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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 quarterly period ended September 30, 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 001-15451

United Parcel Service, Inc.

(Exact name of registrant as specified in its charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	**58-2480149** (IRS Employer Identification No.)
55 Glenlake Parkway, NE **Atlanta, Georgia** (Address of Principal Executive Offices)	**30328** (Zip Code)

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

Former name, former address and former 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 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 ☐

There were 646,186,115 Class A shares, and 470,398,755 Class B shares, with a par value of $0.01 per share outstanding at November 11, 2002.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
September 30, 2002 (unaudited) and December 31, 2001
(In millions, except per share amounts)

	September 30, 2002	December 31, 2001
Assets		
Current Assets:		
Cash & cash equivalents	$ 1,452	$ 858
Marketable securities & short-term investments	1,199	758
Accounts receivable, net	3,745	4,078
Finance receivables, net	1,011	708
Other current assets	909	1,195
Total Current Assets	8,316	7,597
Property, Plant & Equipment—at cost, net of accumulated depreciation & amortization of $11,519 and $10,620 in 2002 and 2001	13,612	13,438
Prepaid Pension Costs	1,936	1,845
Other Assets	2,086	1,756
	$ 25,950	$ 24,636
Liabilities & Shareowners' Equity		

Current Liabilities:		
Current maturities of long-term debt and commerical paper	$ 1,292	$ 518
Accounts payable	1,997	1,899
Accrued wages & withholdings	1,816	1,169
Other current liabilities	1,058	1,200
Total Current Liabilities	6,163	4,786
Long-Term Debt	3,558	4,648
Accumulated Postretirement Benefit Obligation, Net	1,234	1,130
Deferred Taxes, Credits & Other Liabilities	4,038	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 656 and 772 in 2002 and 2001	7	8
Class B common stock, par value $.01 per share, authorized 5,600 shares, issued 461 and 349 in 2002 and 2001	4	3
Additional paid-in capital	3	414
Retained earnings	11,276	10,162
Accumulated other comprehensive loss	(333)	(339)
Deferred compensation arrangements	84	47
	11,041	10,295
Less: Treasury stock (1 shares in 2002 and 2001)	(84)	(47)
	10,957	10,248
	$ 25,950	$ 24,636

See notes to unaudited consolidated financial statements.

UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES
STATEMENTS OF CONSOLIDATED INCOME
Three and Nine Months Ended September 30, 2002 and 2001
(In millions, except per share amounts)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
Revenue	$ 7,754	$ 7,398	$ 23,015	$ 22,324
Operating Expenses:				
Compensation and benefits	4,520	4,306	13,404	12,826
Other	2,284	2,149	6,686	6,570
	6,804	6,455	20,090	19,396
Operating Profit	950	943	2,925	2,928
Other Income and (Expense):				
Investment income	20	34	44	126
Interest expense	(30)	(45)	(121)	(136)
	(10)	(11)	(77)	(10)
Income Before Income Taxes And Cumulative Effect of Change In Accounting Principle	940	932	2,848	2,918
Income Taxes	362	364	1,096	1,138
Income Before Cumulative Effect of Change In Accounting Principle	578	568	1,752	1,780
Cumulative Effect of Change In The Method Of Accounting For Derivatives, Net of Taxes	—	—	—	(26)
Net Income	$ 578	$ 568	$ 1,752	$ 1,754
Basic Earnings Per Share Before Cumulative Effect Of Change In Accounting Principle	$ 0.52	$ 0.50	$ 1.57	$ 1.58
Basic Earnings Per Share	$ 0.52	$ 0.50	$ 1.57	$ 1.56
Diluted Earnings Per Share Before Cumulative Effect Of Change In Accounting Principle	$ 0.51	$ 0.50	$ 1.55	$ 1.55
Diluted Earnings Per Share	$ 0.51	$ 0.50	$ 1.55	$ 1.53

See notes to unaudited consolidated financial statements.

UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF SHAREOWNERS' EQUITY
Nine Months Ended September 30, 2002
(In millions, except per share amounts)
(unaudited)

	Class A Common Stock		Class B Common Stock						Treasury Stock		
	Shares	Amount	Shares	Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Deferred Compensation Arrangements	Shares	Amount	
Balance, January 1, 2002	772	$ 8	349	$ 3	$ 414	$ 10,162	$ (339)	$ 47	(1)	$ (47)	$
Comprehensive income:											
Net income	—	—	—	—	—	1,752	—	—	—	—	
Foreign currency adjustments	—	—	—	—	—	—	2	—	—	—	
Unrealized gain (loss) on marketable securities	—	—	—	—	—	—	(13)	—	—	—	
Unrealized gain (loss) on cash flow hedges	—	—	—	—	—	—	17	—	—	—	
Comprehensive income											
Dividends ($0.57 per share)	—	—	—	—	—	(638)	—	—	—	—	
Stock award plans	5	—	—	—	89	—	—	—	—	—	
Common stock purchases	(10)	—	—	—	(572)	—	—	—	—	—	
Common stock issuances	1	—	—	—	72	—	—	—	—	—	
Common stock held for deferred compensation arrangements	—	—	—	—	—	—	—	37	—	(37)	
Conversion of Class A Common stock to Class B Common stock	(112)	(1)	112	1	—	—	—	—	—	—	
Balance, September 30, 2002	656	$ 7	461	$ 4	$ 3	$ 11,276	$ (333)	$ 84	(1)	$ (84)	$

See notes to unaudited consolidated financial statements.

UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
Nine Months Ended September 30, 2002 and 2001
(In millions)
(unaudited)

	Nine Months Ended September 30,	
	2002	2001
Cash flows from operating activities:		
Net income	$ 1,752	$ 1,754
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	1,086	1,017
Postretirement benefits	104	84
Deferred taxes, credits and other	80	178
Stock award plans	361	386
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable, net	328	611
Finance receivables, net	(581)	(504)
Other current assets	492	352
Prepaid pension costs	(91)	(241)
Accounts payable	98	(249)
Accrued wages and withholdings	344	319
Dividends payable	(212)	(192)
Income taxes payable	(79)	641
Other current liabilities	210	(47)
Net cash from operating activities	3,892	4,109
Cash flows from investing activities:		
Capital expenditures	(1,246)	(1,931)
Disposals of property, plant and equipment	48	80
Purchases of marketable securities and short-term investments	(2,046)	(2,775)
Sales and maturities of marketable securities and short-term investments	1,572	2,666
Payments for acquisitions, net of cash acquired	(14)	(433)
Other asset receipts (payments)	(18)	(73)

Net cash used in investing activities	(1,704)	(2,466)
Cash flows from financing activities:		
Proceeds from borrowings	347	1,845
Repayments of borrowings	(754)	(854)
Purchases of common stock	(572)	(1,716)
Issuances of common stock pursuant to stock awards and employee stock purchase plans	96	208
Dividends	(638)	(644)
Other transactions	(82)	(69)
Net cash used in financing activities	(1,603)	(1,230)
Effect of exchange rate changes on cash	9	11
Net increase in cash and cash equivalents	594	424
Cash and cash equivalents:		
Beginning of period	858	879
End of period	$ 1,452	$ 1,303
Cash paid during the period for:		
Interest (net of amount capitalized)	$ 125	$ 93
Income taxes	$ 1,124	$ 264

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 September 30, 2002, our results of operations for the three and nine months ended September 30, 2002 and 2001, and cash flows for the nine months ended September 30, 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. The interim financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2001.

