We amortize leasehold improvements over the period of the lease or the useful life of the improvement, whichever is shorter.

Leasehold improvements that are placed in service after the start of the lease term are amortized over the shorter of the useful life of the asset or the lease term, including expected renewal options.

#### **Foreign Currency Translation**

We have foreign currency risk related to settlements with foreign postal administrations for international mail. The majority of our international accounts are denominated in special drawing rights (SDRs). The SDR exchange rate fluctuates daily based on a basket of currencies comprised of the euro, Japanese yen, 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 impacts on our financial statements from foreign currency fluctuations were insignificant for 2008, 2007, and 2006.

#### **Outstanding Postal Money Orders**

We sell money orders to the general public at our retail locations. We charge a fee to the customer at the time of sale. The fee is recognized as revenue at the time of sale. We recognize a liability for money orders we expect to be presented for payment.

# Revenue Recognition/Deferred Revenue — Prepaid Postage

We recognize revenue when services are rendered. Because we collect payment in advance of services being performed, we defer the revenue until the services are performed. This is classified as a liability, Deferred revenueprepaid postage, on our balance sheets. In Quarter III of the current year, we changed the methodology used to estimate the deferred revenue for prepaid postage for stamps. This update was made necessary because the introduction of the Forever Stamp in April 2007, combined with the May 2008 price increase, resulted in a change in consumer behavior regarding the purchase and usage of stamps that was not measurable using our prior estimation techniques. We developed a new approach that more accurately captures trends in stamp usage. The change to a new estimation technique is considered a change in the accounting estimate under GAAP.

As required by FAS 154, the impact of the change was recorded in Quarter III, 2008. For the year ended September 30, 2008, we increased the stamp portion of the deferred revenue—prepaid postage liability by \$477 million, \$230 million of which is considered a cumulative change in estimate and \$247 million of which is attributable to changes in consumer behavior during the last two quarters of the year.

#### **Advertising Expenses**

Advertising costs are expensed as incurred and are classified in other operating expenses. Advertising expenses were \$106 million in 2008, \$121 million in 2007, and \$138 million in 2006.

#### Compensation and Benefits Payable

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

#### Workers' Compensation

We pay for workers' compensation costs under a program administered by the Department of Labor (DOL). These costs include employees' medical expenses, compensation for wages lost, and DOL administrative fees. We record these costs as an operating expense. See Note 11, Workers' compensation, in the Notes to the Financial Statements for additional information.

#### **Retiree Benefits**

Our employees are eligible to participate in the federal government retirement programs, including pension and retiree health benefits. We are required to provide funding for those plans as determined by the administrator of the plan, the Office of Personnel Management (OPM). We cannot direct the costs, benefits, or funding requirements of these federally sponsored plans. In accordance with our parent-subsidiary type relationship with the federal government, we account for our participation in these plans using multiemployer plan accounting rules in accordance with Financial Accounting Standards Board Statement (FAS) 87, Employers Accounting for Pension Costs, and FAS 106, Employers Accounting for Postretirement Benefits Other Than Pensions. We account for the cost of our employees' participation in these programs as an expense in the period our contribution is due and payable. As more fully described in Note 4, Postal Accountability and Enhancement Act, Public Law 109-435 (P.L. 109-435), the law significantly impacted our 2007 costs associated with these programs. See also Note 9, Health benefit programs, and Note 10, Retirement programs, in the Notes to the Financial Statements for additional information.

#### Revenue Forgone Appropriation

Revenue Forgone is an appropriation from Congress, that covers our cost of providing free and reduced rate mailing services to groups designated by Congress. The amount of expense estimated by the Postal Service is submitted to Congress annually. Congress subsequently approves or alters the amount and funds the necessary appropriation. See Note 12, *Revenue forgone*, in the Notes to the Financial Statements for additional information.

#### **Emergency Preparedness Appropriation**

Emergency preparedness appropriations are funds we received from the federal government to help pay the costs of keeping the mail, postal employees, and postal customers safe, and are restricted for such use. These funds were accounted for as deferred revenue upon receipt and were largely utilized to procure capital equipment. We recognize revenue for emergency preparedness appropriations at the same time we recognize depreciation expense for capital equipment purchased with these appropriations. The emergency preparedness appropriations revenue recognized during the years ended September 30 was \$61 million in 2008, \$76 million in 2007, and \$85 million in 2006.

Appropriations that have not been recognized as revenue during the years ended September 30 were \$550 million in 2008 and \$611 million in 2007. The current portion is included in prepaid box rent and other deferred revenue, and the long-term portion is in deferred appropriations and other revenue on our balance sheets.

## Note 3 — Recent pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued FAS 157, which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The provisions of FAS 157 are effective as of the beginning of our 2009 fiscal year. FAS 157 does not change any of our measurement or disclosure reporting.

# Note 4 — Postal Accountability and Enhancement Act, Public Law 109-435 (P.L. 109-435)

P.L.109-435, enacted December 20, 2006, made significant reforms in the governance of the Postal Service and significantly altered some of our financial responsibilities, particularly in respect to the funding of CSRS benefits and retiree health benefits. The legislation does not change our parent-subsidiary type relationship as an "independent es-

tablishment of the executive branch of the Government of the United States." Our employees and retirees continue to participate in all federally sponsored retirement and health benefit plans. Therefore, we continue to account for our participation in U.S. government–sponsored health benefit and retirement plans using multiemployer plan accounting rules in accordance with FAS 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, and FAS 87, *Employers' Accounting for Pensions*.

A number of major provisions of P.L.109-435 directly impact our financial statements and are briefly summarized here. For a complete understanding of the law, one must consult the full text, which can be found at *www.thomas.gov*.

P.L.109-435 returned to the U.S. Treasury the obligation to fund the portion of the CSRS retirement benefit earned while serving in the military by participants who retire as postal employees. With the return of this funding requirement to the U.S. Treasury, it was estimated by OPM that we had fully funded our CSRS pension obligation as of September 30, 2006. See Note 10, *Retirement programs*, in the Notes to the Financial Statements for more information on our retirement obligations.

