United States General Accounting Office
Washington, DC 20548

November 13, 2002

The Honorable Daniel K. Akaka
Chairman
The Honorable Thad Cochran
Ranking Minority Member
Subcommittee on International Security,
Proliferation, and Federal Services
Committee on Governmental Affairs
United States Senate

Subject: *U.S. Postal Service Actions to Improve Its Financial Reporting*

Given the vital role of the nation's postal system and the importance of its financial viability, it is imperative that the U.S. Postal Service (the Service), the Congress, stakeholders, and the public have adequate information available to them to understand the Service's financial situation and assess its progress towards meeting its performance goals and planning for its future. During the first part of fiscal year 2001, the Service made numerous revisions to its estimated net income with little or no public explanation. The Service's financial outlook changed from a $480 million deficit in its fiscal year 2001 budget approved in November of 2000, to a $2 billion to $3 billion deficit projected 3 months later in February 2001. Likewise, at the beginning of fiscal year 2002, the Service estimated that it would end the year with a $1.35 billion deficit and then stated, in May 2002, that its net loss for the year could have reached $4.5 billion. Despite the fact that the Service publicly released periodic financial information, these significant changes in financial outlook were not evident from publicly available information and came as a surprise to many stakeholders. More recently, the Service announced the results of a new financial analysis that could significantly reduce its Civil Service Retirement System (CSRS) pension liability if Congress takes related legislative action, which would significantly impact the Service's financial outlook.[1] It will be important for the Service to keep stakeholders well informed about this issue.

Over the past 2 years, we have been raising concerns and have made recommendations regarding the lack of sufficient and timely periodic information on the Service's financial condition and outlook available to the public between publications of its audited year-end financial statements. This report responds to your July 31, 2002, request that we provide periodic updates on several key areas related to the Service's financial outlook,

[1]In May 2002, we asked the Office of Personnel Management (OPM) to, among other things, estimate how much of the underfunded CSRS pension liability is attributable to the Service. OPM's projections indicate that the Service's future payments required under current legislation would overfund the CSRS liability by $71 billion over the remaining benefit period. Legislation would be required to modify the existing funding method so as to prevent overfunding of benefits in the future.

including improvements in financial and performance reporting. Specifically, this report discusses the actions taken by the Service to address our past recommendations to provide sufficient, more timely, and accessible financial reports as well as our assessment of the Service's responses. Our specific recommendations and the Service's initial responses were as follows:

- In April 2001, we recommended that the Service provide summary financial reports to Congress and the public on a quarterly basis. These quarterly reports were to present sufficiently detailed information for stakeholders to understand the Service's current and projected financial condition, how its outlook may have changed since the previous quarter, and its progress towards achieving its desired results.[2] In a letter dated June 2001 to congressional oversight and appropriation committees and subcommittees, the Service agreed to provide additional transparency related to its financial condition and said that it would create, and post to its Web site, financial statements "similar to what publicly traded enterprises provide" and continue this practice quarterly.

- In February 2002, we recommended that the Service provide its monthly and quarterly financial reports on its Web site in a user-friendly format and in a timelier manner.[3] In its February 2002 comments on a draft of our report, the Service agreed with our recommendation and said it was providing financial reports on its Web site in a more timely and user-friendly manner.

- In September 2002, we reported that the Service should carefully reassess its overall accounting treatment for pension and postretirement health obligations and reaffirmed a recommendation that we previously made to the Service to enhance disclosure of its postretirement health benefit obligations in its financial statements. In its September 10 letter commenting on the report, the Service stated that it planned to address its pension and postretirement health obligations in the Management Discussion and Analysis (MD&A) section of its annual report.[4]

This report on the Service's financial reporting is based on our previous work, review of the Service's monthly and quarterly financial reports from the third quarter of fiscal year 2001 through the third quarter of fiscal year 2002, the Service's written responses to our recommendations, and discussions with Service officials about their responses to our recommendations.

We compared the Service's quarterly financial report for the third quarter ending in May 2002, with those of a similar period completed by two of its major publicly traded competitors—FedEx and United Parcel Service (UPS). Publicly traded companies are

[2]U.S. General Accounting Office, *U.S. Postal Service: Transformation Challenges Present Significant Risks*, GAO-01-598T (Washington, D.C.: Apr. 4, 2001).
[3] U.S. General Accounting Office, *U.S. Postal Service: Deteriorating Financial Outlook Increases Need for Transformation*, GAO-02-355 (Washington, D.C.: Feb. 28, 2002).
[4]U.S. General Accounting Office, *U.S. Postal Service: Accounting for Postretirement Benefits*, GAO-02-916R (Washington, D.C.: Sept. 12, 2002).

subject to Securities and Exchange Commission (SEC) quarterly financial reporting requirements.[5] These quarterly reports include three major components: (1) financial statements, which consist of an income statement, balance sheet, cash flow statement, and related footnotes; (2) management's discussion and analysis (MD&A) of financial condition and results of operations; and (3) quantitative and qualitative disclosures about market risk.[6] The SEC requires that information in quarterly reports from publicly traded entities provide investors and others with an accurate understanding of the company's current and prospective financial position and operating results. Although the Service is not subject to SEC reporting requirements, the purpose of these requirements is similar to the intent of our recommendations for improved transparency to enable stakeholders to better understand the Service's financial condition and outlook.

We conducted our review between July 2002 and September 2002 in accordance with generally accepted government auditing standards. We requested comments on a draft of this report from the Postal Service, and its comments are discussed near the end of this letter and are reproduced in enclosure IV.

Results In Brief

Transparency is particularly important because the Service is the hub of a $900 billion mailing industry and is a vital part of the nation's communications network. Its recent financial difficulties have accentuated the need for stakeholders—including the Congress, Postal Rate Commission (PRC), and mailers—to be well apprised of the Service's financial situation and understand how future operating results may be affected by impending events. Further, we recently reported that the Service's financial situation is significantly impacted by its pension and postretirement health obligations and that the Service should reassess its accounting treatment and reporting of these obligations. We also reaffirmed our previous recommendation that the Service disclose the full amount of the accrued postretirement health benefits earned by its employees and retirees in notes to its financial statements. The importance of these obligations was recently highlighted when the Service announced the results of a new analysis that could significantly reduce its CSRS pension liabilities if Congress takes related legislative action. This change would improve its overall financial condition and provide opportunities to address other key financial issues, such as its postretirement health benefit obligations and outstanding debt.

Although the Service has traditionally provided a range of detailed financial and operating data to stakeholders throughout the fiscal year, its periodic financial reports have not clearly explained changes in its financial condition, results of operations, and outlook and have not always been readily available to the public. In response to our recommendations, the Service committed to provide quarterly financial statements "similar to what publicly traded enterprises provide." The Service also has begun posting its quarterly reports on mail volumes and revenues, along with its monthly operating statements, to its Web site. However, we do not believe that the quarterly financial

[5] See 17 C.F.R. §240.13a-13.
[6] Such risks are typically associated with derivative instruments utilized to hedge changing market conditions and may not be applicable to activities of the Service.

reports provided to date meet the intent of our recommendations, because the Service provided only limited analysis and explanations to help stakeholders understand what had changed, why it had changed, and how these changes affected the Service's current financial situation and expected outlook.

The SEC requires that quarterly reports submitted by publicly traded companies include a discussion of material changes in a company's financial condition and results of operations.[7] This type of discussion is consistent with the intent of our recommendations. When we compared the Service's most recent quarterly report with those of two of its publicly traded competitors—FedEx and UPS—we found that the Service's quarterly report generally provided the same basic financial statements as did its competitors. However, unlike the Service, FedEx and UPS also provided very detailed "Management's Discussion and Analysis" sections in their reports that discussed events during the period that may have had a significant impact on the financial condition of the company and the outlook for the future, and compared the results of operations with the prior year's results. FedEx and UPS's reports also included explanatory footnotes to the financial statements that provided details about significant changes that have occurred and material contingencies that were not included in the Service's reports. Further, the Service's quarterly reports were not consistent in format and content, or as available to the public as the FedEx and UPS quarterly reports. These changes in subsequent quarterly reports and their limited availability made it difficult to make comparisons and analyze trends.

In commenting on our draft report, the Service said that it would provide additional information in its periodic financial reports to improve stakeholder understanding of its business and that it would retain the data placed on its Web site for 3 years. The Service also cautioned that public discussion of retirement obligations must be undertaken with great care, and that it would ensure greater public understanding in this area. Due to the magnitude of these costs, the potential effects on current and future ratepayers, and the complexity of the issues involved in reporting retirement-related obligations, we agree that greater public understanding of these obligations is important and that the Service can help accomplish this through enhanced disclosure in its financial and related statements. The Service also said that it makes more financial and operating information available than we reflected in our report. We discuss this issue near the end of this letter.

Background

Traditionally, between the annual issuance of its audited year-end financial statements, the Service has provided several types of periodic financial reports, including its monthly Financial and Operating Statements; quarterly Revenue, Piece, and Weight (RPW) Reports; and most recently, quarterly financial reports.[8] The information provided in its periodic monthly operating statements and quarterly RPW reports is as follows:

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[7] See 17 C.F.R. §229.303 (b)(2002).

[8] The Service uses a 52-week "postal fiscal year" for management purposes that contains 364 days and thus starts and ends on a different day each postal fiscal year. The Service divides each postal fiscal year into 13 accounting periods of 4 weeks each. The first postal quarter corresponds to the first three accounting periods, and the last postal quarter includes the last four accounting periods of the postal fiscal year.

- Monthly Financial and Operating Statements: Cover a 4-week period and include data that provide an overview of financial results for that period, compare results with the budget, compare results with the same period in the previous year, and provide year-to-date information. These statements also include detailed information on revenues, expenses, volumes, and work hours; a balance sheet; a cash flow statement; and capital commitments and outlays. Traditionally, these reports were sent to stakeholders by request or posted on the PRC's Web site. The Service began posting the most recently completed financial and operating statement to its Web site in early 2002.

- Quarterly Revenue, Piece, and Weight Reports: Contain information relating to the Service's mail classes and special services. RPW reports document the total revenue, pieces, and weights for each mail class, subclass, and service for that quarter; in addition, the reports provide data on the amount and percentage change from the same period in the previous year and year-to-date information. Quarterly RPW reports dating back to fiscal year 1999 are currently available on the Service's Web site.

During the fall of 2001, when the Service experienced sharp declines in its mail volumes and revenues, and it requested additional appropriations from Congress, readily available and detailed information on the Service's changing financial situation was scarce. Our February 2002 report noted that from October 2001 to mid-January 2002, the Service did not publicly release its monthly statements for the last accounting period of fiscal year 2001 and for the first three accounting periods of fiscal year 2002.[9] Although the Service issued its annual report for fiscal year 2001 in December 2001, it did not publicly release financial results for the fourth quarter of fiscal year 2001.[10] We reported that more timely availability of monthly and quarterly reports, even if they contain preliminary data subject to revision, would be useful to improve transparency for congressional oversight, the stakeholder community, and the public.[11]

The Service's Quarterly Financial Reports Lacked Explanatory Information, Consistency, and Public Availability

Much attention has recently been focused on efforts to improve accountability and the usefulness of financial information, in both the public and private sectors. One of the key components of the President's Management Agenda is to improve accountability to the American people by enhancing the timeliness, usefulness, and reliability of financial information provided by federal agencies. Likewise, recently enacted legislation—the Sarbanes-Oxley Act of 2002 (Public Law 107-204, enacted into law on July 30, 2002)—seeks to protect investors by improving the accuracy and reliability of corporate

[9]GAO-02-355.
[10]The Service has a long-standing practice of withholding detailed financial information on the fourth quarter of a fiscal year and the first accounting periods of the following fiscal year until its annual financial statements have been audited and approved by the Board of Governors. The board approved the Service's audited financial statements for fiscal year 2001 in December 2001.
[11]GAO-02-355, pp. 44-45.

disclosures made pursuant to the securities laws. Given the importance of the Service's financial condition and outlook, timely, accurate, and complete financial information is needed for oversight purposes and for stakeholders to better understand the Service's changing financial situation and its potential effect on stakeholders' future plans.

The key limitations of the Service's quarterly financial reports were that they have lacked sufficient analysis and explanation of what has changed and why in its financial condition, operating results, and outlook. This type of explanatory information is typically provided in quarterly financial reports of publicly traded companies and is consistent with the intent of our previous recommendations. Further, the Service's quarterly reports have not been consistent in format and content or readily available to the public. Sufficient, consistent, and accessible financial information helps provide the necessary transparency and accountability that are fundamental principles in ensuring public confidence in an organization and proper oversight.

<u>The Service's Quarterly Financial Reports Lacked Sufficient Analysis and Explanations</u>

When we compared the most recent quarterly reports of the Service with those of its publicly traded competitors—FedEx and UPS—we found that the greatest differences were in the level of analysis and explanation provided for changes in financial condition, operating results, and outlook.[12] This information is generally included in the sections titled MD&A in the publicly traded quarterly reports and in the notes to the financial statements.

Management's Discussion and Analysis (MD&A)

The SEC requires publicly traded enterprises to provide a management's discussion and analysis of the entities' financial condition and results of operations, both in quarterly and annual reports. The SEC guidance for interim financial reports states:

> "the MD&A requirements are intended to provide in one section of a filing, material historical and prospective textual disclosure enabling investors and other users to assess the financial condition and results of operations of the registrant, with particular emphasis on the registrant's prospects for the future . . .. Disclosure is mandatory where there is a known trend or uncertainty that is reasonably likely to have a material effect on the registrant's financial condition or results of operations. Accordingly, the development of an MD&A should begin with management's identification and evaluation of what information, including the potential effects of known trends, commitments, events, and uncertainties, is important to providing investors and others an accurate understanding of the company's current and prospective financial position and operating results."[13]

[12]Our comparisons were based on the most recent publicly available quarterly reports by the Postal Service, FedEx, and UPS, which covered different periods. The Postal Service's third quarter report for fiscal year 2002 covered the period February 23-May 17, 2002, and was made publicly available in July 2002. FedEx's third quarter report for fiscal year 2002 covered the period December 1, 2000–February 28, 2002, and was filed with the SEC in April 2002. UPS's first quarter report for fiscal year 2002 covered the period January 1, 2002–March 31, 2002, and was filed with the SEC in May 2002.
[13]See SEC Rel. Nos. 33-8056; 34-45321; FR-61 (Jan. 22, 2002).

In comparing the most recent quarterly reports of the Service, FedEx, and UPS, we found that the most notable differences were in the level of detail provided in the MD&A sections of the reports.[14] For example, FedEx and UPS provided explanations in their MD&A sections of how they planned to meet their working capital needs for the future; causes of changes in revenues and volume, by business line, compared with prior periods; and their outlook for the future, including the effect of significant events, such as the terrorist-related events of the fall of 2001. In contrast, the Service provided minimal explanations in these areas. Given the potential impact of these and other key factors, such as the timing and amount of proposed rate increases, it would be helpful to know how these factors affect the Service's changing year-end outlook. Specific examples of the differences between the MD&A section of the Service's quarterly report and those in FedEx's and UPS's quarterly reports are provided below. The full text of the quarterly reports we compared can be found in enclosure I for the Service, enclosure II for FedEx, and enclosure III for UPS.

- Postal Service discussion of outlook:

  "Volume trends of the past three quarters are expected to continue through the fiscal year end in September. Taking the June 30, 2002 rate increase into account, volume losses in the 3 to 4 percent range are anticipated for the quarter, compared to the same quarter last year.
  With expense reductions in excess of $2.5 billion and the rate increase on June 30, the estimated net loss for the year will be in the range $1.0 billion to $1.5 billion."

- FedEx discussion of outlook:

  "While we believe there is evidence that a modest economic recovery is underway, a significant portion of our U.S. domestic express business comes from the manufacturing and wholesale sectors, especially in the high technology area. Recovery in these sectors is still lagging the rest of the economy on a year-over-year basis. Until these key sectors experience sustained growth, volumes at FedEx Express are expected to remain soft.

  "Our fourth quarter volume outlook for FedEx Express is for U.S. domestic average daily package volume to be approximately 2% below last year's fourth quarter and for IP shipments to be down about 1%. In addition, our dynamic fuel surcharge at FedEx Express effectively has a six-week lag before the surcharge is adjusted for increased fuel prices. Therefore, our operating income may be negatively affected should the spot price of jet fuel increase significantly in the fourth quarter. At FedEx Ground, fourth quarter volume is expected to grow about 16% year-over-year.

  "We believe our diverse portfolio of services is the key factor to our long-term growth. The expansion of our Home Delivery network and continued development and cross selling of the diverse FedEx portfolio of services, particularly to small- and medium-sized businesses, is central to our strategy. Our website, fedex.com, is heavily utilized and has helped us reduce costs and improve customer satisfaction. We believe that our substantially fixed cost express network infrastructure will allow us to realize incremental profits when the economy recovers.

  "Maintenance costs during the fourth quarter of 2002 are expected to be higher due to scheduled maintenance activities. Also, we accrued increased variable compensation in the third quarter of 2002 and expect to continue to do so in the fourth quarter. Our 2002 incentive compensation costs

[14]The Service did not have a section titled Management's Discussion and Analysis in its quarterly report, but it did have similar sections titled "Operating Results" and "Message from the Chief Financial Officer." In our analysis, we compared these sections with the MD&A sections of FedEx and UPS quarterly reports.

will be sharply reduced for most employees (including senior management). However, fourth quarter incentive compensation provisions will be higher year-over-year since the prior year's fourth quarter included reversals of incentive compensation that had been previously accrued.

"We expect pension and health care costs to continue to increase over the near term. Our net pension cost for 2002 will increase by approximately $90 million due to lower interest rates and a reduction in the value of plan assets. We expect next year's pension cost to increase by $90-100 million based on a continued decline in interest rates and a decrease in the expected return on pension plan assets. While employee retirement costs continue to rise, our retirement programs are well funded, with assets more than sufficient to meet our current obligations."

- UPS excerpts of significant events and outlook:

"… Due to the events of September 11, 2001, increased security requirements for air carriers may be forthcoming; however, we do not anticipate that such measures will have a material adverse effect on our financial condition, results of operations or liquidity. In addition, our insurance premiums have risen and we have taken several actions, including self-insuring certain risks, to mitigate the expense increase.