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 September 30,		Nine Months Ended September 30,	
	2002	**2001**	**2002**	**2001**
Numerator:				
Numerator for basic and diluted earnings per share—				
Net income	$ 578	$ 568	$ 1,752	$ 1,754
Denominator:				
Weighted-average shares	1,117	1,125	1,117	1,126
Deferred compensation arrangements	1	1	1	1
Denominator for basic earnings per share	1,118	1,126	1,118	1,127
Effect of dilutive securities:				
Contingent shares—				
Management incentive awards	6	8	5	6
Stock option plans	10	12	10	13
Denominator for diluted earnings per share	1,134	1,146	1,133	1,146
Basic Earnings Per Share	$ 0.52	$ 0.50	$ 1.57	$ 1.56
Diluted Earnings Per Share	$ 0.51	$ 0.50	$ 1.55	$ 1.53

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, 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, as discussed below.

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.

In May 2002, we began settlement discussions with the IRS pursuant to mediation conducted by a judge of the Tax Court. Although these settlement discussions are still in process, we and the IRS have reached a tentative basis for settlement of all outstanding tax issues related to EV package insurance. If this tentative basis for settlement becomes final, we expect to receive a refund or credit of some of the amount we previously paid to the IRS.

Many steps are required before the amount of any refund or credit associated with the EV package insurance issues is determined or before a settlement would become final. These steps will

likely take at least several months and could take substantially longer. There can be no assurance that the tentative basis for settlement will not materially change, or that it or any other settlement will be approved and finalized. If we are unable to finalize a settlement, we intend to vigorously defend the remanded proceedings in the Tax Court.

There are other outstanding tax issues that are unrelated to EV package insurance for tax years covered by the tentative basis for settlement. These issues are described below. The IRS will not issue refunds for a given tax year until all matters for that tax year are resolved. Accordingly, we will not be able to determine the availability, timing or amount of any potential refunds until these unrelated tax issues are concluded.

Therefore, since contingencies continue to exist and we cannot accurately predict the availability, timing or amount of a possible refund or credit, we are not in a position to reverse any portion of the tax assessment charges that we recorded after the August 1999 Tax Court decision.

The IRS has proposed adjustments, unrelated to the EV package insurance 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 $37 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 $173 million in additional income tax expense. For the 1985 through 1994 tax years, unpaid interest on these adjustments through September 30, 2002 could aggregate up to approximately $509 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-two 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 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-two cases have been consolidated for pre-trial purposes in a multi-district litigation proceeding ("MDL Proceeding") in federal court in New York. The Court has ruled on the pending motions to dismiss, granting our motion to dismiss with respect to all of the plaintiffs' tort claims and all of their breach of contract claims prior to August 26, 1994. Claims asserted under specific federal statutes, and breach of contract claims commencing on August 26, 1994, may proceed at this time. UPS intends to continue to seek dismissal of these remaining claims.

The defendants in the MDL Proceeding, including UPS, have stipulated to conditional certification of a plaintiff class in most of the lawsuits challenging the EV insurance program for UPS shippers. Class certification is a procedural step that allows claims to be resolved at one time as to all potential claimants; it does not depend on or reflect the merits of the underlying claims. Defendants may move later to set aside or modify the class certification.

The cases subject to the class certification stipulation will proceed to a single trial before the federal court presiding over the MDL Proceeding, instead of being returned for trial to the numerous federal courts around the country from which they were transferred. In addition, plaintiffs in the five cases with pending motions to remand to state court have withdrawn these motions.

As previously disclosed, 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. This case also has been consolidated into the MDL Proceeding. The plaintiff is seeking to have the case remanded back to state court. Further activity in this case has been stayed until January 2003.