Under P.L. 109-435, the Postal Service Retiree Health Benefits Fund (PSRHBF), which is held by the U.S. Treasury and controlled by OPM, was created. The PSRHBF will be used, commencing in 2017, to pay our share of the health insurance premiums for current and future Postal Service retirees. The initial funding of the PSRHBF consisted of \$17.1 billion, which was identified by OPM to be the surplus of the Postal Service's portion of the CSRS as of September 30, 2006. Beginning in 2007, P.L.109-435 required us to make annual payments into the PSRHBF. The payment schedule in the law requires us to pay, on average, \$5.6 billion per year into the fund for 10 years, which began in 2007. This is in addition to our regularly allocated cost of premiums for current retirees, which will continue to be payable through 2016. After these annual payments are complete, OPM will make an actuarial valuation and determine whether any further payments into the PSRHBF are required. We paid \$5.6 billion into the PSRHBF in 2008 and \$5.4 billion in 2007.

P.L.109-435 repealed the escrow provisions of P.L.108-18, which required us to place into an escrow account by September 2006, any "savings" from the change in the retirement provisions created by P.L.108-18. OPM calculated the savings at \$2,958 million as of September 30, 2006. These escrowed funds were shown as restricted cash on

#### Notes to the Financial Statements

our September 30, 2006, balance sheet. P.L.109-435 required that we pay the 2006 escrowed "savings" to the PSRHBF. In 2007, we expensed the entire amount payable to the PSRHBF. On April 6, 2007, these "savings" were transferred to the PSRHBF.

#### Note 5 — Debt and related interest

#### **Borrowing Limits and Debt**

Under the Postal Reorganization Act, as amended by Public Laws 101-227 and 109-435, we can issue and sell debt obligations. However, at year-end we are limited to net annual increases of \$3 billion in our debt. Our total debt cannot exceed \$15 billion.

Debt consists of the following:

Interest			
Rate %	Terms *	2008	2007
(Dollars in n	nillions)		
NOTES PAY	ABLE TO THE FEDERAL FINANCING BANK (I	FFB):	
	Short-term revolving credit facility; Payable October 1, 2008		
0.297%*	* and 2007	\$ 2,200	\$ 2,900
0.905%	Payable December 11, 2008	2,500	_
0.485%	Payable December 18, 2008	2,000	_
0.155%	Short-term revolving credit facility; Payable December 18, 2008	500	_
3.528%	Overnight revolving credit note; Payable October 1, 2007	_	300
3.101%	Payable November 15, 2007	_	500
3.866%	Payable December 20, 2007	_	500
		\$ 7.200	\$ 4.200

<sup>\*</sup> All debt is repurchasable at any time at a price determined by the Secretary of the Treasury, based on rates prevailing in the Treasury Security market at the time of repricing.

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 notes. At year-end, the current estimated value of our debt is \$7.2 billion.

#### Note Purchase Agreements

Our note purchase agreements with the Federal Financing Bank 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.

#### Interest Payments on Retirement

There were no cash outlays for interest on the retirement "supplemental liability" in 2008 or 2007 because the enactment of P.L. 109-435 suspended this requirement until 2017. In 2006, the cash outlay was \$231 million. See Note 10, *Retirement programs*, in the Notes to the Financial Statements for additional information.

#### Other Interest Payments

Cash outlays for other interest were \$37 million in 2008, \$9 million in 2007, and \$4 million in 2006.

#### Note 6 — Property and equipment

#### Sale of Major Facility

In 2008 and 2006, there were no sales of any major facilities. On March 30, 2007, we sold the James A. Farley building in New York City to the Empire State Development Corporation (ESDC), for \$190 million and additional proceeds of up to \$55 million, contingent upon the achievement of certain development and leasing criteria by the developer of the property. The Postal Service continues to conduct retail and carrier operations at this facility under the terms of an interim lease with annual rentals of \$5.6 million per year. Once the carrier operations are relocated to other facilities, we will continue to conduct retail and some administrative functions in a smaller portion of the building under a 99year lease, with a rental fee of \$1. The Postal Service has an option to require the building owner to change the legal structure of the building ownership into condominium units, with the Postal Service being given the right to purchase the space subject to the 99-year lease.

We accounted for the transaction under the deposit method under the provisions of FAS 66, *Accounting for Sales of Real Estate*. The gain will not be recognized and the asset will not be removed from our accounting records until the lease and other continuing involvement in the building have expired.

In conjunction with this sale, from the funds ESDC paid us, \$10 million was set aside for an environmental clean-up fund. Our environmental liability is limited to \$10 million and is included on our balance sheet under trade payables and other accrued expenses.

#### **Impaired Assets**

The amount of assets that was written down due to impairment in accordance with FAS 144 was immaterial to the balances of fixed assets in 2008 and 2007.

<sup>\*\*</sup> Prior year rate was 3.366%

#### Assets Held For Sale

The balance of those assets held for sale which are classified in accordance with FAS 144 was immaterial to the total fixed asset balance in 2008 and 2007.

#### Interest Capitalization

No interest was capitalized in 2008, 2007, or 2006.

#### Repairs and Maintenance

Repairs and maintenance are charged to expense as incurred. This expense amounted to \$711 million in 2008, \$665 million in 2007, and \$641 million in 2006.

# Note 7 — Leases and other commitments

#### Capital

At September 30, 2008, our future minimum lease payments for all noncancelable leases are as follows.

Lease Obligations	С	perating	Capital	
(Dollars in millions)	ı			
2009	\$	780	\$	102
2010		763		98
2011		710		96
2012		640		98
2013		579		92
After 2013		4,864		523
Total Lease Obligations	\$	8,336	\$	1,009
Less: Interest				376
Total Capital Lease Obligations				633
Less: Short-term portion of capital				
lease obligations				46
Long-term portion of capital lease obligations			\$	587

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

Capital leases included in buildings were \$916 million in 2008 and \$931 million in 2007. Total accumulated amortization is \$419 million in 2008 and \$404 million in 2007. Amortization expense for assets recorded under capital leases is classified as depreciation expense, which is included in other operating expenses in the statements of operations.

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

Rental Expense		2008	2007	2006
(Dollars in millions)				
Non-cancelable real estate leases including related taxes	\$	967	\$ 927	\$ 953
Facilities leased from GSA subject to 120-day cancellation		44	46	49
Equipment and other short-term rentals		294	261	192
Total Rental Expense	\$1	,305	\$ 1,234	\$ 1,194

At September 30, 2008, we estimate our financial commitment for approved capital projects in progress (resources on order) to be \$2,830 million, detailed in the following table.

Capital Resources on Order	2008
(Dollars in millions)	
Mail Processing Equipment	\$ 1,424
Building Improvements	548
Postal Support Equipment	360
Construction and Building Purchase	459
Vehicles	5
Retail Equipment	34
Total Capital Resources on Order	\$ 2,830

#### **Expense Commitments**

In the normal operating of our business, we enter into commitments for expense contracts. The contracts run for periods from one to ten years. Although these contracts contain clauses for termination by the Postal Service, we normally would have early termination costs.