"As of December 31, 2001, we had approximately 232,500 employees (64% of total employees) employed under a national master agreement and various supplemental agreements with local unions affiliated with the International Brotherhood of Teamsters ("Teamsters"). These agreements run through July 31, 2002. The majority of our pilots are employed under a collective bargaining agreement with the Independent Pilots Association, which becomes amendable January 1, 2004. Our airline mechanics are covered by a collective bargaining agreement with Teamsters Local 2727, which became amendable on August 1, 2001. Members of Teamsters 2727 recently voted down a proposed new contract, and negotiations resumed in April 2002 with the assistance of the National Mediation Board. In addition, the majority of our ground mechanics who are not employed under agreements with the Teamsters are employed under collective bargaining agreements with the International Association of Machinists and Aerospace Workers. These agreements have various expiration dates between July 31, 2002 and May 31, 2003.

"We entered into negotiations with the Teamsters in January 2002 for a new national master agreement. It is our desire through these discussions to reach an agreement on a new contract prior to the end of our current five-year agreement on July 31, 2002. Any strike, work stoppage or slowdown that results from our failure to reach a timely agreement with the Teamsters, and any change in shipping behavior by our customers or potential customers due to perceptions that we will not reach a timely agreement with the Teamsters, could have a material adverse effect on our financial condition and results of operations. We do not, however, anticipate that this will occur.

"We believe that funds from operations and borrowing programs will provide adequate sources of liquidity and capital resources to meet our expected long-term needs for the operation of our business, including anticipated capital expenditures such as commitments for aircraft purchases, through 2009."

- Postal Service discussion of changes in revenue:

"Revenue: Revenue of $15.3 billion was 4.9 percent ($796 million) below plan and 2.0 percent ($322 million) below Quarter III of last year. Planned revenue growth for Quarter III was 3.1 percent.

"Volume in Quarter III was 2.5 percent below last year. We processed and delivered 47.1 billion pieces as compared to 48.3 billion pieces last year. Revenue loss from the volume decline of 1.2 billion pieces was offset through expense reductions."

- UPS excerpts of changes in revenue:

  UPS reports its operations in three segments: U.S. domestic package operations, international package operations, and nonpackage operations, as well as on a consolidated basis. Although the entire revenue discussion is included in enclosure III, for brevity purposes, only the U.S. domestic package revenue discussion is presented here, as follows:

  "U.S. domestic package revenue decreased 1.2% compared to last year. This decline was driven by a 1.5% reduction in average daily package volume which was primarily a result of the continued weakness in the U.S. economy. Revenue for our Next Day Air products was also adversely affected by a decline in revenue per piece. The decline results in part from lower package weights combined with a mix shift favoring letters to packages. This reflected what we believe to be continued slowness in the manufacturing sector. Conversely, revenue for our Ground products increased slightly due to a 3.5% increase in average revenue per piece. This improvement resulted in part from having a rate increase that occurred four weeks earlier than compared to the prior year.

  "On January 7, 2002, we increased rates for standard ground shipments an average of 3.5% for commercial deliveries. The ground residential charge increased $0.05 to $1.10 over the commercial ground rate, and this charge will also be applied to express deliveries in 2002. The additional delivery area surcharge, which is added to ground deliveries in certain less accessible areas, remained at $1.50. In addition, in 2002, this charge will also be applied to express deliveries to these addresses. Rates for UPS Hundredweight increased 5.9%.

  "We also increased rates for UPS Next Day Air, UPS Next Day Air Saver, UPS 2nd Day Air, and 3 Day Select an average of 4.0%. The surcharge for UPS Next Day Air Early A.M. increased from $27.50 to $28.50. Rates for international shipments originating in the United States (Worldwide Express, Worldwide Express Plus, UPS Worldwide Expedited and UPS International Standard service) increased an average of 3.9%. Rate changes for shipments originating outside the U.S. were made throughout the past year and varied by geographic market.

  "An index-based fuel surcharge, which became effective December 10, 2001, continued and resets on a monthly basis beginning in February 2002. The index-based surcharge is based on the National U.S. Average On-Highway Diesel Fuel Prices as reported by the U.S. Department of Energy."

- FedEx discussion of changes in revenue:

  FedEx also reports its operations on a consolidated basis and for its major business segments: FedEx Express, FedEx Ground, FedEx Freight, and other Operations. See enclosure II for the complete tables and discussion in each of these areas.

As these examples indicate, the level of explanations in the FedEx and UPS quarterly MD&A sections is significantly greater than that provided by the Service and helps provide the reader with a better understanding not only of what has changed, but why. In comparing the quarterly reports, we developed the following questions that we believe would provide meaningful information for the Service to include in its quarterly report in order to make it a more useful document to its stakeholders:

- Information regarding the current reporting period:

  - What were the major changes in revenue, expense, and volume and the causes of these changes? How do these results compare with the prior period's?
  - What major challenges or risks did the Service face during the period, and what was done to respond to them?
  - What were the financial consequences of these occurrences?

- Information regarding the upcoming reporting period:
  - What challenges are expected, by business line? How will they be overcome?
  - What are the financial expectations of the Service as a whole and on a business line basis?
  - What impact will competitors have in the upcoming period?
  - What significant trends, events, commitments, or uncertainties may affect the Service's expectations?
  - What are the expected cash requirements and year-end cash position?
  - What are the expected capital commitments and outlays?
  - What is the expected net income, and what actions may be taken to address specific situations or conditions? Specifically, focus on the causes of any losses and specific plans to correct them, if known.
  - By major business line, what are the major challenges faced, accomplishments, and plans to generate revenue, reduce costs, and pay down the debt with the U.S. Treasury?

- Information regarding long-term outlook
  - What are the capital expansion plans, projects, time periods, amounts, and return on investment? What are current projects, their status, and planned projects? How will these projects be funded and implemented? How will changing economic factors affect these plans? What risk analysis and contingency plans have been developed? What are the changes to the previously reported plans?
  - What are the plans to remain within the present debt limit and plans to pay off long-term debt?
  - How is the Service prepared to meet its long-term obligations, such as funding postretirement health care costs?

While not all of these issues would necessarily be included in every report, they do represent items that should be considered for disclosure each quarter, giving special consideration to changes that have occurred since the annual report was issued. In addition, some of these disclosures would most appropriately be made in the footnotes accompanying the quarterly financial statements, as are discussed in more detail below.

Financial Statement Footnotes

The Service's most recent quarterly report provided financial statements that were generally comparable to those provided by FedEx and UPS in that they included the basic statements of income, balance sheet, and cash flow. However, unlike the Service, FedEx and UPS provided notes to the quarterly financial statements that included explanations on a variety of issues, including changes in accounting policies, business segment information, major new commitments and contingencies, and supplemental cash flow information. The SEC guidance for the content of interim financial statements states, in part, that

> "… disclosure shall be provided where events subsequent to the end of the most recent fiscal year have occurred which have a material impact on the registrant. Disclosures should encompass, for example, significant changes since the end of the most recently completed fiscal year in such items as: accounting principles and practices; estimates inherent in the preparation of financial statements; status of long-term contracts; capitalization including significant new borrowings or modification of existing financing arrangements; and the reporting entity resulting from business combinations or dispositions. Notwithstanding the above, where material contingencies exist, disclosure of such matters shall be provided even though a significant change since year end may not have occurred..."[15]

These footnote explanations can greatly enhance the reader's understanding of the quarterly financial statements. For example, in their quarterly reports, FedEx and UPS each discuss in detail contingent losses due to pending lawsuits, whereas the Service does not present similar information on contingent losses, even though such contingencies exist.[16]

Another area where footnote disclosures would be helpful to the understanding of the Service's quarterly reports is a more detailed breakdown of certain key line items in the financial statements. For example, the Service includes in its income statement a single line item for "revenues," with no further breakdown provided. UPS also reports a single line item for revenue in its income statement, but then provides breakdowns of revenue for each of its reporting segments, including comparative numbers for the prior quarter. Similarly, details of financial statement line items for "other expenses" and "other assets" are provided in UPS footnotes, which would also be helpful for the Service. "Other liabilities" is also a significant line item on the Service's balance sheet at $41.8 billion, out of $63 billion in total liabilities. Within this number is approximately $30 billion related to deferred pension liabilities that warrant explanation in the footnotes, as well as other liabilities related to employee benefits that are included in this line item. Further, we have recommended that the Service disclose the amount of postretirement health benefits earned by postal employees and retirees in notes to its financial statements to provide more complete information about these significant obligations.[17] In our

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[15]See 17 C.F.R. §210.10-01(a)(5)(2002).

[16]A general discussion in the footnotes to the *U.S. Postal Service Annual Report 2001* discloses contingent liabilities.

[17]In May 1992, we recommended that the Service provide additional information on its postretirement health benefits as part of its annual financial statement (U.S. General Accounting Office, *Financial Reporting: Accounting for the Postal Service's Postretirement Health Care Costs*, GAO/AFMD-92-32, Washington, D.C.: May 20, 1992). The Service did not agree with and did not implement this

September 2002 report, we stated that the Service should reassess its accounting treatment for both its pension and postretirement health obligations and reiterated our previous recommendation that the Service should fully disclose its postretirement health obligations because they represent a very material commitment that affects the future viability of the Service.

An additional useful footnote disclosure for the recent quarterly report would have been a discussion of the $675 million in supplemental funds appropriated to the Service during fiscal year 2002 to deal with expenses relating to the terrorist attacks of September 11 and subsequent anthrax attacks.[18] These funds are significant because the Service, as an entity that is substantially self-financing, generally receives only a small annual appropriation. For example, in fiscal year 2002, the Service was appropriated only about $77 million in its general fiscal year appropriation.[19] Further, disclosure of the approximately $4 billion projected to be needed over the next 5 years for improving the Service's mail processing systems to protect postal employees and the general public from future attacks through the mail would have informed the reader of the potentially material effect these expenses may have on the Service's financial results in the future.[20]

Consideration of the level of detail included in FedEx's and UPS's quarterly reports, as well as that of other organizations' reports, may be helpful to the Service as it makes enhancements to future quarterly reports. We recognize that judgments must be made about the level of detail that should be provided in quarterly financial reports and that not all quarterly reports will be the same. However, it is clear from recently publicized problems in financial reporting that more detailed information and transparency are called for by both Congress and the public. Such transparency is critical for the Service because of the importance of its financial situation and the implications for stakeholders in making their own financial plans. These factors help support stakeholders' need for timely, accurate, and complete financial information that is provided on a consistent basis.

<u>The Service's Quarterly Financial Reports Lacked Consistent Format and Adequate Availability to the Public</u>

The first quarterly report that the Service posted to its Web site for the third quarter of fiscal year 2001 was a good starting point for providing information to Congress and the public. However, changes in subsequent quarterly reports and their limited availability made it difficult to make comparisons and analyze trends. Table 1 shows quarterly financial information provided since our recommendation.

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recommendation. We reiterated this recommendation and also discussed the accounting treatment of these obligations in our recent report, U.S. General Accounting Office, *U.S. Postal Service: Accounting for Postretirement Benefits*, GAO-02-916R (Washington, D.C.: Sept. 12, 2002).

[18]On November 20, 2001, the President released $175 million to the Postal Service from the Emergency Response Fund for expenses relating to the terrorist attacks. In January 2002, the Service was appropriated an additional $500 million for emergency expenses.

[19]Public Law 107-67.

[20]Public Law 107-117 appropriated $500 million to the Service for emergency expenses and required the Service to develop an Emergency Preparedness Plan with its planned expenditures to support this Plan.

Table 1: The Service's Quarterly Financial Reports from Third Quarter Fiscal Year 2001 through Third Quarter Fiscal Year 2002

Fiscal quarter	The Service's actions
Third quarter, FY 2001	Posted quarterly report to its Web site
Fourth quarter, FY 2001	Annual report, no quarterly report available
First quarter, FY 2002	Posted slide presentation to its Web site
Second quarter, FY 2002	Posted slide presentation to its Web site
Third quarter, FY 2002	Posted quarterly report to its Web site

Source: U.S. Postal Service.

The Service stated that its audited fiscal year 2001 annual report would serve as its fourth quarter report, which is a common reporting practice for publicly traded companies under SEC's rules. Although neither FedEx nor UPS are required to submit fourth quarter reports to the SEC, they do issue press releases on their Web sites that include detailed fourth quarter financial information, such as income statement and balance sheet information, and a discussion of quarterly results. The Service occasionally releases financial information via press releases; however, no press release was provided that included financial results for the fourth quarter of fiscal year 2001. Utilizing press releases to discuss fourth quarter results would compensate for the time lapses between the release of its third quarter report and its annual report, thus providing stakeholders with more timely financial information.

Another concern we raised was that the format for quarterly reports was not consistent, so that it was difficult to compare results and analyze trends over time. For the first quarter of fiscal year 2002, the Service changed its reporting format from what was provided in its first publicly available quarterly report for the third quarter of fiscal year 2001. The Service used the Chief Financial Officer's (CFO) first quarter slide presentation to the Board of Governors as its quarterly financial report and stated that it was posted on its Web site. In spring of 2001, the Service stated that for future quarterly reports these slide presentations would be used. The Service then posted the CFO's slide presentation for the second quarter of fiscal year 2002 to its Web site. We testified in May of 2002 that the CFO's slide presentations contained less information than the fiscal year 2001 third quarter report.[21] The slide presentations included summary information on total revenues, expenses, and work-hour information, but did not include any discussion of the Service's current position and outlook. For the third quarter of fiscal year 2002, the Service posted to its Web site a quarterly report that was similar to its third quarter report for fiscal year 2001.

Finally, we raised a concern that the Service's financial reports were not readily available to the public. Although the Service has begun to post both its monthly and quarterly reports to its Web site, it only posted the two most recent monthly reports and the latest quarterly report. In comparison, FedEx and UPS make available not only their most recent report, but also past quarterly reports. For example, FedEx's quarterly reports dating back to April 1998 and UPS's quarterly reports dating back to May 2000 are currently available on their Web sites. Posting past monthly and quarterly reports to the Service's Web site would improve accessibility to past financial information and would

[21] GAO-02-694T.

assist stakeholders in understanding the Service's changing financial condition and allow for trend analysis and comparisons.

Agency Comments and Our Evaluation

The Service provided comments on a draft of this report in a letter from the Chief Financial Officer dated October 17, 2002. These comments are summarized below and reproduced in enclosure IV. In commenting on our draft report, the CFO stated that the Service would provide additional information in its periodic financial reports to improve stakeholder understanding of its business and that it would retain the data placed on its Web site for 3 years. Specifically, the Service agreed to provide explanations about variances from budgeted amounts, financial expectations, and the projected financial and operational impact of material events or transactions.

The CFO pointed out that while the Service received many suggestions for fine-tuning certain disclosures, the financial community expressed overall satisfaction with the quantity and quality of data the Service provides. The CFO commented that the Service publicly discloses information to the PRC during rate case filings that exceeds the amount of information required by SEC-regulated companies and most other government agencies. We acknowledge that the Service provides a significant amount of information in its rate case filings; however, this information is provided only for rate-setting purposes, and rate cases are not filed on a regular cycle. Thus, rate case information does not provide stakeholders timely information about the Service's current financial condition and changes to its expected outlook. As we have reported, stakeholders have been surprised by the significant changes that have occurred during the fiscal year to the Service's net income estimates and financial outlook.

The CFO also stated that our report did not adequately or completely reflect the Service's ongoing financial reporting, including its detailed revenue, volume, and weight information; annual billing determinants data; and 4-week Financial and Operating Statements. Our report does provide descriptions of the Service's periodic financial information, including its quarterly Revenue, Piece, and Weight reports and its monthly Financial and Operating Statements. As we noted, however, these periodic financial reports do not clearly explain changes in its financial condition, outlook, and results of operations, and have not always been readily available to the public. The Service also provides annual information, such as its Annual Auditor's Report and annual billing determinants data, but this information is not available throughout the year for use in periodic analysis. Moreover, the billing determinants data for fiscal year 2001, which ended in September 30, 2001, was not released until October of 2002.

With regard to the CFO's point about the Service's retirement obligations, he cautioned that public discussion of retirement obligations must be undertaken with great care and that the Service would ensure greater public understanding in this area. Due to the magnitude of these costs, the potential effects on current and future ratepayers, and the complexity of the issues involved in reporting retirement-related obligations, we agree that greater public understanding of these obligations is important. The Service's announcement regarding its CSRS pension liability at its November 2002 Board of

Governors meeting further emphasizes the importance of enhanced disclosure and discussion of the implications of all of its retirement-related obligations. Further, the reduction in future pension obligations would increase the Service's options for dealing with its postretirement health obligations and other financial challenges. For these reasons, we believe that the Service needs to enhance its disclosure of its postretirement health obligations in its financial reports. Importantly, a number of major employers have provided disclosures relating to these types of obligations for several years. In addition, the consolidated financial statements of the U.S. government include extensive disclosures of these obligations on a government-wide basis. Without sufficient disclosure of these obligations in the Service's financial statements or the related footnotes, neither Congress nor stakeholders can have adequate information needed to make appropriate decisions related to these issues. We continue to believe that, at a minimum, these obligations should be discussed in the notes to the financial statements.

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We are sending copies of this report to the Chairman and Ranking Minority Member of the Senate Committee on Governmental Affairs, Chairman and Ranking Minority Member of the House Committee on Government Reform, the Service's Postmaster General/Chief Executive Officer, the Service's Chief Financial Officer, the Chairman of the Postal Rate Commission, and other interested parties. We will also make copies available to others on request. In addition, the report will be available at no charge on the GAO Web site at http://www.gao.gov.

If you have any questions about this report or the enclosures, please contact Bernard Ungar at (202) 512-2834, ungarb@gao.gov, or Linda Calbom at (202) 512-8341, calboml@gao.gov. Key contributors to this assignment were Teresa Anderson, Tida Barakat, Joshua Bartzen, Heather Dunahoo, and Michael Fischetti.

Bernard L. Ungar

Bernard L. Ungar
Director, Physical Infrastructure Issues

Linda Calbom

Linda Calbom
Director, Financial Management and
Assurance

Postal Service Fiscal Year 2002 Third Quarter Financial Report

UNITED STATES POSTAL SERVICE

2002 THIRD QUARTER REPORT Page 1

Income Statement (Unaudited)

($ in Millions)	Quarter Ending May 17, 2002	Same Period FY 2001	Year-to-Date May 17, 2002	Same Period FY 2001
Operating Revenue	$ 15,285	$ 15,607	$ 46,263	$ 46,711
Operating Expenses:				
Compensation and Benefits	12,023	11,996	36,019	35,924
Transportation	1,117	1,131	3,686	3,576
Other	1,976	2,105	5,683	6,049
Total Operating Expenses	15,116	15,232	45,387	45,549
Income From Operations	169	375	876	1,162
Interest and Investment Income	11	8	26	25
Interest on Deferred Retirement	(378)	(372)	(1,135)	(1,115)
Interest Expense on Borrowing	(83)	(77)	(243)	(267)
Net Income (Loss)	$ (281)	(65)	(476)	(194)

Based on Postal Fiscal Year

Statement of Cash Flows (Unaudited)

($ in Millions)	Year-to-date May 17, 2002	Same Period FY 2001
Cash Flows from Operating Activities:		
Net Income (Loss) (Government Fiscal Year)	$ (763)	$ (672)
Depreciation and Amortization	1,453	1,387
Changes in Non Current Assets & Liabilities	2,283	2,125
Changes in Current Assets & Liabilities	2,404	1,868
Net Cash Provided by Operating Activities	5,377	4,708
Cash Flows from Investing Activities:		
Sale/Purchase of U. S. Government Securities - Net	1	-
Purchase of Property and Equipment - Net	(1,383)	(2,120)
Net Cash Used by Investing Activities	(1,382)	(2,120)
Cash Flows from Financing Activities:		
Increase/(Decrease) in Long-term Debt	(4,363)	(3,224)
(Increase)/Decrease in Other Non-current Assets	-	-
Net Cash Used by Financing Activities	(4,363)	(3,224)
Net Change in Cash and Cash Equivalents	(368)	(636)
Cash & Cash Equivalents at Beginning of Period	999	677
Cash & Cash Equivalents at End of Period	$ 631	$ 41

Based on Government Fiscal Year

OPERATING RESULTS

NET INCOME: Quarter III net loss of $281 million was $80 million less than the planned net loss of $361 million. Revenue for the quarter was $796 million below plan but expenses were under plan by $876 million resulting in a smaller net loss than planned for the quarter.

REVENUE: Revenue of $15.3 billion was 4.9 percent ($796 million) below plan and 2.0 percent ($322 million) below Quarter III of last year. Planned revenue growth for Quarter III was 3.1 percent.

VOLUME: Total mail volume of 47.1 billion pieces for Quarter III was 3.5 percent below plan. Mail volume declined 2.5 percent during Quarter III against anticipated growth of 1.0 percent. Volume for all mail categories declined during Quarter III.

EXPENSE: Operating expenses of $15.1 billion for Quarter III were $871 million, or 5.2 percent under plan. Personnel costs were $524 million under plan, transportation expense was $80 million under plan, and other Non-personnel expense were $435 million under plan for the quarter. Operating expenses were reduced by 0.8 percent from Quarter III of last year.

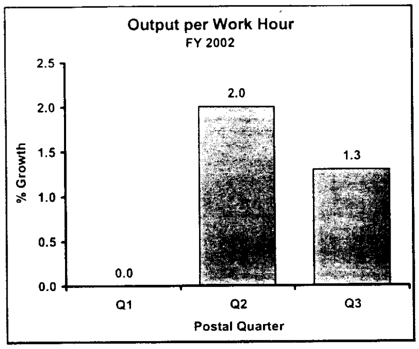
UNITED STATES POSTAL SERVICE

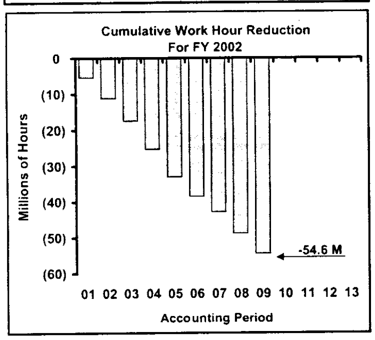
2002 THIRD QUARTER REPORT Page 2

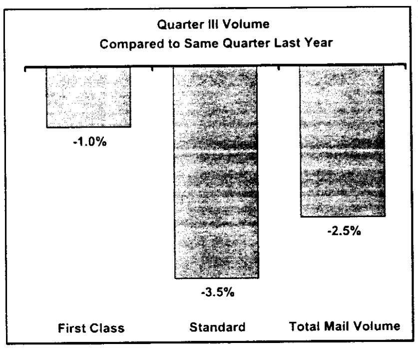
Balance Sheet (Unaudited)

($ in Millions)	May 17, 2002	Sept. 30, 2001
ASSETS		
Current Assets		
Cash & Cash Equiv.	$ 631	$ 999
Other Current Assets	1,007	934
Total Current Assets	1,638	1,933
Property Plant & Equipment - Net	24,693	24,763
Deferred Retirement Costs	33,305	32,023
Other Assets	372	372
Total Assets	**60,008**	**59,091**
LIABILITIES		
Current Liabilities	14,371	11,893
Total Debt	6,952	11,315
Other Liabilities	41,774	38,209
Total Liabilities	**$ 63,097**	**$ 61,417**
EQUITY		
Contributions	$ 3,034	$ 3,034
Deficit Since Reorganization	(6,123)	(5,360)
Total Equity (Capital Deficiency)	**$ (3,089)**	**$ (2,326)**
Total Liabilities & Equity	**$ 60,008**	**$ 59,091**

Based on Government Fiscal Year







Message from the Chief Financial Officer

Performance in Quarter III FY 2002

Performance in Quarter III FY 2002 was better than plan. The net loss of $281 million was $80 million less than the planned net loss. This net income performance was driven by strong operating expense reductions. Total operating expenses were $116 million below last year and $871 million below planned expenses for Quarter III. Revenues were $322 million below Quarter III last year and $796 million below planned revenue.

After initial setbacks from bioterrorism, total factor productivity and output per work hour gains were achieved over last year despite major volume losses. Volume in Quarter III was 2.5 percent below last year. We processed and delivered 47.1 billion pieces as compared to 48.3 billion pieces last year. Revenue loss from the volume decline of 1.2 billion pieces was offset through expense reductions. Although not included in this financial report, measured service also improved.

Positive expense and productivity performance was driven by employee and work hour reductions. Through Quarter III, career complement has been reduced by 13,750 employees, with a reduction of 5,600 in Quarter III. Complement control, along with investments in capital and other productivity initiatives, has enabled operating managers to reduce work hours in Quarter III by 16.1 million hours, bringing total work hour reductions this year to 54.6 million. These complement and work hour reductions are unprecedented.

Volume trends of the past three quarters are expected to continue through the fiscal year end in Spetember. Taking the June 30, 2002 rate increase into account, volume losses in the 3 to 4 percent range are anticipated for the quarter, compared to the same quarter last year.

With expense reductions in excess of $2.5 billion and the rate increase on June 30, the estimated net loss for the the year will be in the range $1.0 billion to $1.5 billion.

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

FedEx Fiscal Year 2002 Third Quarter Financial Report

Enclosure 3

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTER ENDED **February 28, 2002**, OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM __________ TO __________.

Commission file number: 1-15829

FEDEX CORPORATION
(Exact name of registrant as specified in its charter)

Delaware (State of incorporation)	62-1721435 (I.R.S. Employer Identification No.)
942 South Shady Grove Road Memphis, Tennessee (Address of principal executive offices)	38120 (Zip Code)

(901) 818-7500
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock	Outstanding Shares at March 31, 2002
Common Stock, par value $.10 per share	298,419,197

FEDEX CORPORATION

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PART I. FINANCIAL INFORMATION

PART II. OTHER INFORMATION

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

FEDEX CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(IN MILLIONS)

ASSETS

	February 28, 2002 (Unaudited)	May 31, 2001
Current Assets:		
Cash and cash equivalents	$ 220	$ 121
Receivables, less allowances of $95 and $96	2,433	2,506
Spare parts, supplies and fuel	254	269
Deferred income taxes	489	488
Prepaid expenses and other	129	117
Total current assets	3,525	3,501
Property and Equipment, at Cost	17,361	16,412
Less accumulated depreciation and amortization	9,017	8,312
Net property and equipment	8,344	8,100
Other Assets:		
Goodwill	1,027	1,052
Other	801	739
Total other assets	1,828	1,791
	$13,697	$13,392

See accompanying Notes to Condensed Consolidated Financial Statements.

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FEDEX CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(IN MILLIONS, EXCEPT SHARE DATA)

LIABILITIES AND STOCKHOLDERS' INVESTMENT

	February 28, 2002 (Unaudited)	May 31, 2001
Current Liabilities:		
Current portion of long-term debt	$ 288	$ 221
Accrued salaries and employee benefits	696	700
Accounts payable	1,073	1,256
Accrued expenses	1,047	1,073
Total current liabilities	3,104	3,250
Long-Term Debt, Less Current Portion	1,809	1,900
Deferred Income Taxes	561	508
Other Liabilities	1,896	1,834
Commitments and Contingencies (Note 7)		
Common Stockholders' Investment:		
Common stock, $.10 par value; 800,000,000 shares authorized, 298,573,387 issued	30	30
Additional paid-in capital	1,123	1,120
Retained earnings	5,277	4,880
Treasury stock, at cost; deferred compensation and other	(37)	(74)
Accumulated other comprehensive income	(66)	(56)
Total common stockholders' investment	6,327	5,900
	$13,697	$13,392

See accompanying Notes to Condensed Consolidated Financial Statements.

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FEDEX CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)
(IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

	Three Months Ended February 28,		Nine Months Ended February 28,	
	2002	2001	2002	2001
Revenues........................	$5,019	$4,839	$15,191	$14,512
Operating expenses:				
Salaries and employee benefits	2,246	2,098	6,713	6,093
Purchased transportation......	442	412	1,351	1,286
Rentals and landing fees......	444	418	1,348	1,216
Depreciation and amortization.	341	326	1,019	938
Fuel..........................	244	302	817	865
Maintenance and repairs.......	306	270	910	858
Airline stabilization compensation	(3)	-	(119)	-
Other.........................	762	822	2,247	2,408
	4,782	4,648	14,286	13,664
Operating income................	237	191	905	848
Other income (expense):				
Interest, net.................	(36)	(34)	(109)	(102)
Other, net....................	(7)	1	(7)	2
	(43)	(33)	(116)	(100)
Income before income taxes.......	194	158	789	748
Provision for income taxes.......	74	50	300	277
Income before cumulative effect of change in accounting principle....................	120	108	489	471
Cumulative effect of change in accounting for goodwill, net of tax benefit of $10.........	-	-	(15)	-
Net income......................	$ 120	$ 108	$ 474	$ 471
Basic earnings per common share:				
Income before cumulative effect of change in accounting principle	$ .40	$ .38	$ 1.64	$ 1.65
Cumulative effect of change in accounting for goodwill	-	-	(.05)	-
Basic earnings per common share	$ .40	$ .38	$ 1.59	$ 1.65
Diluted earnings per common share:				
Income before cumulative effect of change in accounting principle	$ .39	$ .37	$ 1.61	$ 1.62
Cumulative effect of change in accounting for goodwill	-	-	(.05)	-
Diluted earnings per common share	$ .39	$ .37	$ 1.56	$ 1.62

See accompanying Notes to Condensed Consolidated Financial Statements.

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FEDEX CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(IN MILLIONS)

	Nine Months Ended February 28, 2002	2001
Net Cash Provided by Operating Activities	$1,440	$1,026
Investing Activities:		
Purchases of property and equipment	(1,301)	(1,272)
Proceeds from disposition of property and equipment:		
Sale-leaseback transaction	-	80
Other dispositions	26	23
Acquisition of businesses, net of cash acquired	-	(467)
Other, net	8	(10)
Net cash used in investing activities	(1,267)	(1,646)
Financing Activities:		
Proceeds from debt issuances	88	795
Principal payments on debt	(121)	(121)
Proceeds from stock issuances	65	18
Purchase of treasury stock	(114)	-
Other, net	8	-
Net cash (used in) provided by financing activities	(74)	692
Net increase in cash and cash equivalents	99	72
Cash and cash equivalents at beginning of period	121	68
Cash and cash equivalents at end of period	$ 220	$ 140

See accompanying Notes to Condensed Consolidated Financial Statements.

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FEDEX CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

(1) Summary of Significant Accounting Policies

These interim financial statements of FedEx Corporation ("FedEx") have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and the instructions to Quarterly Report on Form 10-Q and Rule 10-01 of Regulation S-X, and should be read in conjunction with our Annual Report on Form 10-K for the year ended May 31, 2001. Accordingly, significant accounting policies and other disclosures normally provided have been omitted since such items are disclosed therein.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments (including normal recurring adjustments) necessary to present fairly our consolidated financial position as of February 28, 2002, the consolidated results of our operations for the three- and nine-month periods ended February 28, 2002 and 2001, and our consolidated cash flows for the nine-month periods ended February 28, 2002 and 2001. Operating results for the three- and nine-month periods ended February 28, 2002 are not necessarily indicative of the results that may be expected for the year ending May 31, 2002.

In 2001, we changed the actuarial valuation measurement date for our principal pension plans from May 31 to February 28 to conform to the measurement date used for our postretirement health care plans and to facilitate our planning and budgeting process. Additionally, we adopted a calculated value method for determining the fair value of plan assets, which is a method more consistent with the long-term nature of pension accounting. These changes had no material impact on reported net periodic pension cost, either cumulatively at June 1, 2001 or on a pro forma basis for any of the prior three fiscal years. These changes reduced total 2002 pension cost by approximately $32 million. However, our pension cost is materially affected by the discount rate used to measure pension obligations, the level of plan assets available to fund those obligations at the measurement date and the expected rate of return on plan assets. Due to a lower discount rate and a reduction in the value of plan assets at the measurement date for 2002 pension expense (February 28, 2001), our total net pension cost for 2002 will increase by approximately $90 million. An increase of $90-100 million is expected for 2003 based primarily on a continuing decline in the discount rate and a reduction in the expected long-term rate of return on plan assets. Management reviews the assumptions used to measure pension costs (including the discount rate and the expected long-term rate of return on pension assets) on an annual basis. Economic and market conditions at the measurement date may impact these assumptions from year to year.

We are self-insured up to certain levels for workers' compensation, employee health care and vehicle liabilities. Accruals are based on the actuarially estimated undiscounted cost of claims, which includes claims incurred-but-not-reported.

Effective June 1, 2001, we adopted Statement of Financial Accounting Standards No. ("SFAS") 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS 137 and SFAS 138. SFAS 133 requires an entity to recognize all derivatives as either assets or liabilities in the balance sheet and to measure those instruments at fair value. Prior to our adoption of SFAS 133, we accounted for our jet fuel hedging contracts under SFAS 80, "Accounting for Futures Contracts." Under SFAS 80, no asset or liability for the hedges was recorded and the income statement effect was recognized in fuel expense upon settlement of the contract. In the past, we had jet fuel hedging contracts that would have qualified under SFAS 133 as cash flow hedges. However, during 2001 all outstanding jet fuel hedging contracts were effectively closed by entering into offsetting contracts. The net value of those contracts of $15 million ($9 million net of tax) was recognized as a deferred charge in the May 31, 2001 balance sheet. Effective June 1, 2001, under the SFAS 133 transition rules, the deferred charge was reclassified to be included as a component of accumulated other comprehensive income. This charge is being recognized in income in 2002 as the related fuel is purchased. We recognized $5 million ($3 million net of tax) of this amount in the third quarter of 2002 as an increase to fuel expense and $13 million ($8 million net of tax) in the nine months of 2002 (also see Note 3).

The Emerging Issues Task Force ("EITF") issued EITF 01-10 in September 2001 to establish accounting for the impact of the terrorist attacks of September 11, 2001. Under EITF 01-10, federal assistance provided to air carriers in the form of direct compensation from the U.S. government under the Air Transportation Safety and System Stabilization Act (the "Act") should be recognized when the related losses are incurred and compensation under the Act is probable. We recognized $3 million of compensation under the Act in the third quarter of 2002. To date, we have classified all amounts recognized under this program ($119 million in the nine months of 2002, of which $101 million was received as of February 28, 2002) as a reduction of operating expenses under the caption "Airline stabilization compensation." While we believe we have complied with all aspects of the Act, compensation recognized is subject to audit and interpretation by the Department of Transportation ("DOT"). We have received a request from the DOT for additional information in support of our claim under the Act. We cannot be assured of the ultimate outcome of such interpretations, but it is reasonably possible that a material reduction to the amount of compensation recognized by us under the Act could occur. Our subsidiary, Federal Express Corporation ("FedEx Express"), had a small facility in the World Trade Center, where we lost an immaterial amount of leasehold improvements and equipment. Our operating lease payments on the facility have been suspended.

In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS 143, "Accounting for Asset Retirement Obligations," effective for fiscal years beginning after June 15, 2002. This statement addresses the diverse accounting practices for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The adoption of this statement is not anticipated to have a material effect on our financial position or results of operations.

In October 2001, the FASB issued SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," effective for fiscal years beginning after December 15, 2001. SFAS 144 supersedes SFAS 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," and provides a single accounting model for the disposal of long-lived assets from continuing and discontinued operations. The adoption of this statement is not anticipated to have a material effect on our financial position or results of operations.

Certain prior period amounts have been reclassified to conform to the current year's presentation.

(2) Business Combinations, Goodwill and Other Intangible Assets

In June 2001, the FASB completed SFAS 141, "Business Combinations," which requires all business combinations initiated after June 30, 2001 to be accounted for under the purchase method. SFAS 141 also sets forth guidelines for applying the purchase method of accounting in the determination of intangible assets, including goodwill acquired in a business combination, and expands financial disclosures concerning business combinations consummated after June 30, 2001. The application of SFAS 141 did not affect any of our previously reported amounts included in goodwill or other intangible assets.

Effective June 1, 2001, we early adopted SFAS 142, "Goodwill and Other Intangible Assets," which establishes new accounting and reporting requirements for goodwill and other intangible assets. Under SFAS 142, all goodwill amortization ceased effective June 1, 2001 (third quarter 2002 goodwill amortization otherwise would have been $9 million, and $27 million year-to-date) and material amounts of recorded goodwill attributable to each of our reporting

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units were tested for impairment by comparing the fair value of each reporting unit with its carrying value (including attributable goodwill). Fair value was determined using a discounted cash flow methodology. These impairment tests are required to be performed at adoption of SFAS 142 and at least annually thereafter. On an ongoing basis (absent any impairment indicators), we expect to perform our impairment tests during our fourth quarter, in connection with our annual budgeting process.