Expense commitments are classified as miscellaneous, inventory, and research and development. Our miscellaneous expense commitments include contracts for supplies, services, communications, repairs, research, printing, and advertising. Our inventory contracts are for vehicle repair parts and mechanized equipment spare parts. These are summarized in the following table.

Total Expense Resources on Order	\$ 5.049
Research and Development Contracts	 39
Inventory Contracts	50
Miscellaneous Contracts	\$ 4,960
(Dollars in millions)	
Expense Resources on Order	2008

#### Notes to the Financial Statements

In addition, P.L. 109-435 mandates annual payments into the PSRHBF. These payments are listed in the following table.

Retiree Health Benefits Commitments P.L. 109-		
(Dollars in millions)		
2009	\$	5,400
2010		5,500
2011		5,500
2012		5,600
2013		5,600
After 2013		17,200
Total Retiree Health Benefits Commitments	\$	44,800

#### Note 8 — Contingent liabilities

Our contingent liabilities consist mainly of claims and suits resulting from labor, equal employment opportunity, and environmental issues, property damage claims, injuries on postal properties, issues arising from postal contracts, personal claims, and traffic accidents.

Each quarter we review significant new claims and litigation for the probability of an adverse outcome. If a claim is deemed "probable" for an unfavorable outcome and the amount of settlement is estimable, we record a liability. Each quarter we also review and adjust any prior contingencies for settlements, or revisions to prior estimates. No individual claim is material to our financial statements when taken as a whole. The following table summarizes contingent liabilities provided for in our financial statements.

Contingent Liabilities	2008	2007
(Dollars in millions)		
Labor	\$ 318	\$ 526
Equal Employment Opportunity	45	57
Environmental	40	40
Tort	32	39
Contractual	1	14
Total Contingent Liabilities	\$ 436	\$ 676

We believe that adequate provision has been made for probable liabilities from claims and suits. The current portion of this liability at September 30, 2008, of \$198 million is included on the balance sheets under the heading "Trade payables and accrued expenses". On September 30, 2007, this amount was \$248 million. The long-term portion on September 30, 2008, of \$238 million is accrued under the

heading, "Noncurrent Liabilities, Contingent liabilities and other" in our balance sheet. On September 30, 2007, the long-term liability was \$428 million.

We also have other claims and suits that we deem reasonably possible of unfavorable outcomes and for which we cannot yet determine the amounts or a reasonable range of potential losses, if any. No provisions for these are included in our financial statements.

#### Note 9 — Health benefit programs

#### **Current Employees**

Substantially all of our career employees are covered by the Federal Employees' Health Benefits Program (FEHBP). OPM administers the program and allocates the cost of the program to the various participating government agency employers. We cannot direct the costs, benefits, or funding requirements of the federally sponsored plan, and therefore account for these costs using multiemployer plan accounting rules.

Our portion of the cost is based upon the weighted average premium cost of the various employee coverage choices and the specific coverage choices made by our employees. Our employees paid approximately 18% of the premium costs in 2008, and 17% in 2007 and 2006. We paid the remainder of employee health care expense, which was \$5,376 million in 2008, \$5,401 million in 2007, and \$5,345 million in 2006.

#### Retirees

Employees 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 retired postal 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 civil service before that date.

As discussed in Note 4, *Postal Accountability and Enhancement Act*, Public Law 109-435 (P.L. 109-435), resulted in our retiree health benefit expenses increasing dramatically beginning in 2007. Total expenses were \$7,407 million in 2008 and \$10,084 million in 2007, compared to only \$1,637 million in 2006. These costs are reflected as Retiree health benefits in our Statements of Operations.

#### Note 10 — Retirement programs

#### **Pension Programs**

Our employees participate in one of the following pension programs based upon the starting date of their employment with the federal government. Employee and employer contributions are made to the Civil Service Retirement System (CSRS), the Dual Civil Service Retirement System/ Social Security (Dual CSRS), or the Federal Employees Retirement System (FERS), all of which are administered by the Office of Personnel Management. Employees may also participate in the Thrift Savings Plan (TSP), which is a defined contribution retirement savings and investment plan. Postal Service employees are authorized to participate in the TSP by the Federal Employees Retirement System Act of 1986. The TSP is administered by the Federal Retirement Thrift Investment Board.

#### **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 at rates prescribed by law. Effective October 14, 2006, P.L.109-435 suspends the obligation of making employer contributions for CSRS employees' retirement. We do not match TSP contributions for employees who participate in CSRS.

#### **DUAL CSRS**

Employees with prior U.S. government service who were hired between January 1, 1984, and January 1, 1987, are covered by Dual CSRS, which consists of a basic annuity and Social Security. We and the employee contribute to Social Security and the basic annuity at rates prescribed by law. We do not match TSP contributions for employees who participate in Dual CSRS.

#### **FERS**

Effective January 1, 1987, officers and career employees hired since December 31, 1983, are covered by the Federal Employees Retirement System Act of 1986, except for those covered by Dual CSRS. Also included are employees formerly covered by CSRS who elected in 1987, 1988, and 1998 to participate in FERS.

FERS consists of Social Security, a basic annuity plan, and TSP. 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 TSP a minimum of 1% per year of the basic pay of employees covered by this system. We also match a voluntary employee contribu-

tion up to 3% of the employee's basic pay, and 50% of a contribution between 3% and 5% of basic pay.

#### **Employee / Employer Contributions**

Employer and employee contributions, as a percentage of employee basic pay, are as follows for each of the three plans for 2008, 2007, and 2006.

Retirement Contribution	2008	2007	2006
(Percentage)			
CSRS Employer	_	_	17.4
CSRS Employee	7.0	7.0	7.0
Dual CSRS Employer	_	_	18.0
Dual CSRS Employee	0.8	0.8	0.8
FERS Employer	11.2	11.2	11.2
FERS Employee	0.8	0.8	0.8

The number of employees enrolled in each of the retirement plans at the end of 2008, 2007, and 2006 is as follows.

Retirement Enrollment by Program	2008	2007	2006
(Actual numbers)		'	
CSRS	130,126	144,034	157,945
Dual CSRS	7,128	7,716	8,150
FERS	525,984	533,012	530,043

#### **Expense Components**

The following table lists the components of our total retirement expenses that are included in Compensation and benefits expense in the Statements of Operations for 2008, 2007, and 2006.

Retirement Expense	2008	2007	2006
(Dollars in millions)			
FERS	\$ 2,909	\$ 2,771	\$ 2,652
Social Security	1,932	1,904	1,843
FERS Thrift Savings Plan	1,058	1,007	960
CSRS	_	52	1,450
Dual CSRS	_	3	75
CSRS "Supplemental Liability"	_	_	26
Total Retirement Expense	\$ 5,899	\$ 5,737	\$ 7,006

Employer cash contributions to retirement plans were \$3,936 million in 2008, \$3,889 million in 2007, and \$5,122 million in 2006. These amounts do not include Social Security contributions and interest expense on deferred retirement liabilities.

#### Notes to the Financial Statements

Beginning in 2004, we had been required by P.L.108-18 to pay an additional annual amount into the CSRS retirement plan, if necessary, each September, as determined by OPM. The "supplemental liability" represented the excess of the actuarial present value of the future benefits liability over the actuarial present value of plan assets, future contributions, earnings, and other actuarial factors related to Postal Service participants in the CSRS plan. In 2006, we paid \$257 million including interest towards this liability, of which \$231 million was interest and the remaining \$26 million a reduction in the principal amount of the liability.

P.L.109-435 relieved the Postal Service of the obligation to pay for the portion of the CSRS pension costs attributable to the military service of its retirees that was previously imposed by P.L.108-18. The cost of these benefits was estimated by OPM to be \$27 billion in 2003. The elimination of the military service funding requirement dramatically impacted the funded status of the portion of the CSRS allocated to the Postal Service. OPM determined that, as a result of the changes imposed by P.L. 109-435, the Postal Service portion of the CSRS had a surplus of \$17.1 billion as of September 30, 2006. Accordingly, the "supplemental liability" payment previously required by P.L. 108-18 was suspended and no amount was incurred or paid in 2008 or 2007.

The "supplemental liability" payments were suspended until 2017 by P.L. 109-435. At that time, OPM will perform an actuarial valuation and determine whether additional "supplemental liability" payments are necessary.

## Note 11 — Workers' compensation

We pay for workers' compensation costs under a program administered by DOL. These costs, recorded as an operating expense, include employees' medical expenses, compensation for wage loss, and DOL administrative fees. The program also provides for payment of benefits to dependents of employees who die from work-related injuries or diseases.

Our liability at September 30, 2008, represents the estimated present value of the total amount we expect to pay in the future for postal workers injured through the end of 2008. The estimated total cost of a claim is based upon the date of injury, pattern of historical payments, frequency and severity of the injuries, and the expected trend in future costs.

We estimated our total liability for future workers' compensation costs to be \$7,968 million at the end of 2008 and \$7,771 million at the end of 2007. 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 \$732 million. A decrease of 1% would increase our estimate of the liability by approximately \$871 million.

We implemented a revised actuarial model to calculate our workers' compensation liability on September 30, 2008. The model's methodology is similar to that used in the independent consulting firm actuarial valuation, which formed the basis for the recorded liability in 2007. The revised model explicitly projects the estimated cost to resolve the most recent 10 injury years. We continue to rely on an independent actuarial consulting firm to perform an actuarial valuation on injuries occurring more than 10 years in the past.

Our model estimates the liability for the most recent 10 years using the paid loss development method, two frequency/ severity methods, and an expected unpaid method. The paid loss development method estimates the liability based on the historical pattern of payments observed over many years. The frequency/severity methods estimate the liability by considering not only the cost, but the number of claims payments over many years. The frequency/severity methods require that we make explicit assumptions about the future changes in the average payment amounts due to inflation or other cost increases. The expected unpaid method estimates the liability by giving weight to both the expected development from the paid loss development method and the estimated ultimate value from the frequency/severity method. For injuries occurring more than 10 years in the past, an estimate of the ultimate liability is prepared by an independent actuary and incorporated into the new model. All of the methods used in calculating the 2008 and 2007 workers' compensation liability are generally accepted actuarial techniques and are each valid for estimating a liability such as ours.

We also annually review the inflation and discount rates used to determine the present value of estimated future workers' compensation payments. Separate analyses of the appropriate inflation rates for the medical and compensation portions of the liability were performed, utilizing forecasts of medical inflation and inflation in the general economy, and forecasted rates of return on baskets of Treasury securities of varying durations. During 2007, we validated our assumptions and methodology with an independent actuarial firm. Our assumptions used to calculate the liability in 2008 and 2007 are projected returns on investments for compensation claims of 5.6% and wage inflation of 3.0%.

For medical claims, we used 5.4% for returns on investments and 5.0% for medical future inflation for both 2008 and 2007.

The workers compensation liability estimation technique used in 2006 and prior years utilized a net discount rate, which was the estimated difference between the expected return on investments in a basket of Treasury securities offset by the estimated inflation rate for medical costs and wages. The net discount rate in 2006 was 3.3% for compensation claims and -0.8% for medical claims. The estimation technique used by the independent actuarial consulting firm in 2007 and by our new model in 2008 uses separate calculations for returns on investment and inflation factors rather than a net discount rate. The combined reduction to our 2007 liability as a result of the changes in actuarial valuation technique, and the underlying assumptions of inflation and discount rates was \$685 million. This is shown in the following table.

#### 2007 Workers'

Compensation Assumption Changes	Old Assumptions	Α	Current Assumptions	Net Reduction
(Dollars in millions)				
Compensation Claims	\$ 5,565	\$	5,272	\$ 293
Medical Claims	2,820		2,428	392
Total Liability	\$ 8,385	\$	7,700	\$ 685

In 2008, the independent actuary changed their model calculating our liability related to injuries occurring more than 10 years in the past by increasing the length of the period of our past claim payment experience used as a basis to project future claim payments. This change decreased our liability for 2008 by approximately \$154 million.

In 2008, we recorded \$1,227 million in workers' compensation expense, compared to the \$880 million in 2007 and \$1,279 million recorded in 2006. The effect of the 2008 and 2007 changes discussed above are accounted for as changes in the accounting estimate, as defined by GAAP.

In addition to the cost of workers' compensation claims, DOL charges us an administrative fee for processing claims. In 2008, the administrative fee, which is included in the expense above, was \$52 million, compared to \$49 million in 2007 and \$45 million in 2006.