Based on our initial impairment tests, we recognized an adjustment of $25 million ($15 million or $.05 per share, net of tax) in the first quarter of 2002 to reduce the carrying value of goodwill at a subsidiary of one of our non-reportable operating segments to its implied fair value. The adjustment was required because economic conditions at the time of testing (including declining volumes and higher fuel costs) reduced the estimated future expected performance for this operating unit. Under SFAS 142, the impairment adjustment recognized at adoption of the new rules was reflected as a cumulative effect of accounting change in our first quarter 2002 income statement. Impairment adjustments recognized after adoption, if any, generally are required to be recognized as operating expenses.

The carrying amount of goodwill attributable to each reportable operating segment with goodwill balances and changes therein follows (in millions):

	May 31, 2001	Impairment Adjustment	February 28, 2002
FedEx Express	$ 357	$ -	$ 357
FedEx Freight	595	-	595
Other	100	(25)	75
	$ 1,052	$ (25)	$ 1,027

In connection with adopting SFAS 142, we also reassessed the useful lives and the classification of our identifiable intangible assets and determined that they continue to be appropriate. The components of our amortized intangible assets follow (in millions):

	February 28, 2002		May 31, 2001	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Contract based	$ 73	$ (31)	$ 73	$ (27)
Technology based and other	63	(28)	63	(22)
Total	$ 136	$ (59)	$ 136	$ (49)

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Amortization expense for intangible assets during the third quarter of 2002 was $3.4 million ($10.4 million year-to-date). Estimated amortization expense for the remainder of 2002 and the five succeeding fiscal years follows (in millions):

	Estimated Amortization Expense
2002 (remainder)	$ 3
2003	12
2004	8
2005	8
2006	8
2007	8

Actual results of operations for the three- and nine-month periods ended February 28, 2002 and pro forma results of operations for the three- and nine-month periods ended February 28, 2001 had we applied the nonamortization provisions of SFAS 142 in those periods follow (in millions, except per share amounts):

	Three Months Ended February 28,		Nine Months Ended February 28,	
	2002	2001	2002	2001
Reported net income	$ 120	$ 108	$ 474	$ 471
Add: Goodwill amortization, net of tax	-	4	-	11
Adjusted net income	$ 120	$ 112	$ 474	$ 482
Basic earnings per share				
Reported net income	$ .40	$ .38	$ 1.59	$ 1.65
Goodwill amortization	-	.01	-	.04
Adjusted net income	$ .40	$ .39	$ 1.59	$ 1.69
Diluted earnings per share				
Reported net income	$ .39	$ .37	$ 1.56	$ 1.62
Goodwill amortization	-	.01	-	.04
Adjusted net income	$ .39	$ .38	$ 1.56	$ 1.66

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(3) Comprehensive Income

The following table provides a reconciliation of net income reported in our consolidated financial statements to comprehensive income (in millions):

	Three Months Ended February 28, 2002	Three Months Ended February 28, 2001
Net income	$120	$108
Other comprehensive income:		
Foreign currency translation adjustments, net of deferred tax benefit of $1 and $1	(4)	4
Adjustment for jet fuel hedging contract charges recognized in income during period, net of deferred taxes of $2	3	-
Comprehensive income	$119	$112

	Nine Months Ended February 28, 2002	Nine Months Ended February 28, 2001
Net income	$474	$471
Other comprehensive income:		
Unrealized loss on available-for-sale securities, net of deferred tax benefit of $1	-	(1)
Foreign currency translation adjustments, net of deferred tax benefit of $1 and $4	(9)	(11)
Reclassification of deferred jet fuel hedging charge upon adoption of SFAS 133, net of deferred tax benefit of $6	(9)	-
Adjustment for jet fuel hedging contract charges recognized in income during period, net of deferred taxes of $5	8	-
Comprehensive income	$464	$459

(4) Financing Arrangements

From time to time, we finance certain operating and investing activities through the issuance of commercial paper. Our commercial paper program is backed by unused commitments under two revolving credit agreements totaling $1 billion and reduces the amount available under these agreements. At February 28, 2002, no commercial paper was outstanding and the entire $1 billion under the revolving credit agreements was available for future borrowings.

On December 12, 2001, the Memphis-Shelby County Airport Authority (the "Authority") issued $88 million of its Special Facilities Revenue Refunding Bonds, Series 2001 ("Series 2001 Bonds") at par, bearing interest annually at 5% and maturing on September 1, 2009. This obligation is reflected as a capital lease in long-term debt on our balance sheet. The Series 2001 Bonds were issued to provide funds to refund the 7.875% Special Facilities Revenue Bonds issued by the Authority in 1984 ("Series 1984 Bonds"). The Series 1984 Bonds were issued to finance the acquisition and construction of various facilities and equipment at the Memphis International Airport. Lease agreements with the Authority covering the facilities and equipment financed with bond proceeds obligate FedEx Express to make lease payments equal to principal and interest due on the bonds. FedEx Express has separately guaranteed repayment of the Series 2001 Bonds. The

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proceeds from the Series 2001 Bonds, along with other funds, including $9 million of proceeds from the liquidation of the Series 1984 Bonds Reserve Fund, were used on January 23, 2002 to refund the Series 1984 Bonds ($93 million plus a 3% premium).

(5) Computation of Earnings Per Share

The calculation of basic and diluted earnings per share for the three- and nine-month periods ended February 28, 2002 and 2001 was as follows (in millions, except per share amounts):

	Three Months Ended February 28,		Nine Months Ended February 28,	
	2002	2001	2002	2001
Net income	$120	$108	$ 474	$ 471
Weighted-average shares of common stock outstanding	298	288	298	286
Basic earnings per share	$.40	$.38	$1.59	$1.65
Weighted-average shares of common stock outstanding	298	288	298	286
Common equivalent shares:				
Assumed exercise of outstanding dilutive options	17	15	16	14
Less shares repurchased from proceeds of assumed exercise of options	(11)	(10)	(11)	(10)
Weighted-average common and common equivalent shares	304	293	303	290
Diluted earnings per share	$.39	$.37	$1.56	$1.62

(6) Business Segment Information

We are a premier global provider of transportation, e-commerce and supply chain management services, whose operations are primarily represented by FedEx Express, the world's largest express transportation company; FedEx Ground Package System, Inc. ("FedEx Ground"), North America's second largest provider of small-package ground delivery service, and FedEx Freight Corporation ("FedEx Freight"), a leading provider of regional less-than-truckload ("LTL") freight services, formed in the third quarter of 2001. FedEx Freight includes American Freightways, Inc. ("American Freightways"), a multi-regional LTL carrier, and Viking Freight, Inc. ("Viking Freight"), an LTL carrier operating principally in the western United States. These operating companies comprise our reportable segments. Included within "Other" are the operations of FedEx Custom Critical, Inc., a critical-shipment carrier; FedEx Trade Networks, Inc., whose subsidiaries form a global trade services company; and FedEx Corporate Services, Inc. ("FedEx Services"), a provider of supply chain management services and sales, marketing and information technology ("IT") support for our global brands. Other also includes the operations of Viking Freight through November 30, 2000 and certain unallocated corporate items.

The formation of FedEx Services, effective June 1, 2000, represented the implementation of a business strategy wherein the sales, marketing and IT functions of our FedEx Express and FedEx Ground reportable segments were combined to form a shared services operation that supports the package businesses of both of these segments. Prior to the formation of FedEx Services, each business had its own self-contained sales, marketing and IT functions. The costs for those

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activities are now allocated based on metrics such as relative size of operations and estimated services provided. These allocations materially approximate the cost of providing these functions.

For 2001 results, the FedEx Freight segment includes the operations of American Freightways from January 1, 2001 and the operations of Viking Freight from December 1, 2000.

The following table provides a reconciliation of reportable segment revenues and operating income to our consolidated financial statement totals (in millions):

	Three Months Ended February 28,		Nine Months Ended February 28,	
	2002	2001	2002	2001
Revenue				
FedEx Express	$3,776	$3,785	$11,328	$11,682
FedEx Ground	668	529	1,968	1,653
FedEx Freight	440	337	1,438	337
Other	135	188	457	840
	$5,019	$4,839	$15,191	$14,512
Operating income				
FedEx Express	$ 145	$ 160	$ 575	$ 689
FedEx Ground	69	18	209	119
FedEx Freight	20	18	117	18
Other	3	(5)	4	22
	$ 237	$ 191	$ 905	$ 848

(7) Commitments and Contingencies

As of February 28, 2002, our purchase commitments for the remainder of 2002 and annually thereafter for each of the next five years under various contracts were as follows (in millions):

	Aircraft	Aircraft-Related[1]	Other[2]	Total
2002 (remainder)	$ 23	$277	$110	$410
2003	284	430	40	754
2004	58	362	13	433
2005	96	442	9	547
2006	76	403	8	487
2007	-	195	8	203

(1) Primarily aircraft modifications, rotables, spare parts and spare engines.

(2) Primarily vehicles, facilities, computers and other equipment.

FedEx Express is committed to purchase 10 DC10s, three MD11s, seven A300s, six A310s and 75 Ayres ALM 200s to be delivered through 2007. Deposits and progress payments of $12 million have been made toward these purchases and other planned aircraft transactions. Because Ayres Corporation filed for Chapter 11 bankruptcy protection in November 2000 and its assets were subsequently foreclosed on by its senior lender, we believe it is unlikely that any of the ALM 200 aircraft will be delivered to FedEx Express. Accordingly, all deposits and other capitalized costs related to the Ayres commitment were expensed in 2001. The purchase commitment amounts related to these aircraft are $35 million, $96 million and $76 million in 2004, 2005 and 2006, respectively, and are included in the above table. Total commitments for years 2003 and thereafter exclude approximately $825 million due to the cancellation of certain contractual

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obligations to acquire 19 MD11 aircraft from an affiliate of SAirGroup, which filed for protection from creditors under Swiss law.

In January 2001, FedEx Express entered into a memorandum of understanding to acquire 10 A380 aircraft from Airbus Industrie. The acquisition of these aircraft is subject to the execution of a definitive purchase agreement, which is currently under negotiation. No amounts for these aircraft are included in the table above.

A class action lawsuit is pending in Federal District Court in San Diego, California against FedEx Express generally alleging that customers who had late deliveries during the 1997 Teamsters strike at United Parcel Service were entitled to a full refund of shipping charges pursuant to our money-back guarantee, regardless of whether they gave timely notice of their claim. The court has ruled for FedEx Express on all but the first eight days of the UPS strike. A hearing on plaintiffs' motion for summary judgment is scheduled for April 29, 2002. Should the plaintiffs prevail, we plan to appeal to the 9th Circuit Court of Appeals. A trial date is scheduled for June 2002 should the plaintiffs' motion for summary judgment be denied.

Another class action lawsuit is pending in Illinois state court against FedEx Express generally alleging that FedEx Express imposed a fuel surcharge in a manner that is not consistent with the terms and conditions of its contracts with customers. The court has certified the class and notices will be sent to class members during the fourth quarter of 2002.

We believe that the claims in both of these cases are without merit. We have denied any liability with respect to these claims and intend to vigorously defend ourselves in these cases. Given the nature and status of these claims, an estimate of potential loss, if any, cannot be made and no amounts have been provided for these contingencies.

FedEx and its subsidiaries are subject to other legal proceedings that arise in the ordinary course of their business. In the opinion of management, the aggregate liability, if any, with respect to these other actions will not materially adversely affect our financial position, results of operations or cash flows.

(8) Supplemental Cash Flow Information

	Nine Months Ended February 28, 2002	2001
	(In millions)	
Cash payments for:		
Interest (net of capitalized interest)	$ 133	$ 111
Income taxes	284	432
Non-cash investing and financing activities:		
Fair value of assets acquired under exchange agreements	18	3
Fair value of treasury stock and common stock options issued in a business acquisition	-	506

Non-cash investing activities reflect the contractual acquisition of aircraft, spare parts and other equipment in exchange for engine noise reduction kits.

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(9) Other Events

FEDEX EXPRESS ASSET IMPAIRMENTS

During the fourth quarter of 2001, asset impairments at FedEx Express related to aircraft were recorded in the amount of $102 million. All values were based on estimated fair market values. None of the impaired assets were being depreciated at the time of the impairment charge because none of the assets were available for their intended use. The impaired assets related to the MD10 program are held for disposal and we expect to complete the disposal in 2002. As of February 28, 2002, 9 of the 29 impaired aircraft have been scrapped at amounts approximating those previously estimated. Accordingly, no changes to our original estimates for the disposal values of these assets have been made.

FEDEX SUPPLY CHAIN SERVICES RESTRUCTURING

On April 24, 2001, FedEx Supply Chain Services, Inc., a subsidiary of FedEx Services, committed to a plan to reorganize part of its unprofitable, nonstrategic logistics business and reduce overhead. Total 2001 costs of $22 million were incurred in connection with this plan ($12 million of which were accrued at May 31, 2001). The reorganization was completed in 2002. Activity in the restructuring accrual through February 28, 2002 follows (in millions):

	Contract Settlement Costs	Severance and Separation Costs	Other Costs	Total
Balance at May 31, 2001	$ 5	$ 4	$ 3	$ 12
Less: First quarter payments made	(1)	(2)	(1)	(4)
Second quarter payments made	(1)	-	-	(1)
Third quarter payments made	-	-	(1)	(1)
Balance at February 28, 2002	$ 3	$ 2	$ 1	$ 6

(10) Subsequent Events

BUSINESS ACQUISITION

On March 1, 2002, a subsidiary of FedEx Trade Networks acquired certain assets of Fritz Companies, Inc. that provide customs clearance services exclusively for FedEx Express in four U.S. locations. The cost of this cash acquisition was $36.5 million. A substantial portion of the purchase price is expected to be allocated to goodwill.

DEBT PREPAYMENT

On April 5, 2002, we prepaid $100 million of senior notes that were assumed in the American Freightways acquisition in 2001. This long-term debt has been reclassified to current liabilities in the accompanying February 28, 2002 balance sheet.

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REVIEW OF CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
BY INDEPENDENT PUBLIC ACCOUNTANTS

Arthur Andersen LLP, independent public accountants, has performed a review of the condensed consolidated balance sheet of FedEx as of February 28, 2002, and the related condensed consolidated statements of income for the three- and nine-month periods ended February 28, 2002 and 2001, and the condensed consolidated statements of cash flows for the nine-month periods ended February 28, 2002 and 2001, included herein, as indicated in their report thereon included on page 17.

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Stockholders of FedEx Corporation:

We have reviewed the accompanying condensed consolidated balance sheet of FedEx Corporation (a Delaware corporation) and subsidiaries as of February 28, 2002 and the related condensed consolidated statements of income for the three- and nine-month periods ended February 28, 2002 and 2001, and the condensed consolidated statements of cash flows for the nine-month periods ended February 28, 2002 and 2001. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the financial statements referred to above for them to be in conformity with accounting principles generally accepted in the United States.

We have previously audited, in accordance with auditing standards generally accepted in the United States, the consolidated balance sheet of FedEx Corporation as of May 31, 2001 (not presented herein), and, in our report dated June 27, 2001, we expressed an unqualified opinion on that statement. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of May 31, 2001, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Arthur Andersen LLP

Arthur Andersen LLP

Memphis, Tennessee
March 19, 2002

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Item 2. Management's Discussion and Analysis of Results of Operations and Financial Condition

GENERAL

The following management's discussion and analysis describes the principal factors affecting the results of operations, liquidity and capital resources of FedEx Corporation (also referred to herein as "FedEx"). This discussion should be read in conjunction with the accompanying unaudited condensed consolidated financial statements and the related notes thereto, which include additional information about our significant accounting policies, practices and the transactions that underlie our financial results.

Except as otherwise indicated, references to years mean our fiscal year ending May 31, 2002 or ended May 31 of the year referenced, and comparisons are to the corresponding period of the prior year.

RESULTS OF OPERATIONS

Consolidated Results

Dollars in millions, except per share amounts
Three and nine months ended February 28:

	Three Months Ended 2002	Three Months Ended 2001	Percent Change	Nine Months Ended 2002	Nine Months Ended 2001	Percent Change
Revenues	$5,019	$4,839	+ 4	$15,191	$14,512	+ 5
Operating income	237	191	+24	905	848	+ 7
Income before cumulative effect of change in accounting for goodwill	120	108	+11	489	471	+ 4
Net income	120	108	+11	474	471	+ 1
Diluted earnings per common share before cumulative effect of change in accounting for goodwill	$ 0.39	$ 0.37	+ 5	$ 1.61	$ 1.62	- 1
Diluted earnings per common share	$ 0.39	$ 0.37	+ 5	$ 1.56	$ 1.62	- 4

The earnings improvement in the third quarter of 2002 over the comparable prior year period was primarily attributable to revenue and earnings growth at FedEx Ground. Operating income at this segment increased $51 million, reflecting volume growth in FedEx Ground's core business and reduced losses in our Home Delivery service. These factors, and the addition of American Freightways in the third quarter of 2001, also contributed to improved net income for the nine months of 2002, but were mitigated by continued softness in package volumes at FedEx Express.

Volume levels in our FedEx Express domestic and international package services declined in the third quarter and nine months of 2002 as a result of continued weakness in the U.S. and global economies (particularly in the manufacturing and wholesale sectors), which has decreased demand for our higher-priced express services. Revenue from our agreement with the U.S. Postal Service and effective cost management helped soften the impact of reduced package volumes.

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Net income for the nine months of 2002 reflects the cumulative effect of an accounting change recorded in the first quarter of 2002. This change resulted from adoption of new rules from the Financial Accounting Standards Board ("FASB") for the treatment of goodwill and other intangible assets (see Note 2 to the accompanying financial statements). Adoption of these new rules resulted in the first quarter recognition of a $25 million ($15 million net of tax or $.05 per share) impairment charge to our recorded goodwill. Results for the third quarter and nine months of 2002 also reflect the cessation of $9 million and $27 million, respectively, of goodwill amortization from operating expenses, as required under the new accounting rules.

Other Income and Expense and Income Taxes

Net interest expense increased in both the third quarter and nine months of 2002 due to additional debt incurred for the American Freightways acquisition in the third quarter of 2001, partially offset by reduced commercial paper borrowings during 2002.

Our effective tax rate for the third quarter of 2002 was 38% (compared to 31% in the prior year period). For the nine months of 2002, the effective tax rate was 38% (compared to 37% in the prior year period). The lower effective tax rate in the third quarter of the prior year was due to the utilization of excess foreign tax credits, which increased prior year third quarter net income by approximately $12.8 million or $.04 per share.