#### Note 12 — Revenue forgone

Our operating revenue includes accruals for revenue forgone. Revenue is forgone when Congress mandates that we provide mail services for designated mailers at free or reduced rates. Congress then appropriates money to reimburse us for the revenue that we have forgone in providing these services.

We estimate the amount of services that will be provided during a given year and forward a funding request to Congress. At the end of the year we reconcile this request with the actual usage. Depending upon whether actual usage is higher or lower than our estimate, we will request additional funding or return the excess funding via a reduction to our next revenue forgone funding request.

In 2008, we included \$103 million of revenue forgone as operating revenue, \$63 million in 2007, and \$99 million in 2006. We record requested amounts as government receivables until the appropriations are received.

The Revenue Forgone Reform Act of 1993 authorized Congress to make 42 annual payments of \$29 million each, beginning in 1994 and continuing through 2035. These payments are reimbursement for two purposes: services we performed in 1991, 1992, and 1993 for which we have not yet been fully paid; and for shortfalls in the reimbursement for the costs we incurred for processing and delivering certain Nonprofit mail entitled to statutorily reduced costs from 1994 through 1998.

The future payments authorized by the Revenue Forgone Reform Act of 1993 totaled \$1,218 million for which we calculated the present value, at 7% interest, to be approximately \$390 million. We recognized the \$390 million as revenue during fiscal years 1991 through 1998. The discounted present value of the remaining future payments as of the years ended September 30 was \$349 million in 2008 and \$353 million in 2007.

The total receivable for revenue forgone as of the years ended September 30 was \$495 million in 2008 and \$476 million in 2007.

# Operating **Statistics**

Category of Service		2008		2007		2006		2005		2004
(In millions of units indicated, unaudited)										
MAILING SERVICES										
First-Class Mail										
Revenue	\$	38,179.3	\$	38,404.5	\$	37,604.9	\$	36,802.7	\$	37,109.8
Pieces, Number		91,696.7		96,297.3		98,016.2		98,567.1		98,433.1
Weight, Pounds		4,165.1		4,401.4		4,418.1		4,448.3		4,467.1
Standard Mail										
Revenue	\$	20,586.3	\$	20,778.6	\$	19,876.5	\$	18,953.5	\$	18,122.5
Pieces, Number		99,084.2	·	103,516.1	·	102,459.6		100,943.9	·	95,565.1
Weight, Pounds		11,017.2		11,820.7		11,771.2		11,656.5		11,148.4
Periodicals										
Revenue	\$	2,294.9	\$	2,187.9	\$	2,215.2	\$	2,160.8	\$	2,191.8
Pieces, Number		8,605.2		8,795.8		9,022.5		9,070.0		9,135.3
Weight, Pounds		3,676.9		3,895.6		4,040.7		4,025.6		4,067.5
Package Services										
Revenue	\$	1,845.5	\$	1,812.3	\$	1,751.1	\$	1,646.5	\$	1,623.3
Pieces, Number		846.2		914.5		918.8		885.0		860.8
Weight, Pounds		2,155.3		2,297.5		2,323.2		2,294.4		2,233.0
U.S. Postal Service										
Pieces, Number		823.7		1,008.4		1,010.1		621.3		529.3
Weight, Pounds		148.9		140.6		128.1		110.7		105.4
Free Matter for the Blind										
Pieces, Number		72.0		72.0		74.2		76.4		71.1
Weight, Pounds		33.3		33.6		35.4		34.4		34.6
Mailgrams										
Revenue	\$	_	\$	_	\$	_	\$	0.8	\$	0.7
Pieces, Number								1.9		1.6
Total Mailing Services Mail	_		_		4		_		_	
Revenue	\$	62,906.0	\$	63,183.3	\$	61,447.7	\$	59,563.5	\$	59,047.4
Pieces, Number		201,128.0		210,604.1		211,501.4		210,163.7		204,594.7
Weight, Pounds		21,196.7		22,589.4		22,716.7		22,569.9		22,056.0
ANCILLARY & SPECIAL SERVICES										
Registered Mail	_		_		_		_		_	
Revenue	\$	56.9	\$	53.3	\$	72.8	\$	77.2	\$	75.0
Number of articles		3.9		4.3		7.1		7.7		7.4
Certified Mail	ф	717.0	Φ	000.0	ф	001.0	ф	000.0	ф	000 5
Revenue	\$	717.8	\$	698.2	\$	631.6	\$	600.6	\$	629.5
Number of articles		268.9		280.2		265.7		261.1		273.7
Insurance	ф	4440	Φ	150.7	ф	100 7	ф	100.0	ф	407.0
Revenue	\$	144.6	\$	156.7	\$	136.7	\$	132.2	\$	127.8
Number of articles		51.6		57.0		52.8		53.6		53.2
Delivery Receipt Services	Φ	704.0	Φ	000.7	ф	010.0	ф	C77 C	ф	E 40, 4
Revenue Number of articles	\$	704.6	\$	639.7	\$	619.9 1,020.3	\$	577.5	\$	548.4
		1,192.2		1,098.3		1,020.3		954.7		841.9
Money Orders	Φ	204.0	Φ	010 5	Φ	101.0	Φ	20E 0	Φ	200 0
Revenue	\$ \$	204.8	\$	210.5	\$ \$	191.2	\$	205.9	\$	228.0
Face value of issues (non-add)  Number of articles	Φ	25,709.3 149.1	\$	27,194.0 162.9	Φ	28,277.4 176.2	\$	28,723.0 180.4	\$	28,782.2 187.2
Box rent revenue	\$	149.1 896.7	\$	836.9	\$	813.7	\$	791.5	\$	779.9
Stamped envelope and card revenue	Ф \$	24.4	\$	16.9	\$	25.2	\$	21.0	\$	21.9
Other Mailing Services Revenue	Ф \$	894.5	\$	1,108.2	\$	1,224.0	\$	823.6	\$	689.3
Total Ancillary & Special Services										
	\$	3,644.3	\$	3,720.4	\$	3,715.1	\$	3,229.5	\$	3,099.8
Revenue										

Category of Service	2008	2007	2006	2005	2004
(In millions of units indicated, unaudited)					
SHIPPING SERVICES					
Revenue	\$ 8,355.0	\$ 7,851.6	\$ 7,461.1	\$ 7,085.2	\$ 6,821.3
Pieces, Number	1,574.9	1,629.9	1,636.3	1,579.0	1,510.9
Weight, Pounds	3,040.6	3,053.8	3,215.1	3,271.6	3,224.9
Shipping Services					
Ancillary & Special Services Revenue	\$ 26.7	\$ 22.8	\$ 26.5	\$ 29.2	\$ 27.5
Total Shipping Services Revenue	\$ 8,381.7	\$ 7,874.4	\$ 7,487.6	\$ 7,114.4	\$ 6,848.8
Postal Service Totals					
Revenue	\$ 71,261.0	\$ 71,034.9	\$ 68,908.8	\$ 66,648.7	\$ 65,868.7
Pieces, Number	202,702.9	212,234.0	213,137.7	211,742.7	206,105.6
Weight, Pounds	24,237.3	25,643.2	25,931.8	25,841.5	25,280.9
Total Ancillary &					
Special Services Revenue	\$ 3,671.0	\$ 3,743.2	\$ 3,741.6	\$ 3,258.7	\$ 3,127.3
Total Operating Revenue	\$ 74,932.0	\$ 74,778.1	\$ 72,650.4	\$ 69,907.4	\$ 68,996.0

Note: The charts have been reformatted to reflect the new Mailing Services and Shipping Services categories. The following summarizes the major reclassification changes.

\* The First-Class Mail category includes First-Class Mail International.

<sup>\*</sup> Package Services includes single-piece Parcel Post, International Inbound Surface Parcel Post, Bound Printed Matter, Media Mail and Library Mail, but now excludes Parcel Select and Parcel Return Service.

<sup>\*</sup> Shipping Services includes Priority Mail, Express Mail, Destination entry Parcel Post, Parcel Select Return Service and International Mail, excluding single-piece First-Class Mail International.

# Operating **Statistics**

	2008	2007	2006	2005	2004
(Actual numbers, unaudited)					
Career Employees					
Headquarters and HQ Related Employees					
Headquarters	2,892	2,856	2,761	2,654	2,708
Headquarters — Field Support Units *	4,429	4,527	4,402	4,333	3,396
Inspection Service — Field	2,890	2,991	3,130	3,443	3,648
Inspector General	1,159	1,147	1,071	843	782
Total HQ and HQ Related Employees	11,370	11,521	11,364	11,273	10,534
Field Employees					
Area Offices *	1,316	1,281	1,395	1,420	2,196
Postmasters / Installation Heads	25,250	25,285	25,429	25,322	25,519
Supervisors / Managers	31,787	32,635	33,201	33,234	33,635
Professional Administration and Technical Personnel	8,010	8,058	8,539	8,945	9,168
Clerks	194,773	204,145	213,920	221,644	226,183
Nurses	134	160	166	167	167
Mail Handlers	55,812	57,882	57,158	56,028	54,769
City Delivery Carriers	211,661	222,132	224,400	228,278	228,140
Motor Vehicle Operators	8,558	8,726	8,715	8,689	8,628
Rural Delivery Carriers — Full Time	68,900	67,584	66,344	64,335	62,762
Building and Equipment					
Building and Equipment Maintenance Personnel	40,248	39,948	39,986	39,893	40,263
Vehicle Maintenance Employees	5,419	5,405	5,521	5,488	5,521
Total Field Employees	651,868	673,241	684,774	693,443	696,951
Total Career Employees	663,238	684,762	696,138	704,716	707,485
Noncerear Employees					
Noncareer Employees Casuals	12,000	22,078	22,518	19,182	20,529
Nonbargaining Temporary		1,244	1,135	1,185	
Rural Part Time: Subs / RCA / RCR / AUX	1,119 58,072	60,444	59,087	57,411	1,138 56,403
Postmaster Relief and Leave Replacements	12,327	12,169	12,188	12,046	12,157
Transitional Employees	18,332	5,232	5,133	8,460	9,884
Total Noncareer Employees	101,850	101,167	100,061	98,284	100,111
Total Employees	765,088	785,929	796,199	803,000	807,596
iotal Employees	7 00,000	100,020	700,100	000,000	007,000

<sup>\*</sup> Beginning 2005, employees in the sales organization were reported as headquarters related instead of in the area offices.

	2008	2007	2006	2005	2004
(In actual units indicated, unaudited)					
Post Offices, Stations and Branches					
Post Offices	27,232	27,276	27,318	27,385	27,505
Classified Stations, Branches, and Carrier Annexes	5,509	5,419	5,557	5,622	5,623
Contract Postal Units	3,148	3,131	3,014	3,116	2,889
Community Post Offices	834	895	937	1,019	1,142
Total Offices, Stations, and Branches	36,723	36,721	36,826	37,142	37,159
Residential Delivery Points*					
City Delivery	79,848,415	79,470,894	78,949,153	78,524,242	77,967,046
Rural	37,684,158	37,022,488	36,068,838	34,958,986	33,817,615
PO Box	15,639,031	15,635,480	15,615,744	15,614,801	15,634,610
Highway Contract	2,516,783	2,473,323	2,345,255	2,243,520	2,162,772
Total Residential Delivery	135,688,387	134,602,185	132,978,990	131,341,549	129,582,043
Business Delivery Points*					
City Delivery	7,436,965	7,411,582	7,343,020	7,280,384	7,185,300
Rural	1,407,942	1,360,478	1,297,022	1,230,645	1,172,499
PO Box	4,587,454	4,548,973	4,490,102	4,412,559	4,321,862
Highway Contract	71,538	69,304	65,062	61,228	58,084
Total Business Delivery	13,503,899	13,390,337	13,195,206	12,984,816	12,737,745
Total Delivery Points	149,192,286	147,992,522	146,174,196	144,326,365	142,319,788
Change in Delivery Points	1,199,764	1,818,326	1,847,831	2,006,577	958,512

<sup>\*</sup> The table above shows delivery growth of 958,512 in FY 2004. The absolute growth is 1,782,900 deliveries if FY 2003 were adjusted to reflect the current reporting procedure as implemented in FY 2004.