Terrorist Attacks of September 11

Fiscal 2002 second quarter operations were significantly affected by the terrorist attacks on September 11, 2001. All domestic FedEx Express aircraft were mandatorily grounded on September 11 and 12, and flight operations resumed on the evening of September 13, 2001. During the period our aircraft were grounded, both domestic and international priority ("IP") shipments were impacted, with domestic average daily express volumes declining almost 50% from prior year levels. We executed contingency plans and transported all domestic shipments during this period through ground-based trucking operations. We resumed air operations within hours of receiving clearance from the Federal Aviation Administration. While business levels at FedEx Ground and FedEx Freight were not materially affected, total volumes at FedEx Express declined substantially.

In the aftermath of the terrorist attacks of September 11, the U.S. Congress passed the Air Transportation Safety and System Stabilization Act (the "Act"), an emergency economic assistance package to mitigate the dramatic financial losses experienced by the nation's air carriers. The Act provides for $5 billion to be used for financial assistance to airlines to offset losses caused by service disruptions and declines in business activity related to these attacks for the period September 11, 2001 through December 31, 2001.

The Emerging Issues Task Force ("EITF") issued EITF 01-10 in September 2001 to establish accounting for the impact of the terrorist attacks of September 11, 2001. Under EITF 01-10, federal assistance provided to air carriers in the form of direct compensation from the U.S. government under the Act should be recognized when the related losses are incurred and compensation under the Act is probable. We recognized $3 million of compensation under the Act in the third quarter of 2002. To date, we have classified all amounts recognized under this program ($119 million in the nine months of 2002, of which $101 million was received as of February 28, 2002) as a reduction of operating expenses under the caption "Airline stabilization compensation." While we believe we have complied with all aspects of the Act, compensation recognized is subject to audit and interpretation by the Department of Transportation ("DOT"). We have received a request from the DOT for additional information in support of our claims under the Act. We cannot be assured of the ultimate outcome of such interpretations, but it is reasonably possible that a material reduction to the amount of compensation recognized by us under the Act could occur.

Although increased security requirements for air cargo carriers have been put in place and further measures may be forthcoming, as of yet we have no estimate of what impact any such measures may have on our results of operations or financial position. Furthermore, we are not certain how the events of September 11, or any subsequent terrorist activities, will ultimately impact the U.S. and global economies in general, and the air transportation industry in particular, and what effects these events will have on our costs or on the demand for our services.

Outlook

While we believe there is evidence that a modest economic recovery is underway, a significant portion of our U.S. domestic express business comes from the manufacturing and wholesale sectors, especially in the high technology area. Recovery in these sectors is still lagging the rest of the economy on a year-over-year basis. Until these key sectors experience sustained growth, volumes at FedEx Express are expected to remain soft.

Our fourth quarter volume outlook for FedEx Express is for U.S. domestic average daily package volume to be approximately 2% below last year's fourth quarter and for IP shipments to be down about 1%. In addition, our dynamic fuel surcharge at FedEx Express effectively has a six-week lag before the surcharge is adjusted for increased fuel prices. Therefore, our operating income may be negatively affected should the spot price of jet fuel increase significantly in the fourth quarter. At FedEx Ground, fourth quarter volume is expected to grow about 16% year-over-year.

We believe our diverse portfolio of services is the key factor to our long-term growth. The expansion of our Home Delivery network and continued development and cross selling of the diverse FedEx portfolio of services, particularly to small- and medium-sized businesses, is central to our strategy. Our website, fedex.com, is heavily utilized and has helped us reduce costs and improve customer satisfaction. We believe that our substantially fixed cost express network infrastructure will allow us to realize incremental profits when the economy recovers.

Maintenance costs during the fourth quarter of 2002 are expected to be higher due to scheduled maintenance activities. Also, we accrued increased variable compensation in the third quarter of 2002 and expect to continue to do so in the fourth quarter. Our 2002 incentive compensation costs will be sharply reduced for most employees (including senior management). However, fourth quarter incentive compensation provisions will be higher year-over-year since the prior year's fourth quarter included reversals of incentive compensation that had been previously accrued.

We expect pension and health care costs to continue to increase over the near term. Our net pension cost for 2002 will increase by approximately $90 million due to lower interest rates and a reduction in the value of plan assets. We expect next year's pension cost to increase by $90-100 million based on a continued decline in interest rates and a decrease in the expected return on pension plan assets. While employee retirement costs continue to rise, our retirement programs are well funded, with assets more than sufficient to meet our current obligations.

NEW ACCOUNTING PRONOUNCEMENTS

In June 2001, the FASB issued Statement of Financial Accounting Standard ("SFAS") No. 143, "Accounting for Asset Retirement Obligations." Also, in October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." Both of these new statements will be adopted for FedEx beginning in 2003. We do not expect the application of these new accounting standards to have a material effect on our financial statements.

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REPORTABLE SEGMENTS

The formation of FedEx Services, effective at the beginning of 2001, represented the implementation of a business strategy wherein the sales, marketing and information technology functions of our FedEx Express and FedEx Ground reportable segments were combined to form a shared services operation that supports the package businesses of both of these segments. FedEx Services provides our customers with a single point of contact for all express and ground services. Prior to the formation of FedEx Services, each business had its own self-contained sales, marketing and information technology functions.

The costs for these activities are now allocated based on metrics such as relative size of operations and estimated services provided. These allocations materially approximate the cost of providing these functions. The line item "Intercompany charges" on the accompanying financial summaries of our reportable segments includes the allocations from FedEx Services to FedEx Express and FedEx Ground, and certain other costs such as corporate management fees.

FEDEX EXPRESS

The following table compares revenues, operating expenses and operating income (dollars in millions) and selected statistics (in thousands, except yield amounts) for the three- and nine-month periods ended February 28:

	Three Months Ended 2002	Three Months Ended 2001	Percent Change	Nine Months Ended 2002	Nine Months Ended 2001	Percent Change
Revenues:						
Package:						
U.S. overnight box[1]	$1,299	$1,425	- 9	$3,970	$4,388	-10
U.S. overnight envelope[2]	424	451	- 6	1,309	1,379	- 5
U.S. deferred	618	639	- 3	1,775	1,891	- 6
Total domestic package revenue	2,341	2,515	- 7	7,054	7,658	- 8
International Priority (IP)	899	945	- 5	2,807	2,952	- 5
Total package revenue	3,240	3,460	- 6	9,861	10,610	- 7
Freight:						
U.S.	357	157	+127	892	496	+80
International	90	103	-13	286	321	-11
Total freight revenue	447	260	+72	1,178	817	+44
Other	89	65	+37	289	255	+13
Total revenues	$3,776	$3,785	-	$11,328	$11,682	- 3
Operating Expenses:						
Salaries and employee benefits	$1,611	$1,574	+ 2	$4,787	$4,752	+ 1
Purchased transportation	136	144	- 6	422	441	- 4
Rentals and landing fees	382	356	+ 7	1,151	1,053	+ 9
Depreciation and amortization	204	199	+ 3	602	596	+ 1
Fuel	226	275	-18	748	817	- 8
Maintenance and repairs	242	216	+12	718	722	- 1
Airline stabilization compensation	(3)	-	n/a	(119)	-	n/a
Intercompany charges	333	321	+ 4	990	993	-
Other	500	540	- 7	1,454	1,619	-10
Total operating expenses	3,631	3,625	-	10,753	10,993	- 2
Operating income	$ 145	$ 160	- 9	$ 575	$ 689	-17
Package:						
Average daily packages:						
U.S. overnight box	1,193	1,288	- 7	1,167	1,278	- 9
U.S. overnight envelope	698	749	- 7	698	755	- 8
U.S. deferred	958	962	-	871	920	- 5
Total domestic packages	2,849	2,999	- 5	2,736	2,953	- 7
IP	332	340	- 2	335	345	- 3
Total packages	3,181	3,339	- 5	3,071	3,298	- 7
Revenue per package (yield):						
U.S. overnight box	$17.56	$17.84	- 2	$17.91	$18.08	- 1
U.S. overnight envelope	9.78	9.70	+ 1	9.86	9.62	+ 2
U.S. deferred	10.41	10.71	- 3	10.72	10.81	- 1
Domestic composite	13.25	13.52	- 2	13.57	13.65	- 1
IP	43.75	44.89	- 3	44.14	44.99	- 2
Composite	16.43	16.71	- 2	16.90	16.93	-
Freight:						
Average daily pounds:						
U.S.	8,985	4,204	+114	7,254	4,441	+ 63
International	1,989	2,164	- 8	2,063	2,238	- 8
Total freight	10,974	6,368	+72	9,317	6,679	+ 39
Revenue per pound (yield):						
U.S.	$ .64	$ .60	+ 7	$ .65	$ .59	+ 10
International	.73	.77	- 5	.73	.75	- 3
Composite	.66	.66	-	.67	.64	+ 5

1 The U.S. Overnight Box category includes packages exceeding 8 ounces in weight.
2 The U.S. Overnight Envelope category includes envelopes weighing 8 ounces or less.

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FedEx Express Revenues

Revenues and volumes at FedEx Express continue to be below levels experienced prior to the economic slowdown and the terrorist attacks on September 11, 2001. All domestic FedEx Express aircraft were mandatorily grounded on September 11 and 12, and flight operations resumed on the evening of September 13, 2001. We experienced significant costs and lost revenues related to shutting down, and then restarting, our airline operations. During the period our aircraft were grounded, both domestic and IP shipments were impacted.

Total package revenues decreased at FedEx Express in both the third quarter and nine months of 2002. In the third quarter of 2002, domestic package revenue decreased 7% (on 5% lower average daily domestic packages and a 2% lower yield). Domestic package revenue was 8% lower for the nine months of 2002 (on 7% lower average daily domestic packages and a 1% lower yield). IP package revenue decreased 5% year-over-year in both the third quarter and nine months of 2002. These declines were mostly experienced in U.S. outbound shipments, which decreased 11% in the third quarter and 10% in the nine months of 2002.

Despite a difficult economic environment, pricing has remained stable. However, package yields are lower in both the third quarter and nine months of 2002 in virtually all product categories due to the decline in fuel surcharge revenue and a decrease in average weight per package. In the second quarter of 2002, we implemented a new index for determining our fuel surcharge. Using this new index, the fuel surcharge was 2% in December, 1% in January and 0% in February. In contrast, the third quarter of 2001 included a 4% fuel surcharge for the entire period. Excluding the effects of the fuel surcharge, yield per pound increased in the third quarter of 2002.

Total freight revenue for both the third quarter and nine months of 2002 increased significantly due to improved domestic freight volume and yield, reflecting the impact of the U.S. Postal Service agreement. On December 13, 2001, we signed an addendum to our transportation agreement with the U.S. Postal Service, effective for a 10-month period beginning January 1, 2002, which allows us to carry incremental pounds of mail at higher committed volumes than required under the original agreement. These incremental volumes are at a more favorable rate to the U.S. Postal Service.

FedEx Express Operating Income

Year-over-year, operating income at FedEx Express decreased 9% for the third quarter and 17% through the nine months of 2002. Negative revenue growth on a largely fixed cost structure more than offset continued cost management actions.

Salaries, wages and benefits increased for the quarter and year-to-date periods as reductions in hours were not sufficient to offset base salary increases and higher pension and medical costs. Compared to the prior year periods, incentive compensation provisions were down significantly for the nine months of 2002 but were flat in the third quarter.

Rentals and landing fees were higher in the third quarter and nine months of 2002 primarily due to an increase in aircraft usage as a result of incremental U.S. domestic freight volume. Also, maintenance expenses were 12% higher in the third quarter of 2002 (while relatively flat in the nine month period) due to scheduled maintenance activities.

Total fuel expenses were lower in the third quarter and nine months of 2002 as a result of lower fuel prices. While fuel usage was higher due to incremental freight pounds transported under the U.S. Postal Service agreement, average price per gallon of aircraft fuel decreased 27% in the third quarter and 14% for the nine months of 2002. Because of the lag that exists before fuel surcharges are adjusted for changes in fuel prices, we may be exposed to net incremental fuel costs should the spot price of jet fuel increase significantly in the fourth quarter.

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Contractual reimbursements received from the U.S. Postal Service have substantially offset network expansion costs incurred during the third quarter and nine months of 2002, principally in increased salaries. U.S. Postal Service reimbursements are reflected as a credit to other operating expenses, which is the principal reason other operating expenses were comparatively lower in the third quarter and nine months of 2002. However, this reimbursement had no effect on operating income as it represented the recovery of incremental costs incurred.

In the second quarter of 2002, FedEx Express recognized $16.5 million of operating income from the resolution of a state sales tax matter, which is reflected as a reduction of other operating expenses for the nine months of 2002.

FEDEX GROUND

The following table compares revenues, operating expenses and operating income (dollars in millions) and selected package statistics (in thousands, except yield amounts) for the three- and nine-month periods ended February 28:

	Three Months Ended		Percent	Nine Months Ended		Percent
	2002	2001	Change	2002	2001	Change
Revenues	$668	$529	+26	$1,968	$1,653	+19
Operating Expenses:						
Salaries and employee benefits	134	112	+20	392	337	+16
Purchased transportation	258	213	+21	758	657	+15
Rentals	18	17	+ 6	55	49	+12
Depreciation and amortization	34	29	+17	97	80	+21
Fuel	1	3	-67	3	5	-40
Maintenance and repairs	19	16	+19	54	47	+15
Intercompany charges	60	52	+15	177	161	+10
Other	75	69	+ 9	223	198	+13
Total operating expenses	599	511	+17	1,759	1,534	+15
Operating income	$ 69	$ 18	+283	$ 209	$ 119	+76
Average daily packages	1,749	1,441	+21	1,714	1,512	+13
Revenue per package (yield)	$ 6.16	$ 5.82	+ 6	$ 6.08	$ 5.72	+ 6

FedEx Ground Revenues

Core business growth and increasing popularity of the FedEx Home Delivery service helped FedEx Ground realize double-digit revenue growth in both the third quarter and nine months of 2002 as both volumes and yields increased. Our sales and marketing activities have been effective in attracting new small- and medium-sized customers that generate higher yielding package revenues. More than one-third of third quarter volume growth is attributable to our FedEx Home Delivery service. Our FedEx Home Delivery service has added facilities to reach almost 90% coverage of the U.S. population. Expansion efforts are on track to achieve nearly 100% U.S. coverage by September 2002.

The increases in average daily packages represent positive volume growth in all of FedEx Ground's principal markets. Yields increased 6% during the third quarter over the prior year period due to a January 2002 rate increase and higher revenue from ancillary charges.

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FedEx Ground Operating Income

FedEx Ground's operating income significantly increased in the third quarter and nine months of 2002 primarily due to package volume growth, higher yields and effective cost management. Productivity enhancements in both employee and contractor labor were also major contributors to the improved results this year. While Home Delivery is still operating at a loss, during the third quarter of 2002 we realized a $6 million improvement from the third quarter 2001 loss. We expect the Home Delivery service to become profitable sometime in 2004.

FEDEX FREIGHT

The following table shows revenues, operating expenses and operating income (in millions) and selected statistics for the three- and nine-month periods ended February 28:

	Three Months Ended (1)		Nine Months Ended (2)
	2002	2001	2002
Revenues	$440	$337	$1,438
Operating Expenses:			
Salaries and employee benefits	275	198	862
Purchased transportation	12	9	42
Rentals	16	11	48
Depreciation and amortization	23	18	65
Fuel	14	18	53
Maintenance and repairs	20	15	65
Intercompany charges	2	1	6
Other	58	49	180
Total operating expenses	420	319	1,321
Operating income	$ 20	$ 18	$ 117
Shipments per day	52,585	54,176	55,458
Weight per shipment (lbs)	1,108	1,132	1,114
Revenue per hundredweight	$12.39	$11.80	$12.39

1 Third quarter results for 2001 include only two months of operations for American Freightways.
2 Prior year results for the nine months are not presented because FedEx Freight was not formed until the third quarter of 2001 and comparisons are not meaningful.

We announced in February 2002 that American Freightways and Viking Freight are being rebranded over the next three years under the name "FedEx Freight." We believe this will allow us to take advantage of the FedEx brand and create additional synergies, which will give us a competitive advantage in the less-than-truckload segment. The costs for this rebranding are expected to be approximately $40 to $45 million over the next 36 months.

Revenues were impacted by a decrease in our fuel surcharge and lower than expected volumes due to the economic slowdown. In the third quarter of 2002 (based on the portion of the quarter which includes both American Freightways and Viking Freight in the prior year), average shipments per day were down 3% and weight per shipment was down 2%, while revenue per hundredweight was up 5%.

Yield management, enhanced productivity and cost control measures continue to be major focus areas for FedEx Freight in order to minimize the effects of a soft economy and a highly competitive pricing environment.

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OTHER OPERATIONS

Other operations include FedEx Custom Critical, a critical-shipment carrier; FedEx Trade Networks, whose subsidiaries form a global trade services company; FedEx Services, a provider of supply chain management services and sales, marketing and IT support for our global brands; and certain unallocated corporate items. The operating results of Viking Freight prior to December 1, 2000 are also included in this category.

Revenues from other operations were $135 million (down 28%) in the third quarter and $457 million (down 46%) for the nine months of 2002. A majority of the decreased revenues from other operations is because current year results for this category no longer reflect Viking Freight's revenues. Also, the economic downturn has contributed to lower revenues at FedEx Custom Critical (which are down 21% in the third quarter and 29% in the nine months of 2002). The demand for services provided by this operating subsidiary (critical shipments) is highly elastic and tied to key economic indicators, principally in the automotive industry, where volumes have continued to decline since the beginning of calendar 2001.

On March 1, 2002, a subsidiary of FedEx Trade Networks acquired certain assets of Fritz Companies, Inc. that provide customs clearance services exclusively for FedEx Express in four U.S. locations. The cost of the acquisition was $36.5 million, which was paid entirely with cash. A substantial portion of the purchase price is expected to be allocated to goodwill.

FINANCIAL CONDITION

Liquidity

Cash and cash equivalents totaled $220 million at February 28, 2002 compared to $121 million at May 31, 2001. Cash flows from operating activities for the nine months of 2002 totaled $1,440 million compared to $1,026 million for the prior year period, reflecting aggressive working capital management, principally in accounts receivable collections. Cash flow from operations during the nine months of 2002 exceeded our cash used in investing activities of $1,267 million, creating free cash flow of $173 million for the nine-month period.

During the third quarter of 2002 we purchased 1.8 million shares (2.2 million in the nine months of 2002) under our 5.0 million share repurchase program to provide shares for stock incentive programs.

We currently have $1.0 billion in revolving credit facilities that are generally used to finance temporary operating cash requirements and to provide support for the issuance of commercial paper. As of February 28, 2002, we had no commercial paper outstanding and the entire credit facilities were available. For more information regarding these credit facilities, see Note 4 of the accompanying financial statements.