# Financial History **Summary**

		2008		2007		2006		2005		2004
(Dollars in millions)										
Statements of Operations										
Total revenue	\$	74,968	\$	74,973	\$	72,817	\$	69,993	\$	69,029
Total expense **	Ψ	77,774	Ψ	80,115	Ψ	71,917	Ψ	68,548	Ψ	65,964
Net (Loss) Income	\$	(2,806)	\$	(5,142)	\$	900	\$	1,445	\$	3,065
Operating revenue	\$	74,829	\$	74,715	\$	72,551	\$	69,798	\$	68,960
Revenue foregone		103		63		99		109		36
Total operating revenue		74,932		74,778		72,650		69,907		68,996
Compensation and benefits**		53,585		54,186		54,665		52,449		50,821
Retiree health benefits **		7,407		10,084		1,637		1,495		1,313
Other expenses		16,746		15,835		15,379		14,337		13,717
Total operating expenses **		77,738		80,105		71,681		68,281		65,851
Income from operations		(2,806)		(5,327)		969		1,626		3,145
Interest and investment income		36		195		167		86		33
Interest expense deferred retirement		_		_		(231)		(263)		(103)
Other interest expense		(36)		(10)		(5)		(4)		(10)
Net (Loss) Income	\$	(2,806)	\$	(5,142)	\$	900	\$	1,445	\$	3,065
Balance Sheets										
Current assets	\$	2,354	\$	1,859	\$	2,041	\$	1,933	\$	1,851
Property, equipment, and other assets		23,632		23,988		26,447		23,065		22,858
Total Assets	\$	25,986	\$	25,847	\$	28,488	\$	24,998	\$	24,709
Current liabilities *	\$	16,729	\$	13,804	\$	11,613	\$	9,160	\$	10,800
Other liabilities *		10,929		10,909		10,599		10,462		9,978
(Deficit) equity		(1,672)		1,134		6,276		5,376		3,931
Total Liabilities and Net Capital	\$	25,986	\$	25,847	\$	28,488	\$	24,998	\$	24,709
Changes in Nat Capital										
Changes in Net Capital	ф	2.024	Φ	0.004	Φ	0.004	Φ	0.004	Φ	0.004
Capital contributions of the U.S. government	\$	3,034	\$	3,034	\$	3,034	\$	3,034	\$	3,034
(Deficit) equity since 1971 reorganization		(1,900)		3,242		2,342		897		(2,168)
Total beginning balance		1,134		6,276		5,376		3,931		866
Net (loss) income		(2,806)	Φ.	(5,142)	<u></u>	900	Φ.	1,445	Φ.	3,065
Ending Balance	\$	(1,672)	\$	1,134	\$	6,276	\$	5,376	\$	3,931

<sup>\*</sup> Certain reclassifications have been made to previously reported amounts.

\*\* The net impact of P.L.109-435 legislation was \$6.8 billion of additional expense in 2007 (\$8.4 billion in additional retiree health benefits less \$1.6 billion in CSRS savings).

# Selected Quarterly Financial Data

2008		Quarter 1		Quarter 2		Quarter 3		Quarter 4
(Dollars in millions, unaudited)								
Operating revenue	\$	20,369	\$	18.916	\$	17,910	\$	17,737
Total operating expenses	•	19,683	Ψ	19,622	Ψ	19,015	Ψ	19,418
Income (loss) from operations		686		(706)		(1,105)		(1,681)
Interest income (expense) — net		(14)		(1)		7		8
Net Income (loss)	\$	672	\$	(707)	\$	(1,098)	\$	(1,673)

2007	Quarter 1	Quarter 2	Quarter 3	Quarter 4
(Dollars in millions, unaudited)				
Operating revenue	\$ 19,637	\$ 18,277	\$ 18,347	\$ 18,517
Total operating expenses	22,656	19,577	18,837	19,035
(Loss) from operations	(3,019)	(1,300)	(490)	(518)
Interest income (expense) — net	48	61	37	39
Net (Loss)	\$ (2,971)	\$ (1,239)	\$ (453)	\$ (479)

Note: 2006 quarterly data was not prepared using the same standards and principles of those used in 2007 and 2008. Therefore, it is not comparative to these years and would be misleading to include here.

#### 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.

**Asset.** An economic resource that is expected to be of benefit in the future.

**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.

Cautionary Statements. Statements contained in Management's Discussion and Analysis that represent our best estimate of the trends we know about, the trends we anticipate, and the trends we think are relevant to our future operations.

**Contingent Liability.** A potential liability that is contingent on a future event.

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.

**Enhanced Carrier Route.** A subclass of Standard Mail for mailpieces weighing less than 16 ounces and prepared in carrier route sequence.

**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 all matter sealed or otherwise closed against inspection. This service is required for personal correspondence, handwritten or typewritten letters, and bills or statements of account.

**Fiscal 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.

**Fixed Asset.** Any tangible property such as buildings, machinery and equipment, furniture, and leasehold improvements.

**Forever Stamp.** A stamp that once purchased is good for mailing one-ounce First-Class letters anytime in the future — regardless of price changes. It was introduced in 2007.

Generally Accepted Accounting Principles (GAAP). The rules and procedures of accepted accounting practice as defined by the Financial Accounting Standards Board.

**Impaired Asset.** When the market value of an economic resource has been permanently lowered below the recorded value of the asset.

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.

Intelligent Mail. Products and services or a strategy used to describe products and services that use machinereadable codes, such as barcodes, to uniquely identify mail. This enables large mailers to follow the progress of their mail through the many stages of processing all the way to delivery.

**Leasehold.** An asset that gives the Postal Service the right to use property under a lease.

**Liability.** Any debt or obligation that is owed by the Postal Service at some future period of time.

Mailing Services. Market-dominated products as defined by the PRC. These are products for which the Postal Service has market power to set prices substantially above costs without risk of losing business to others. The Mailing Services products include: First-Class Mail letters and sealed parcels; First-Class Mail cards; Periodicals; Standard Mail; single-piece Parcel Post; Media Mail; Bound Printed Matter; Library Mail; Special Services; and single-piece International Mail.

**Operating Expense.** Expenses that are incurred in providing our primary business services and products.

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

**Operating Revenue.** Revenues that are earned from our primary business services and products.

**OPM.** Office of Personnel Management. The agency that manages and maintains the government retirement and health benefit plans.

Package Services. Mailing category offered for any merchandise or printed matter weighing up to 70 pounds. These services include Parcel Post, Bound Printed Matter, Library Mail, and Media Mail.

**Payable.** Money that is owed by the Postal Service.

**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 mail and misuse of the postal system.

Postal Regulatory Commission (PRC) (formerly the Postal Rate Commission). An independent federal establishment with oversight responsibility for the Postal Service to review and approve rates, review financial data, and hear and rule on rate and service complaints.

**Prepaid.** Payments made in advance of service being provided.

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 is a 1–3-day non-guaranteed delivery service.