We believe that cash flow from operations, our commercial paper program and the credit facilities mentioned above will adequately provide for our working capital needs for the foreseeable future.

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The following cash-based measure is presented as an additional means of evaluating our financial condition because we incur significant noncash charges, including depreciation and amortization, related to the material capital assets utilized in our business. This measure should not be considered as a superior alternative to net income, operating income, cash from operations, or any other operating or liquidity performance measure as defined by accounting principles generally accepted in the United States. The following table compares EBITDA (earnings before cumulative effect of goodwill accounting change, interest, taxes, depreciation and amortization) for the three- and nine-month periods ended February 28 (in millions):

	Three Months Ended		Percent	Nine Months Ended		Percent
	2002	2001	Change	2002	2001	Change
EBITDA	$ 571	$ 519	+10	$1,917	$1,788	+ 7

Capital Resources

Our operations are capital intensive, characterized by significant investments in aircraft, vehicles, computer and telecommunications equipment, package-handling facilities and sort equipment. The amount and timing of capital additions depend on various factors, including pre-existing contractual commitments, anticipated volume growth, domestic and international economic conditions, new or enhanced services, geographical expansion of services, competition, availability of satisfactory financing and actions of regulatory authorities.

The following table compares capital expenditures for the three- and nine-months ended February 28 (in millions):

	Three Months Ended		Nine Months Ended	
	2002	2001	2002	2001
Aircraft and related equipment	$217	$216	$ 619	$ 502
Facilities and sort equipment	55	81	236	253
Information and technology equipment	46	84	205	265
Other equipment	47	72	241	252
Total capital expenditures	$365	$453	$1,301	$1,272

The third quarter 2002 decrease in capital spending reflects management's cost reduction actions. The slight increase in capital spending during the nine months of 2002 is due to the addition of American Freightways and to scheduled deliveries of aircraft that were planned and committed to well before the economic slowdown. We will continue to manage capital spending based on current and anticipated volume levels and defer or limit capital additions where economically feasible. We expect capital spending for all of 2002 to be less than 2001 capital expenditures, which aggregated $1.9 billion. However, we plan to continue to make strategic capital investments, particularly in information technology and ground network expansion, in support of our long-term growth goals.

We have historically financed a significant amount of our aircraft needs (and certain other equipment needs) using long-term operating leases (a type of "off-balance sheet financing"), which is a common practice in the airline industry. The determination to lease versus buy equipment is a financing decision, and both forms of financing are considered when evaluating the resources committed for capital. The amount that we would have expended to purchase these assets had we not chosen to obtain their use through operating leases is considered equivalent capital and is included in our internal capital budget. We had no equivalent capital expenditures during the nine months of 2002 or 2001.

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Certain of our aircraft operating leases were arranged using special purpose entities under terms that are considered customary in the airline industry. In accordance with accounting principles generally accepted in the United States, our operating leases are not recorded in our balance sheet; however, the minimum lease payments related to these leases are disclosed in the footnotes to our annual report and in the table below. The FASB is currently evaluating the criteria for consolidation of special purpose entities which could affect the accounting for certain of our operating leases. However, credit rating agencies routinely use the information concerning our operating leases to calculate our debt capacity, and our debt covenants would not be adversely affected by the capitalization of some or all of our operating leases. Therefore, we do not expect a change in the views by outside agencies of our financial condition if accounting rules should be revised and we are required to capitalize some of our operating leases.

We believe the capital resources available to us provide flexibility to access the most efficient markets for financing capital acquisitions, including aircraft, and are adequate for our future capital needs. For information on our purchase commitments, see Note 7 of the accompanying financial statements as well as the table below.

Contractual Obligations

The following table sets forth a summary of our contractual cash obligations as of February 28, 2002. Certain of these contractual obligations are reflected in our balance sheet, while others are disclosed as future obligations under accounting principles generally accepted in the United States.

CONTRACTUAL CASH OBLIGATIONS	Payments Due by Fiscal Year (in millions)						
	FY02 (remainder)	**FY03**	**FY04**	**FY05**	**FY06**	**There-after**	**Total**
Obligations reflected in balance sheet:							
Long-term debt	$ 286	$ 31	$ 250	$ 5	$ 275	$ 1,043	$ 1,890
Capital lease obligations	4	15	15	15	15	275	339
Other cash obligations not included in balance sheet:							
Operating leases	322	1,261	1,158	1,092	990	9,371	14,194
Unconditional purchase obligations	410	754	433	547	487	347	2,978
Total	$ 1,022	$ 2,061	$ 1,856	$ 1,659	$ 1,767	$11,036	$19,401

In addition, we have other commercial commitments incurred in the normal course of business to support our operations, including surety bonds and standby letters of credit. These instruments are generally required under certain self-insurance programs. While the notional amounts of these instruments are material, there are no additional contingent liabilities associated with the instruments as the liabilities for these self-insurance programs are already reflected in our balance sheet as accrued expenses and other long-term liabilities. We also have guarantees, amounting to $137 million at February 28, 2002, under certain operating leases for the residual values of aircraft, vehicles and facilities at the end of the operating lease periods. These guarantees are not reflected in our balance sheet since they are not currently considered probable; therefore, they do not represent liabilities under accounting principles generally accepted in the United States.

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Euro Currency Conversion

Since the beginning of the European Union's transition to the euro on January 1, 1999, our subsidiaries were prepared to quote rates to customers, generate billings and accept payments, in both euro and legacy currencies. The legacy currencies remained legal tender through January 1, 2002. We did not experience a material impact on our consolidated financial position, results of operations or cash flows from the introduction of the euro and any price transparency brought about by its introduction and the phasing out of the legacy currencies. Costs associated with the euro project were expensed as incurred and were funded entirely by internal cash flows.

* * *

Certain statements contained in this Report are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, such as statements relating to management's views with respect to future events and financial performance. Such forward-looking statements are subject to risks, uncertainties and other factors, which could cause actual results to differ materially from historical experience or from future results expressed or implied by such forward-looking statements. Potential risks and uncertainties include, but are not limited to, any impacts on our business resulting from the terrorist attacks that occurred on September 11, 2001, as well as general economic and competitive conditions in the markets where we operate, the timing and amounts of compensation we may be entitled to receive under the Air Transportation Safety and System Stabilization Act, increases in fuel costs and the ability to mitigate the effects of such increases through fuel surcharges and hedging activities, matching capacity to volume levels and other uncertainties detailed from time to time in our Securities and Exchange Commission filings and press releases.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

As of February 28, 2002, there had been no material changes in our market risk sensitive instruments and positions since the disclosure in our Annual Report on Form 10-K for the year ended May 31, 2001. While we are a global provider of transportation services, the substantial majority of our transactions are denominated in U.S. dollars. The distribution of our foreign currency denominated transactions is such that currency declines in some areas of the world are often offset by foreign currency gains of equal magnitude in other areas of the world. The principal foreign currency exchange rate risks to which we are exposed are in the euro, British pound sterling, Canadian dollar and Japanese yen. Foreign currency fluctuations during the third quarter of 2002 did not have a material effect on our results of operations for the period.

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PART II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits.

Exhibit Number	Description of Exhibit
10.1	Amendment No. 2 dated January 21, 2002, amending the Modification Services Agreement dated September 16, 1996 between McDonnell Douglas Corporation and FedEx Express. Confidential treatment has been requested for confidential commercial and financial information, pursuant to Rule 24b-2 under the Securities Exchange Act of 1934, as amended.
12.1	Computation of Ratio of Earnings to Fixed Charges.
15.1	Letter re: Unaudited Interim Financial Statements.

(b) Reports on Form 8-K.

During the quarter ended February 28, 2002, FedEx Corporation filed one Current Report on Form 8-K. The December 13, 2001 report disclosed the terms of the addendum to the January 10, 2001 contract between FedEx Express and the United States Postal Service.

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EXHIBIT INDEX

Exhibit Number	Description of Exhibit
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12.1	Computation of Ratio of Earnings to Fixed Charges.
15.1	Letter re: Unaudited Interim Financial Statements.

E-1

EXHIBIT 12.1

FEDEX CORPORATION
COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES
(UNAUDITED)
(IN MILLIONS, EXCEPT RATIOS)

	Nine Months Ended February 28,		Year Ended May 31,				
	2002	2001	2001	2000	1999	1998	1997
Earnings:							
Income before income taxes	$ 789	$ 748	$ 928	$1,138	$1,061	$ 900	$ 426
Add back:							
Interest expense, net of capitalized interest	113	112	155	121	111	136	110
Amortization of debt issuance costs	-	1	2	1	9	1	1
Portion of rent expense representative of interest factor	535	492	667	625	571	508	440
Earnings as adjusted	$1,437	$1,353	$1,752	$1,885	$1,752	$1,545	$ 977
Fixed Charges:							
Interest expense, net of capitalized interest	$ 113	$ 112	$ 155	$ 121	$ 111	$ 136	$ 110
Capitalized interest	23	19	27	35	39	33	46
Amortization of debt issuance costs	-	1	2	1	9	1	1
Portion of rent expense representative of interest factor	535	492	667	625	571	508	440
	$ 671	$ 624	$ 851	$ 782	$ 730	$ 678	$ 597
Ratio of Earnings to Fixed Charges	2.1	2.2	2.1	2.4	2.4	2.3	1.6

EXHIBIT 15.1

March 19, 2002

FedEx Corporation
942 South Shady Grove Road
Memphis, Tennessee 38120

We are aware that FedEx Corporation will be incorporating by reference in its previously filed Registration Statements No. 2-95720, 33-20138, 33-38041, 33-55055, 333-03443, 333-45037, 333-71065, 333-74701, 333-34934 and 333-55266 its Report on Form 10-Q for the quarter ended February 28, 2002, which includes our report dated March 19, 2002 covering the unaudited interim financial information contained therein. Pursuant to Regulation C of the Securities Act of 1933, that report is not considered a part of these registration statements prepared or certified by our Firm or a report prepared or certified by our firm within the meaning of Sections 7 and 11 of the Act. It should be noted that we have not performed any procedures subsequent to March 19, 2002.

Very truly yours,

/s/ Arthur Andersen LLP

Arthur Andersen LLP

United Parcel Service Quarterly Report

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

Quarterly Report Under Section 13 or 15 (d)
of the Securities Exchange Act of 1934

For the Quarter Ended March 31, 2002

Commission file number 0-4714

United Parcel Service, Inc.
(Exact name of registrant specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**58-2480149** (I.R.S. Employer Identification No.)
55 Glenlake Parkway, NE **Atlanta, Georgia** (Address of principal executive office)	**30328** (Zip Code)

Registrant's telephone number, including area code **(404) 828-6000**

Not Applicable
Former name, address and fiscal year, if changed since last report

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities and Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.

YES ☒ NO ☐

Class A and B Common Stock, par value $.01 per share
(Title of Class)

726,704,363 Class A shares, 390,313,407 Class B shares
Outstanding as of May 10, 2002

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

UNITED PARCEL SERVICE, INC., AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
March 31, 2002 (unaudited) and December 31, 2001
(In millions except per share amounts)

	March 31, 2002	December 31, 2001
Assets		
Current Assets:		
Cash & cash equivalents	$ 1,142	$ 858
Marketable securities & short-term investments	885	758
Accounts receivable, net	3,896	4,078
Finance receivables, net	640	708
Prepaid health and welfare benefit costs	261	446
Other current assets	614	749
Total Current Assets	7,438	7,597
Property, Plant & Equipment—at cost, net of accumulated depreciation & amortization of $10,885 and $10,620 in 2002 and 2001	13,654	13,438
Prepaid Pension Costs	1,842	1,845
Other Assets	1,795	1,756
	$ 24,729	$ 24,636
Liabilities & Shareowners' Equity		
Current Liabilities:		
Current maturities of long-term debt and commercial paper	$ 276	$ 518
Accounts payable	1,756	1,899
Accrued wages & withholdings	1,474	1,169
Income taxes payable	300	92
Other current liabilities	920	1,108
Total Current Liabilities	4,726	4,786
Long-Term Debt	4,717	4,648
Accumulated Postretirement Benefit Obligation, Net	1,172	1,130
Deferred Taxes, Credits & Other Liabilities	3,826	3,824
Shareowners' Equity:		
Preferred stock, no par value, authorized 200 shares, none issued	—	—
Class A common stock, par value $.01 per share, authorized 4,600 shares, issued 732 and 772 in 2002 and 2001	7	8
Class B common stock, par value $.01 per share, authorized 5,600 shares, issued 384 and 349 in 2002 and 2001	4	3
Additional paid-in capital	100	414
Retained earnings	10,512	10,162
Accumulated other comprehensive loss	(335)	(339)
Deferred compensation arrangements	47	47
	10,335	10,295
Less: Treasury stock (1 shares in 2002 and 2001)	(47)	(47)
	10,288	10,248

	$ 24,729	$ 24,636

See notes to unaudited consolidated financial statements.

UNITED PARCEL SERVICE, INC., AND SUBSIDIARIES
STATEMENTS OF CONSOLIDATED INCOME
Three Months Ended March 31, 2002 and 2001
(In millions except per share amounts)
(unaudited)

	Three Months Ended March 31,	
	2002	2001
Revenue	$ 7,579	$ 7,435
Operating Expenses:		
Compensation and benefits	4,449	4,251
Other	2,183	2,240
	6,632	6,491
Operating Profit	947	944
Other Income and (Expense):		
Investment income	12	53
Interest expense	(43)	(44)
	(31)	9
Income Before Income Taxes And Cumulative Effect of Change In Accounting Principle	916	953
Income Taxes	353	371
Income Before Cumulative Effect of Change In Accounting Principle	563	582
Cumulative Effect of Change In The Method Of Accounting For Derivatives, Net of Taxes	—	(26)
Net Income	$ 563	$ 556
Basic Earnings Per Share Before Cumulative Effect Of Change In Accounting Principle	$ 0.50	$ 0.52
Basic Earnings Per Share	$ 0.50	$ 0.49
Diluted Earnings Per Share Before Cumulative Effect Of Change In Accounting Principle	$ 0.50	$ 0.51
Diluted Earnings Per Share	$ 0.50	$ 0.48

See notes to unaudited consolidated financial statements.

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UNITED PARCEL SERVICE, INC., AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF SHAREOWNERS' EQUITY
Three Months Ended March 31, 2002
(In millions except per share amounts)
(unaudited)

	Class A Common Stock		Class B Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Deferred Compensation Arrangements	Treasury Stock		Total Shareowners' Equity
	Shares	Amount	Shares	Amount					Shares	Amount	
Balance, January 1, 2002	772	$ 8	349	$ 3	$ 414	$ 10,162	$ (339)	$ 47	(1)	$ (47)	$ 10,248
Comprehensive income:											
Net income	—	—	—	—	—	563	—	—	—	—	563
Foreign currency adjustments	—	—	—	—	—	—	(26)	—	—	—	(26)
Unrealized gain (loss) on marketable securities	—	—	—	—	—	—	—	—	—	—	—
Unrealized gain (loss) on cash flow hedges	—	—	—	—	—	—	30	—	—	—	30
Comprehensive income											567
Dividends ($0.19 per share)	—	—	—	—	—	(213)	—	—	—	—	(213)
Stock award plans	—	—	—	—	23	—	—	—	—	—	23
Common stock purchases	(6)	—	—	—	(363)	—	—	—	—	—	(363)
Common stock issuances	1	—	—	—	26	—	—	—	—	—	26
Conversion of Class A Common stock to Class B Common stock	(35)	(1)	35	1	—	—	—	—	—	—	—
Balance, March 31, 2002	732	$ 7	384	$ 4	$ 100	$ 10,512	$ (335)	$ 47	$ (1)	$ (47)	$ 10,288

See notes to unaudited consolidated financial statements.

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UNITED PARCEL SERVICE, INC., AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
Three Months Ended March 31, 2002 and 2001
(In millions)
(unaudited)

	Three Months Ended March 31,	
	2002	2001

Cash flows from operating activities:		
Net income	$ 563	$ 556
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	351	318
Postretirement benefits	42	33
Deferred taxes, credits and other	(24)	38
Stock award plans	140	143
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable	182	447
Finance receivables	(31)	(21)
Prepaid health and welfare benefit costs	185	207
Other current assets	212	(89)
Prepaid pension costs	3	(7)
Accounts payable	(143)	(117)
Accrued wages and withholdings	187	137
Dividends payable	(212)	(192)
Income taxes payable	208	197
Other current liabilities	24	56
Net cash from operating activities	1,687	1,706
Cash flows from investing activities:		
Capital expenditures	(624)	(515)
Disposals of property, plant and equipment	72	11
Purchases of marketable securities and short-term investments	(484)	(1,312)
Sales and maturities of marketable securities and short-term investments	357	1,048
Construction funds in escrow	—	21
Payments for acquisitions, net of cash acquired	—	(72)
Other asset receipts	10	—
Net cash used in investing activities	(669)	(819)
Cash flows from financing activities:		
Proceeds from borrowings	136	1,170
Repayments of borrowings	(312)	(716)
Purchases of common stock	(363)	(622)
Issuances of common stock pursuant to stock awards and employee stock purchase plans	27	18
Dividends	(213)	(215)
Net cash used in financing activities	(725)	(365)
Effect of exchange rate changes on cash	(9)	(83)
Net increase in cash and cash equivalents	284	439
Cash and cash equivalents:		
Beginning of period	858	879
End of period	$ 1,142	$ 1,318
Cash paid during the period for:		
Interest (net of amount capitalized)	$ 55	$ 22
Income taxes	$ 145	$ 132

See notes to unaudited consolidated financial statements.

UNITED PARCEL SERVICE, INC., AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. For interim consolidated financial statement purposes, we compute our tax provision on the basis of our estimated annual effective income tax rate, and provide for accruals under our various employee benefit plans for each three month period based on one quarter of the estimated annual expense.

2. In our opinion, the accompanying interim, unaudited, consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly our financial position as of March 31, 2002, the results of operations for the three months ended March 31, 2002 and 2001, and cash flows for the three months ended March 31, 2002 and 2001. The results reported in these consolidated financial statements should not be regarded as necessarily indicative of results that may be expected for the entire year.

Certain prior period amounts have been reclassified to conform to the current period presentation.

3. The following table sets forth the computation of basic and diluted earnings per share (in millions except per share amounts):

	Three Months Ended March 31, 2002	2001
Numerator:		
Numerator for basic and diluted earnings per share—		
Net income	$ 563	$ 556
Denominator:		
Weighted-average shares—	1,118	1,129
Deferred compensation arrangements	1	1
Denominator for basic earnings per share	1,119	1,130
Effect of dilutive securities:		
Contingent shares—		
Management incentive awards	3	4
Stock option plans	12	15
Denominator for diluted earnings per share	1,134	1,149
Basic Earnings Per Share	$ 0.50	$ 0.49
Diluted Earnings Per Share	$ 0.50	$ 0.48

4. On August 9, 1999, the United States Tax Court held that we were liable for tax on income of Overseas Partners Ltd. ("OPL"), a Bermuda company that had reinsured excess value ("EV") package insurance purchased by our

customers beginning in 1984, and that we were liable for additional tax for the 1983 and 1984 tax years. The Court held that for the 1984 tax year we were liable for taxes of $31 million on income reported by OPL, penalties and penalty interest of $93 million, and interest for a total after-tax exposure estimated at approximately $246 million.

On June 20, 2001, the United States Court of Appeals for the Eleventh Circuit reversed the Tax Court's decision. On September 13, 2001, the Eleventh Circuit denied the IRS's petition to have the appeal reheard en banc. The IRS did not attempt to appeal the case to the U.S. Supreme Court and, consequently, the case has been remanded to the Tax Court to consider alternative arguments raised by the parties. At this time, we do not know what the outcome of the remanded proceedings in the Tax Court will be.

The IRS has taken similar positions to those advanced in the Tax Court decision for tax years subsequent to 1984. Tax years 1985 through 1990 currently are docketed in the Tax Court, although no trial date has been set pending resolution of the case that covers the 1984 year. Further, the IRS has issued a report asserting similar positions for the 1991 through 1994 tax years, and we expect the IRS to take similar positions for tax years 1995 through 1999. Based on the Tax Court decision, we estimate that our total after-tax exposure for tax years 1984 through 1999 could be as high as $2.353 billion.

In our second quarter 1999 financial statements, we recorded a tax assessment charge of $1.786 billion, which included an amount for related state tax liabilities. The charge included taxes of $915 million and interest of $871 million. This assessment resulted in a tax benefit of $344 million related to the interest component of the assessment. As a result, our net charge to net income for the tax assessment was $1.442 billion, increasing our total after-tax reserve at that time with respect to these matters to $1.672 billion. The tax benefit of deductible interest was included in income taxes in 1999; however, since none of the income on which this tax assessment is based is our income, we did not classify the tax charge as income taxes.

We determine the size of our reserve with respect to these matters in accordance with accounting principles generally accepted in the United States of America. In 1999, we estimated our most likely liability based on the initial Tax Court decision. In making this determination, we concluded that, based on the Tax Court decision, it was more likely that we would be required to pay taxes on income reported by OPL and interest, but that it was not probable that we would be required to pay any penalties and penalty interest. In our prior estimation, if penalties and penalty interest ultimately were determined to be payable, we would have had to record an additional charge of up to $681 million. We currently do not know what impact the Eleventh Circuit decision and the remanded proceedings in the Tax Court ultimately will have on our recorded reserve and above estimations for this matter.

Further, again as a result of the unfavorable Tax Court decision, and in order to stop the potential accrual of additional interest that might ultimately be determined to be due to the IRS, on August 31, 1999, we paid $1.349 billion and, on August 8, 2000, we paid an additional $91 million, to the IRS related to these matters for the 1984 through 1994 tax years. We included the profit of the EV insurance program, using the IRS's methodology for calculating these amounts, for both 1998 and 1999 in filings we made with the IRS in 1999. In February 2000, we paid $339 million to the IRS related to these matters for the 1995 through 1997 tax years. These amounts will remain with the IRS pending further proceedings.

The EV program that was the subject of the Tax Court decision has been changed since September 1999. The revised arrangement should eliminate the issues considered by the Tax Court and the Eleventh Circuit related to OPL.

The IRS has proposed adjustments, unrelated to the OPL matters discussed above, regarding the allowance of deductions and certain losses, the characterization of expenses as capital rather than ordinary, the treatment of certain income, and our entitlement to the investment tax credit and the research tax credit in the 1985 through 1990 tax years. The proposed adjustments would result in $16 million of additional income tax expense. Also, the IRS has issued a report taking a similar position with respect to some of these issues for each of the years from 1991 through 1994. This report proposes adjustments that would result in $155 million in additional income tax expense. For the 1985 through 1994 tax years, unpaid interest on these adjustments through March 31, 2002 could aggregate up to approximately $449 million, after the benefit of related tax deductions. We expect that we will prevail on substantially all of these issues. Specifically, we believe that our practice of expensing the items that the IRS alleges should have been capitalized is consistent with the practices of other industry participants. The IRS may take similar positions with respect to some of these issues for each of the years 1995 through 2001. The IRS's proposed adjustments include penalties and penalty interest. We believe that the possibility that such penalties and penalty interest will be sustained is remote. We believe that the eventual resolution of these issues will not have a material adverse effect on our financial condition, results of operations or liquidity.

We are named as a defendant in twenty-five pending lawsuits that seek to hold us liable for the collection of premiums for EV insurance in connection with package shipments since 1984. Based on a variety of state and federal tort, contract and statutory claims, these cases generally claim that we failed to remit collected EV premiums to an independent insurer; we failed to provide promised EV insurance; we acted as an insurer without complying with state insurance laws and regulations; and the price for EV insurance was excessive.

These actions all were filed after the August 9, 1999 Tax Court decision. As discussed above, on June 20, 2001, the U.S. Court of Appeals for the Eleventh Circuit ruled in our favor and reversed the Tax Court decision.

These twenty-five cases have been consolidated for pre-trial purposes in a multi-district litigation proceeding ("MDL Proceeding") in federal court in New York. Motions to dismiss these cases are pending, as are motions to remand several of these cases to state court.

In addition to the cases in which UPS is named as a defendant, there is also an action, *Smith v. Mail Boxes Etc.,* against Mail Boxes Etc. and its franchisees relating to UPS EV insurance purchased through Mail Boxes Etc. centers. Although the case had been pending in California state court, the complaint was amended in late 2001 to allege a nationwide plaintiff class, and to add a UPS subsidiary, Mail Boxes Etc., Inc. ("New MBE"), and an MBE franchisee as a representative of a purported nationwide defendant class of franchisees, as new defendants. Previously, only the former franchisor, which was not affiliated with UPS, was named a defendant. New MBE has removed the case to federal court, and it also has been consolidated into the MDL Proceeding. The plaintiff is seeking to have the case remanded back to state court.

We believe that the allegations in these cases have no merit and intend to continue to defend them vigorously. The ultimate resolution of these cases cannot presently be determined.

In addition, we are a defendant in various other lawsuits that arose in the normal course of business. We believe that the eventual resolution of these cases will not have a material adverse effect on our financial condition, results of operations or liquidity.

5. We report our operations in three segments: U.S. domestic package operations, international package operations and non-package operations. Package operations represent our core business and are divided into regional operations around the world. Regional operations managers are responsible for both domestic and export operations within their geographic region. International package operations include shipments wholly outside the U.S. as well as shipments with either origin or distribution outside the U.S. Non-package operations, which include the UPS Logistics Group and UPS Freight Services, are distinct from package operations and are thus managed and reported separately.

Segment information for the three months ended March 31 is as follows (in millions):

	Three Months Ended March 31,	
	2002	2001
Revenue:		
U.S. domestic package	$ 5,903	$ 5,976
International package	1,054	1,074
Non-package	622	385
Consolidated	$ 7,579	$ 7,435

Operating profit:		
U.S. domestic package	$ 862	$ 845
International package	30	39
Non-package	55	60
Consolidated	$ 947	$ 944

Two changes were made during the first quarter of 2002, which affect revenue reporting within the non-package segment. Neither of these changes have any effect on current or prior period income. First, effective January 1, 2002, the results of operations of the Transportation Unit of our Logistics Group were moved to our Freight Services Group. Amounts in prior periods have been reclassified for comparison purposes.

Second, our Logistics Group has historically reported revenue from freight under management gross, whereas our Freight Services Group, which was formed with the acquisition of the Fritz Companies in the second quarter of 2001, reports revenue net of freight under management. Beginning with the first quarter of 2002, we are now reporting revenue for both the Logistics Group and Freight Services net of freight under management. Amounts for prior periods have been modified to reflect revenue net of freight under management for comparison purposes. Following is a reconciliation of gross to net revenue for the non-package segment:

	Three Months Ended March 31,	
	2002	**2001**
UPS Logistics Group	$ 278	$ 212
Less freight under management	(42)	(58)
Net revenue	236	154
UPS Freight Services	459	117
Less freight under management	(235)	(17)
Net revenue	224	100
Other	162	131
Non-package revenue	$ 622	$ 385

Non-package operating profit included $28 and $27 million for the three months ended March 31, 2002 and 2001, respectively, of intersegment profit, with a corresponding amount of operating expense, which reduces operating profit, included in the U.S. domestic package segment.

6. The major components of other operating expenses for the three months ended March 31 are as follows (in millions):

Three Months Ended March 31,

	2002	2001
Repairs and maintenance	$ 259	$ 262
Depreciation and amortization	351	318
Purchased transportation	358	428
Fuel	196	247
Other occupancy	139	143
Other expenses	880	842
Consolidated	$ 2,183	$ 2,240

7. Other assets as of March 31, 2002 and December 31, 2001 consist of the following (in millions):

	March 31, 2002	December 31, 2001
Goodwill	$ 1,102	$ 1,112
Intangible assets, net of accumulated amortization	100	107
Non-current finance receivables, net of allowance for credit losses	341	242
Other non-current assets	252	295
Consolidated	$ 1,795	$ 1,756

8. Effective January 1, 2001, we adopted Financial Accounting Standards Board (FASB) Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" (FAS 133), as amended by Statements No. 137 and No. 138. FAS 133, as amended, requires us to record all financial derivative instruments on our balance sheet at fair value. Derivatives not designated as hedges must be adjusted to fair value through income. If a derivative is designated as a hedge, depending the nature of the hedge, changes in its fair value that are considered to be effective, as defined, either offset the change in fair value of the hedged assets, liabilities, or firm commitments through income, or are recorded in other comprehensive income (OCI) until the hedged item is recorded in income. Any portion of a change in a derivative's fair value that is considered to be ineffective, or is excluded from the measurement of effectiveness, is recorded immediately in income.

The nature of our business activities necessitates the management of various financial and market risks, including those related to changes in commodity prices, foreign currency exchange rates, interest rates, and equity prices. As discussed more fully in note 13 "Derivative Instruments and Risk Management" to our consolidated financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2001, we use derivative financial instruments to mitigate or eliminate certain of those risks. The January 1, 2001 accounting change described above affected only the pattern and timing of non-cash accounting recognition.

At January 1, 2001, our financial statements were adjusted to record a cumulative effect of adopting FAS 133, as follows:

	Income	OCI
	(in millions, except per share amounts)	
Adjustment to fair value of derivatives (a)	$ (42)	$ 37
Income tax effects	16	(14)

Total	$ (26)	$ 23
Effect on diluted earnings per share (a)	$ (0.03)	

(a) For income effect, amount shown is net of adjustment to hedged items.

The cumulative effect on income resulted primarily from marking to market the time value of option contracts used in commodity and foreign currency cash flow hedging. The cumulative effect on OCI resulted primarily from marking to market swap contracts used as cash flow hedges of anticipated foreign currency cash flows and anticipated purchases of energy products.

9. In June 2001, the FASB issued Statement No. 141 "Business Combinations" (FAS 141) and Statement No. 142 "Goodwill and Other Intangible Assets" (FAS 142). FAS 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. FAS 141 also specifies the types of acquired intangible assets that are required to be recognized and reported separately from goodwill. FAS 142 eliminates the requirement to amortize goodwill and indefinite-lived intangible assets, addresses the amortization of intangible assets with a defined life, and addresses the impairment testing and recognition for goodwill and intangible assets.

To comply with the transition provisions of FAS 142, we have determined our reporting units and assigned goodwill and other net assets to those reporting units. Goodwill attributable to each of our reporting units is being tested for impairment by comparing the fair value of each reporting unit with its carrying value. Fair value is primarily being determined through the use of a discounted cash flow methodology. We have not completed our impairment testing required by the transition provisions of FAS 142, and therefore it is not practical, at this time, to estimate the impact of adoption of this statement.

The following table indicates the allocation of goodwill by reportable segment, as of March 31, 2002 and December 31, 2001 (in millions).

	March 31, 2002	December 31, 2001
Goodwill by Segment:		
U.S. domestic package	$ —	$ —
International package	99	98
Non-package	1,003	1,014
Consolidated	$ 1,102	$ 1,112

Intangible assets consisting of franchise rights, non-compete agreements, licenses, and patents of $87 million are continuing to be amortized under the provisions of FAS 142. The remaining intangible assets, consisting of trade names, of $13 million are considered indefinite-lived intangible assets under FAS 142, and are no longer being amortized.

Goodwill amortization ceased upon the implementation of FAS 142 on January 1, 2002. The following table indicates the impact on net income and earnings per share if the non-amortization provisions of FAS 142 had been applied in the first quarter of 2001.

Three Months Ended March 31,	
2002	2001

Reported net income	$ 563	$ 556
Adjustments: Goodwill amortization	—	13
Income taxes	—	(2)
Adjusted net income	563	567
Cumulative effect of change in accounting principle (FAS 133)	—	26
Adjusted net income before cumulative effect of change in accounting principle	$ 563	$ 593
Basic earnings per share:		
Reported	$ 0.50	$ 0.49
Adjusted	$ 0.50	$ 0.50
Diluted earnings per share:		
Reported	$ 0.50	$ 0.48
Adjusted	$ 0.50	$ 0.49
Basic earnings per share before cumulative effect of change in accounting principle:		
Reported	$ 0.50	$ 0.52
Adjusted	$ 0.50	$ 0.52
Diluted earnings per share before cumulative effect of change in accounting principle:		
Reported	$ 0.50	$ 0.51
Adjusted	$ 0.50	$ 0.52

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Three Months Ended March 31, 2002 and 2001

The following tables set forth information showing the change in revenue, average daily package volume and average revenue per piece, both in dollars or amounts and in percentage terms:

	Three Months Ended March 31,			
	2002	2001	$	%
Revenue (in millions):				
U.S. domestic package:				
Next Day Air	$ 1,313	$ 1,383	$ (70)	(5.1)%
Deferred	700	716	(16)	(2.2)
Ground	3,890	3,877	13	0.3
Total U.S. domestic package	5,903	5,976	(73)	(1.2)
International package:				
Domestic	222	232	(10)	(4.3)
Export	737	748	(11)	(1.5)
Cargo	95	94	1	1.1
Total International package	1,054	1,074	(20)	(1.9)

Non-package:				
UPS Logistics Group	236	154	82	53.2
UPS Freight Services	224	100	124	124.0
Other	162	131	31	23.7
Total non-package	622	385	237	61.6
Consolidated	$ 7,579	$ 7,435	$ 144	1.9 %
			#	
Average Daily Package Volume (in thousands):				
U.S. domestic package:				
Next Day Air	1,092	1,106	(14)	(1.3)%
Deferred	880	888	(8)	(0.9)
Ground	10,034	10,192	(158)	(1.6)
Total U.S. domestic package	12,006	12,186	(180)	(1.5)
International package:				
Domestic	780	804	(24)	(3.0)
Export	427	399	28	7.0
Total International package	1,207	1,203	4	0.3
Consolidated	13,213	13,389	(176)	(1.3)%
Operating days in period	63	64		
			$	
Average Revenue Per Piece:				
U.S. domestic package:				
Next Day Air	$ 19.09	$ 19.54	$ (0.45)	(2.3)%
Deferred	12.63	12.60	0.03	0.2
Ground	6.15	5.94	0.21	3.5
Total U.S. domestic package	7.80	7.66	0.14	1.8
International:				
Domestic	4.52	4.51	0.01	0.2
Export	27.40	29.29	(1.89)	(6.5)
Total International package	12.61	12.73	(0.12)	(0.9)
Consolidated	$ 8.24	$ 8.12	$ 0.12	1.5 %

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U.S. domestic package revenue decreased 1.2% compared to last year. This decline was driven by a 1.5% reduction in average daily package volume which was primarily a result of the continued weakness in the U.S. economy. Revenue for our Next Day Air products was also adversely affected by a decline in revenue per piece. The decline results in part from lower package weights combined with a mix shift favoring letters to packages. This reflected what we believe to be continued slowness in the manufacturing sector. Conversely, revenue for our Ground products increased slightly due to a 3.5% increase in average revenue per piece. This improvement resulted in part from having a rate increase that occurred four weeks earlier than compared to the prior year.

On January 7, 2002, we increased rates for standard ground shipments an average of 3.5% for commercial deliveries. The ground residential charge increased $0.05 to $1.10 over the commercial ground rate, and this charge will also be applied to express deliveries in 2002. The additional delivery area surcharge, which is added to ground deliveries in certain less accessible areas, remained at $1.50. In addition, in 2002, this charge will also be applied to express deliveries to these addresses. Rates for UPS Hundredweight increased 5.9%.

We also increased rates for UPS Next Day Air, UPS Next Day Air Saver, UPS 2nd Day Air, and 3 Day Select an average of 4.0%. The surcharge for UPS Next Day Air Early A.M. increased from $27.50 to $28.50. Rates for international shipments originating in the United States (Worldwide Express, Worldwide Express Plus, UPS Worldwide Expedited and UPS International Standard service) increased an average of 3.9%. Rate changes for shipments originating outside the U.S. were made throughout the past year and varied by geographic market.

An index-based fuel surcharge, which became effective December 10, 2001, continued and resets on a monthly basis beginning in February 2002. The index-based surcharge is based on the National U.S. Average On-Highway Diesel Fuel Prices as reported by the U.S. Department of Energy.

The decrease in international package revenue was due primarily to one less operating day, combined with the timing of Easter. Because of the timing of Easter, many of our international locations effectively experienced two less operating days. Nevertheless, we experienced strong average daily volume growth of 7.0% for our export products, offset by a decline in revenue per piece. The volume growth was primarily driven by strong growth in both the Europe and Asia-Pacific regions. European average daily export volume was up 13% while Asia-Pacific was up 11%. The revenue per piece decline resulted from a combination of currency fluctuations and continued strong growth in our lower-yielding, intra-Europe volume. In total, international package average daily volume increased .3% and average revenue per piece decreased .9%. Adjusting the average revenue per piece for currency would have resulted in a 2.4% increase compared to the prior year.