**Receivable.** Money that is owed to the Postal Service.

**Recognize.** To record in Postal Service accounts as income or expense.

Repositionable Notes. Repositionable Notes are specially designed and applied "Post-It" type notes that let mailers affix a message to the outside of the envelope, calling attention to the mailer's product or service to help the mailer get an extra edge. They are First-Class Mail and Standard Mail products.

Shipping Services. Products that are not Mailing Services and are considered competitive products. The competitive product list includes: Priority Mail, Expedited Mail, Bulk Parcel Post, and Bulk International Mail.

**Special Services.** A category of services that add value to mail by providing added security, proof of delivery, or loss recovery. These services include: Certified Mail, Registered Mail, Delivery Confirmation, Signature Confirmation, and insurance up to \$1,000.

Standard Mail. Mailing service offered for any item, including advertisements and merchandise weighing less than 16 ounces that are not required to be sent using First-Class Mail. Standard Mail is typically used for bulk advertising to multiple delivery addresses.

**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.

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

Workshare. Tasks performed by mailers that otherwise would be done by the Postal Service, such as preparing, sorting, barcoding, and transporting mail. Reduced postage rates are offered to these customers.

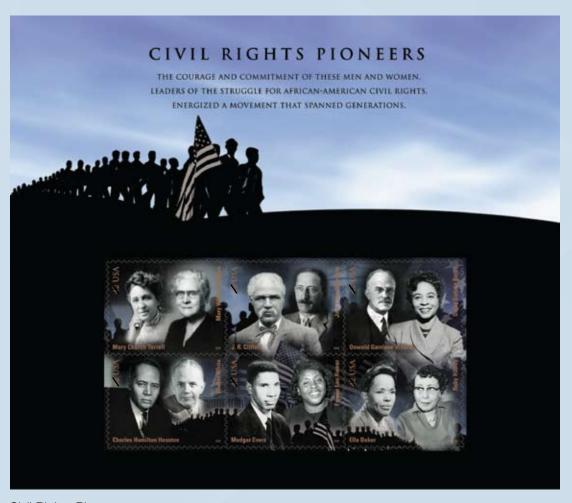
#### 2009 Postage Stamps

Abraham Lincoln
Alaska Statehood
Angel with Lute
Anna Julia Cooper
Bob Hope

Christmas — Sassoferrato
Civil Rights Pioneers
Early TV Memories
Edgar Allan Poe

Edward Hopper
Flags of Our Nation — Set 3
Flags of Our Nation — Set 4
Gary Cooper
Gulf Coast Lighthouses
Hanukkah

Hawaii Statehood Kelp Forest Kwanzaa Love — King & Queen of Hearts
Lunar New Year — Ox
Miami University
Oregon Statehood
Supreme Court Justices
Thanksgiving Day Parade
Weddings — Cake & Rings
Winter Holidays





Gary Cooper



Bob Hope

Civil Rights Pioneers









Abraham Lincoln













**Edward Hopper** 

Gulf Coast Lighthouses



Thanksgiving Day Parade



Edgar Allan Poe



Anna Julia Cooper



Weddings — Cake & Rings



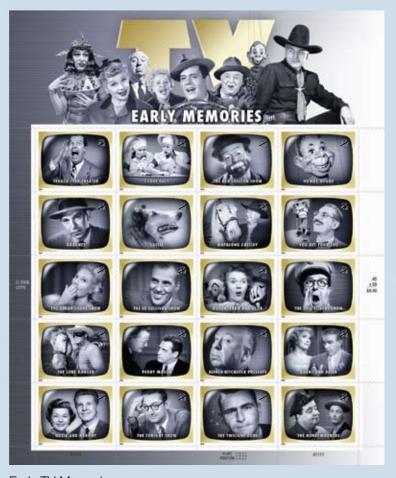
Angel with Lute



Supreme Court Justices



Love - King & Queen of Hearts



Early TV Memories



Lunar New Year — Ox



Alaska Statehood



Christmas — Sassoferrato



Hanukkah



Kwanzaa













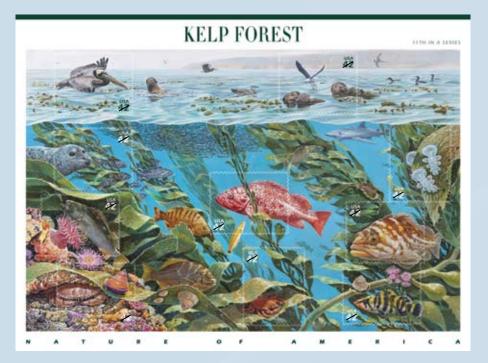








Flags of Our Nation — Set 3



1859 OREGON

Oregon Statehood



Kelp Forest Hawaii Statehood



MIAMI UNIVERSITY OXFORD, OHIO USA 2/

Winter Holidays Miami University





















Flags of Our Nation — Set 4

The following are among the many trademarks owned by the United States Postal Service:

United States Postal Service®, U.S. Postal Service®, USPS®, First-Class Mail®, usps. com®, Click-N-Ship®, Automated Postal Center®, APC®, Express Mail®, Priority Mail®, Standard Mail®, Parcel Post®, Media Mail®, Customized MarketMail®, Intelligent Mail®, Parcel Select®, Express Mail International®, Quick, Easy, Convenient®, United States Postal Service Office of Inspector General™, Post Office™, Postal Service™, Signature Confirmation™, Certified Mail™, Delivery Confirmation™, Registered Mail™, ZIP Code™, Carrier Pickup™, Priority Mail International™, First-Class Mail International™, Premium Forwarding Service™, Forever Stamp™ and Postmaster General™.

The Sonic Eagle Logo, Round Top Collection Box design, Letter Carrier Uniform design, and the Mail Truck design are also trademarks belonging to the United States Postal Service.



United States Postal Service 475 L'Enfant Plaza SW Washington DC 20260-3100 The Annual Report of the United States Postal Service is published by:

United States Postal Service Corporate Communications 475 L'Enfant Plaza, SW Washington, DC 20260-3100

We welcome your financial questions and comments at:

United States Postal Service Corporate Accounting 475 L'Enfant Plaza, SW Washington, DC 20260-5241

Read our Annual Report on the web at: usps.com/financials/ar/welcome.htm

© 2008 United States Postal Service. All rights reserved.

Production notes for the printed version:

Paper stock — Cover: Rolland Enviro 100, 80lb white; Text Rolland Enviro 100, 70lb white.

Paper stock is 100 post-consumer paper, certified EcoLogo, processed chlorine free, FSC recycled and manufactured by Cascade using biogas energy. This report is printed using environmentally safe inks.