Non-package revenue increased a total of $237 million, or 62%, during the quarter. UPS Logistics Group revenue was up 53% of which 18% was due to organic growth and the balance from acquisitions, much of which was contributed by the new UNI-DATA subsidiary in Germany acquired last August. UPS Freight Services revenue more than doubled during the quarter primarily due to the acquisition of Fritz which occurred in May of 2001.

Two changes were made during the first quarter of 2002, which affect revenue reporting within the non-package segment. Neither of these changes have any effect on current or prior period income. First, effective January 1, 2002, the results of operations of the Transportation Unit of our Logistics Group were moved to our Freight Services Group. Amounts in prior periods have been reclassified for comparison purposes.

Second, our Logistics Group has historically reported revenue from freight under management gross, whereas our Freight Services Group, which was formed with the acquisition of the Fritz Companies in the second quarter of 2001, reports revenue net of freight under management. Beginning with the first quarter of 2002, we are now reporting revenue for both the Logistics Group and Freight Services net of freight under management. Amounts for prior periods have been modified to reflect revenue net of freight under management for comparison purposes. Following is a reconciliation of gross to net revenue for the non-package segment:

	Three Months Ended March 31,	
	2002	**2001**
UPS Logistics Group	$ 278	$ 212
Less freight under management	(42)	(58)
Net revenue	236	154
UPS Freight Services	459	117
Less freight under management	(235)	(17)

Net revenue	224	100
Other	162	131
Non-package revenue	$ 622	$ 385

Consolidated operating expenses increased by $141 million, or 2.2%. Compensation and benefits expenses increased by $198 million, while other operating expenses decreased by $57 million. The majority of the increase in compensation and benefits expense resulted from the acquisitions that we completed in 2001. Other operating expenses decreased primarily due to lower purchased transportation costs, lower fuel costs and the continuing benefits of our cost savings initiatives.

Our operating margin, defined as operating profit as a percentage of revenue, decreased slightly from 12.7% during the first quarter of 2001 to 12.5% during the first quarter of 2002. This decline is the continuation of the trend that began in the fourth quarter of 2000 as the economy began to weaken, although the rate of decline moderated in the first quarter compared to what we experienced during 2001.

The following table sets forth information showing the change in operating profit, both in dollars (in millions) and in percentage terms:

	Three Months Ended March 31,		Change	
Operating Segment	**2002**	**2001**	**$**	**%**
U.S. domestic package	$ 862	$ 845	$ 17	2.0%
International package	30	39	(9)	(23.1)
Non-package	55	60	(5)	(8.3)
Consolidated Operating Profit	$ 947	$ 944	$ 3	0.3%

U.S. domestic package operating profit increased $17 million primarily due to the continued cost saving efforts that were implemented last year. We also benefited from favorable trends in fuel and other energy costs compared to the first quarter of last year.

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The decline in operating profit for our international package operations was primarily currency-related. The strengthening of the U.S. dollar against most major currencies this year versus last year accounted for $8 million of the total $9 million decrease.

The decrease in non-package operating profit was primarily caused by an earnings decline in our excess value insurance business, due to reduced volumes and favorable claims results in the first quarter of 2001. This segment did benefit by $10 million due to the elimination of goodwill amortization in 2002, as discussed in Note 9.

The decrease in investment income of $41 million for the first quarter of 2002 is due in part to a combination of lower interest rates and lower balances available for investment in 2002. Investment income in 2001 also included realized investment gains compared to a small, realized loss in 2002.

Net income for the first quarter of 2002 was $563 million, an increase of $7 million from $556 million in the first quarter of 2001, resulting in an increase in diluted earnings per share from $0.48 in 2001 to $0.50 in 2002. The 2001 results reflect a non-recurring FAS 133 cumulative expense adjustment, net of tax, of $26 million. Excluding the impact of this non-recurring item and adjusting for the non-amortization provisions of FAS 142, our net income for the first quarter of 2001 would have been $593 million, which results in a slight decrease in diluted earnings per share ($0.52 in 2001 compared to $0.50 in 2002- See Note 9).

Liquidity and Capital Resources

Our primary source of liquidity is our cash flow from operations. We maintain significant cash, cash equivalents, marketable securities and short-term investments, amounting to $2.0 billion at March 31, 2002.

As part of our continuing share repurchase program, $1.0 billion was authorized for share repurchases in February 2002, of which $947 million was still available as of March 31, 2002.

We maintain two commercial paper programs under which we are authorized to borrow up to $7.0 billion. Approximately $1.45 billion was outstanding under these programs as of March 31, 2002. Of this amount, $1.25 billion has been classified as long-term debt in accordance with our intention and ability to refinance such obligations on a long-term basis under our revolving credit facilities. The average interest rate on the amount outstanding at March 31, 2002 was 1.79%. In addition, we maintain an extendible commercial notes program under which we are authorized to borrow up to $500 million. No amounts were outstanding under this program at March 31, 2002.

We maintain two credit agreements with a consortium of banks. These agreements provide revolving credit facilities of $3.75 billion and $1.25 billion, expiring on April 24, 2003 and April 27, 2005, respectively. Interest on any amounts we borrow under these facilities would be charged at 90-day LIBOR plus 15 basis points. There were no borrowings under either of these agreements as of March 31, 2002.

We also maintain a $1.0 billion European medium-term note program. Under this program, we may issue notes from time to time, denominated in a variety of currencies. At March 31, 2002, $1.0 billion was available under this program.

We have a $2.0 billion shelf registration statement under which we may issue debt securities in the United States. There was approximately $1.268 billion issued under this shelf registration statement at March 31, 2002. As of March 31, 2002, $627 million in notes have been issued under the UPS Notes program, $138 million of which were issued in the first quarter 2002. These notes have various terms and maturities, all with fixed interest rates.

On August 9, 1999, the United States Tax Court held that we were liable for tax on income of Overseas Partners Ltd. ("OPL"), a Bermuda company that had reinsured excess value ("EV") package insurance purchased by our customers beginning in 1984, and that we were liable for additional tax for the 1983 and 1984 tax years. The Court held that for the 1984 tax year we were liable for taxes of $31 million on income reported by OPL, penalties and penalty interest of $93 million, and interest for a total after-tax exposure estimated at approximately $246 million.

On June 20, 2001, the United States Court of Appeals for the Eleventh Circuit reversed the Tax Court's decision. On September 13, 2001, the Eleventh Circuit denied the IRS's petition to have the appeal reheard en banc. The IRS did not appeal the case to the U.S. Supreme Court and, consequently, the case has been remanded to the Tax Court to consider alternative arguments raised by the parties. At this time, we do not know what the outcome of the remanded proceedings in the Tax Court will be.

The IRS has taken similar positions to those advanced in the Tax Court decision for tax years subsequent to 1984. Tax years 1985 through 1990 currently are docketed in the Tax Court, although no trial date has been set pending resolution of the case that covers the 1984 year. Further, the IRS has issued a report asserting similar positions for the 1991 through 1994 tax years, and we expect the IRS to take similar positions for tax years 1995 through 1999.

We are named as a defendant in twenty-five pending lawsuits that seek to hold us liable for the collection of premiums for excess value EV insurance in connection with package shipments since 1984. Based on a variety of state and federal tort, contract and statutory claims, these cases generally claim that we failed to remit collected EV premiums to an independent insurer; we failed to provide promised EV insurance; we acted as an insurer without complying with state insurance laws and regulations; and the price for EV insurance was excessive.

These actions were filed after the August 9, 1999 Tax Court decision. As discussed above, on June 20, 2001, the U.S. Court of Appeals for the Eleventh Circuit ruled in our favor and reversed the Tax Court decision.

These twenty-five cases have been consolidated for pre-trial purposes in a multi-district litigation proceeding ("MDL Proceeding") in federal court in New York. Motions to dismiss these cases are pending, as are motions to remand several of these cases to state court.

We believe that the allegations in these cases have no merit and intend to continue to defend them vigorously. The ultimate resolution of these cases cannot presently be determined.

In addition, we are a defendant in various other lawsuits that arose in the normal course of business. We believe that the eventual resolution of these cases will not have a material adverse effect on our financial condition, results of operations or liquidity.

Reference is made to Note 4 to the accompanying unaudited consolidated financial statements for more information on the preceding matters.

Due to the events of September 11, 2001, increased security requirements for air carriers may be forthcoming; however, we do not anticipate that such measures will have a material adverse effect on our financial condition, results of operations or liquidity. In addition, our insurance premiums have risen and we have taken several actions, including self-insuring certain risks, to mitigate the expense increase.

As of December 31, 2001, we had approximately 232,500 employees (64% of total employees) employed under a national master agreement and various supplemental agreements with local unions affiliated with the International Brotherhood of Teamsters ("Teamsters"). These agreements run through July 31, 2002. The majority of our pilots are employed under a collective bargaining agreement with the Independent Pilots Association, which becomes amendable January 1, 2004. Our airline mechanics are covered by a collective bargaining agreement with Teamsters Local 2727, which became amendable on August 1, 2001. Members of Teamsters 2727 recently voted down a proposed new contract, and negotiations resumed in April 2002 with the assistance of the National Mediation Board. In addition, the majority of our ground mechanics who are not employed under agreements with the Teamsters are employed under collective bargaining agreements with the International Association of Machinists and Aerospace Workers. These agreements have various expiration dates between July 31, 2002 and May 31, 2003.

We entered into negotiations with the Teamsters in January 2002 for a new national master agreement. It is our desire through these discussions to reach an agreement on a new contract prior to the end of our current five-year agreement on July 31, 2002. Any strike, work stoppage or slowdown that results from our failure to reach a timely agreement with the Teamsters, and any change in shipping behavior by our customers or potential customers due to perceptions that we will not reach a timely agreement with the Teamsters, could have a material adverse effect on our financial condition and results of operations. We do not, however, anticipate that this will occur.

We believe that funds from operations and borrowing programs will provide adequate sources of liquidity and capital resources to meet our expected long-term needs for the operation of our business, including anticipated capital expenditures such as commitments for aircraft purchases, through 2009.

At March 31, 2002, we had unfunded loan commitments totaling $729 million, consisting of letters of credit of $56 million and other unfunded lending commitments of $673 million.

New Accounting Pronouncements

In June 2001, the FASB issued Statement No. 141 "Business Combinations" (FAS 141) and Statement No. 142 "Goodwill and Other Intangible Assets" (FAS 142). FAS 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. FAS 141 also specifies the types of acquired intangible assets that are required to be recognized and reported separately from goodwill. FAS 142 eliminates the requirement to amortize goodwill and indefinite-lived intangible assets, addresses the amortization of intangible assets with a defined life, and addresses the impairment testing and recognition for goodwill and intangible assets.

To comply with the transition provisions of FAS 142, we have determined our reporting units and assigned goodwill and other net assets to those reporting units. Goodwill attributable to each of our reporting units is being tested for impairment by comparing the fair value of each reporting unit with its carrying value. Fair value is primarily being determined through the use of a discounted cash flow methodology. We have not completed our impairment testing required by the transition provisions of FAS 142, and therefore it is not practical, at this time, to estimate the impact of adoption of this statement.

Goodwill amortization ceased upon the implementation of FAS 142 on January 1, 2002. Reference is made to Note 9 to the accompanying consolidated financial statements for a summary of the impact goodwill amortization had on 2001 income and earnings per share.

Forward-Looking Statements

Except for historical information contained herein, "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Liquidity and Capital Resources" and other parts of this report contain "forward-looking" statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Such forward-looking statements involve certain risks and uncertainties, including statements regarding the intent, belief or current expectations of UPS and its management regarding strategic directions, prospects and future results. Certain factors may cause actual results to differ materially from those contained in the forward-looking statements, including economic and other conditions in the markets in which we operate, governmental regulations, our competitive environment, strikes, work stoppages and slowdowns (or customer behavior in anticipation of such events), increases in aviation and motor fuel prices, cyclical and seasonal fluctuations in our operating results, and other risks discussed in our Form 10-K and other filings with the Securities and Exchange Commission, which discussions are incorporated herein by reference.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market Risk

We are exposed to market risk from changes in foreign currency exchange rates, interest rates, equity prices, and certain commodity prices. All of this market risk arises in the normal course of business, as we do not engage in speculative trading activities. In order to manage the risk arising from these exposures, we utilize a variety of foreign exchange, interest rate, equity and commodity forward contracts, options, and swaps.

Our market risks, hedging strategies, and financial instrument positions at March 31, 2002 are similar to those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2001. During the first three months of 2002, we issued a total of $138 million of fixed rate notes with various maturities under our UPS Notes program. All of these fixed rate notes were effectively converted to floating interest rates using interest rate swaps.

The total fair value asset (liability) of our derivative financial instruments, including derivatives added during the first three months of 2002, is summarized in the following table (in millions):

	March 31, 2002	December 31, 2001
Energy Hedges	$ 28	$ (27)
Currency Hedges	9	4
Interest Rate Hedges	(51)	(74)
Investment Hedges	217	214
	$ 203	$ 117

The forward contracts, swaps, and options previously discussed contain an element of risk that the couterparties may be unable to meet the terms of the agreements. However, we minimize such risk exposures for these instruments by limiting the counterparties to large banks and financial institutions that meet established credit guidelines. We do not expect to incur any losses as a result of counterparty default.

The information concerning market risk under the sub-caption "Market Risk" of the caption "Management's Discussion and Analysis" on pages 29-31 of our consolidated financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2001, is hereby incorporated by reference in this Quarterly Report on Form 10-Q.

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Item 6. Exhibits and Reports on Form 8-K

A) Exhibits:

(10) Material Contracts

(a) Credit Agreement (364-Day Facility) dated April 25, 2002 among United Parcel Service, Inc., the initial lenders named therein, Salomon Smith Barney Inc. as Arranger and Bank of America, N.A., and Bank One, NA, as Co-Documentation Agents and Citibank, N.A. as Administrative and Syndication Agent.

(B) Reports on Form 8-K:

None

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EXHIBIT INDEX

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

UNITED PARCEL SERVICE, INC.

(Registrant)

Date: May 15, 2002

By: /s/ D. Scott Davis

D. Scott Davis
Senior Vice President,
Treasurer and
Chief Financial Officer

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QuickLinks

Comments from the U.S. Postal Service

RICHARD J. STRASSER, JR.
CHIEF FINANCIAL OFFICER
EXECUTIVE VICE PRESIDENT

UNITED STATES
POSTAL SERVICE

October 17, 2002

Mr. Bernard Ungar
Director, Physical Infrastructure Issues
General Accounting Office
441 G Street, NW
Washington DC 20548-0001

Thank you for the opportunity to provide comments on the General Accounting Office's (GAO) proposed report entitled *U. S. Postal Service: Postal Financial Reporting.*

In line with the recommendations made to improve stakeholder understanding of our business, the Postal Service intends to add enhanced discussion of performance to our accounting period or quarterly reports. Starting in Fiscal Year 2003, the Postal Service will provide:

- explanations of material events or transactions and their projected impact on current operations and financial results;
- on a quarterly basis, expectations for the upcoming quarter; and,
- on a quarterly basis, explanation if actual results for the prior quarter differ significantly from previously discussed expectations.

The suggestions and list of questions provided in your latest correspondence will be utilized to assist in this effort. These will be combined with any feedback received from stakeholders (e.g., the Mailers Technical Advisory Committee), to determine whether additional information, revised formatting, or similar efforts would improve communication of the Postal Service's financial condition and outlook. Consistency in presentation will be one of our goals, provided the consistency itself does not preclude additional improvements. The Postal Service will retain the data placed on its web site for three years beyond the current year. Ultimately, the information produced by these actions will promote greater public understanding of the Postal Service's financial condition and outlook.

The Postal Service has considered very carefully the GAO's discussion of Securities and Exchange Commission (SEC) reporting requirements for publicly-traded companies, in the context of the stated missions of both the SEC and the Postal Rate Commission (PRC). We also requested viewpoints from equity market analysts, who regularly review our disclosures and those of competitor organizations. While we received many suggestions that will help us fine-tune certain disclosures, the financial community expressed overall satisfaction with both the quality and quantity of the data we provide.

We believe that our public disclosures to the PRC far exceed, on balance, the information that is legally required of SEC-regulated companies. During omnibus rate case proceedings, our disclosures even include responses to interrogatories filed by our competitors. We also are pleased that we exceed most, if not all government agencies in the area of financial reporting, in terms of both content and timeliness. In addition, we have noted over the years that numerous financial and mailing industry publications and experts have been able to produce fairly accurate analyses and forecasts through use of data we routinely disclose to the public.

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With respect to its retirement obligations, the Postal Service believes that public discussion of this issue must be undertaken with great care, and we will endeavor to ensure greater public understanding. Certain data are highly sensitive to assumptions, and all parties must be mindful of the potential for large numbers to be discussed in isolation or out of context, which can lead to public misunderstanding that becomes very difficult to correct. Since postal reorganization in 1971 and through the end of Fiscal Year 2002, the Postal Service has made cash payments totaling $55 billion for its Civil Service Retirement System (CSRS) liabilities associated with pay increases and retiree cost-of-living adjustments. Current postage rates include approximately $4 billion per year for payment of these costs. Indeed, the rate setting process is designed to provide adequate funds on an ongoing basis to fully liquidate the current and future CSRS deferred retirement liabilities.

I want to emphasize that the suggestions and recommendations provided by the GAO will be taken under advisement as we move forward. Over the past two years, I have appreciated our open dialog, and I look forward to continued frank discussion of the multifaceted issues before us. In that spirit, I would be remiss if I did not mention my strong belief that the proposed GAO report did not reflect adequately or completely the ongoing reporting of Postal Service financial information. For example, each accounting period and each quarter, the Postal Service provides detailed product line revenue, volume, and weight information. In addition, the report did not mention the publicly available annual billing determinant data that are produced by the Postal Service and then provided to the PRC. These billing determinant data supply highly specific domestic volume and revenue data at the rate element level. The Postal Service also produces Financial and Operating Statement reports at the close of each accounting period, which we believe provide richer data than required under SEC regulations. Discussion of these publicly available data in the GAO report would help prevent erroneous conclusions regarding Postal Service transparency.

In summary, the Postal Service is pleased to be implementing changes to help ensure greater public understanding of our financial performance. We also appreciate GAO's efforts and the opportunity to provide our response to the report. My staff and I look forward to working with you and your colleagues.

Sincerely,

Richard J. Strasser, Jr.

(543036)