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 and nine months ended September 30 is as follows (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
Revenue:				
U.S. domestic package	$ 5,889	$ 5,806	$ 17,700	$ 17,763
International package	1,184	1,012	3,382	3,136
Non-package	681	580	1,933	1,425
Consolidated	$ 7,754	$ 7,398	$ 23,015	$ 22,324
Operating profit (loss):				
U.S. domestic package	$ 809	$ 895	$ 2,570	$ 2,706
International package	65	(4)	157	59
Non-package	76	52	198	163
Consolidated	$ 950	$ 943	$ 2,925	$ 2,928

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 on a gross basis, whereas our Freight Services Group, which was formed with the acquisition of Fritz Companies, Inc. 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 (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
UPS Logistics Group gross revenue	$ 328	$ 244	$ 898	$ 675
Less freight under management	(62)	(56)	(172)	(172)
Net revenue	266	188	726	503
UPS Freight Services gross revenue	613	437	1,590	803
Less freight under management	(371)	(196)	(891)	(312)
Net revenue	242	241	699	491
Other	173	151	508	431
Non-package revenue	$ 681	$ 580	$ 1,933	$ 1,425

Non-package operating profit included $28 and $27 million for the three months ended September 30, 2002 and 2001, respectively, and $84 and $83 million for the nine months ended September 30, 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 and nine months ended September 30 are as follows (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
Repairs and maintenance	$ 261	$ 258	$ 793	$ 781
Depreciation and amortization	373	361	1,086	1,017

Purchased transportation	394	381	1,092	1,196
Fuel	242	260	675	751
Other occupancy	120	120	379	382
Other expenses	894	769	2,661	2,443
Consolidated	$ 2,284	$ 2,149	$ 6,686	$ 6,570

7. Other assets as of September 30, 2002 and December 31, 2001 consist of the following (in millions):

	September 30, 2002	December 31, 2001
Goodwill	$ 1,149	$ 1,112
Intangible assets, net of accumulated amortization	108	107
Non-current finance receivables, net of allowance for credit losses	520	242
Other non-current assets	309	295
Consolidated	$ 2,086	$ 1,756

8. Effective January 1, 2002, we adopted Financial Accounting Standards Board (FASB) Statement No. 142 "Goodwill and Other Intangible Assets" (FAS 142). Under the provisions of FAS 142, goodwill and intangible assets with indefinite lives are no longer amortized, but rather are subjected to periodic impairment testing. The transitional impairment test required by FAS 142 is a two-step process. The first step involves estimating the fair value of each reporting unit that has goodwill assigned to it and comparing the estimated fair value to the reporting unit's carrying value. A second step is required if the reporting unit's estimated fair value is less than its carrying value. The second step of the impairment test involves estimating the fair value of the goodwill and comparing that estimate to the goodwill's carrying value. A shortfall of the goodwill's fair value below carrying value represents the amount of goodwill impairment.

We have completed the first step of the impairment testing described above, but we have not completed the second step. Our approach to determining fair value is primarily based on the use of a discounted cash flow methodology. Pursuant to the results of the first step, there is an indication we may have some limited impairment within our non-package segment. The amount of impairment will be determined upon completion of the second step of the impairment test, which will occur by year-end 2002.

The following table indicates the allocation of goodwill by reportable segment, as of September 30, 2002 and December 31, 2001 (in millions):

	September 30, 2002	December 31, 2001
Goodwill by Segment:		
U.S. domestic package	$ —	$ —
International package	100	98
Non-package	1,049	1,014
Consolidated	$ 1,149	$ 1,112

Goodwill in the international package and non-package segments increased from year-end due to the resolution of purchase price contingencies and other purchase price adjustments to acquisitions closed in 2001.

Intangible assets of $95 million consisting of franchise rights, non-compete agreements, licenses, and patents continue to be amortized under the provisions of FAS 142 because they have finite lives. 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 beginning January 1, 2001 (in millions, except per share amounts).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
Reported net income	$ 578	$ 568	$ 1,752	$ 1,754
Adjustments:				
Goodwill amortization	—	21	—	51
Income taxes	—	(3)	—	(10)
Adjusted net income	578	586	1,752	1,795
Cumulative effect of change in accounting principle (FAS 133)	—	—	—	26
Adjusted net income before cumulative effect of change in accounting principle	$ 578	$ 586	$ 1,752	$ 1,821
Basic earnings per share:				
Reported	$ 0.52	$ 0.50	$ 1.57	$ 1.56
Adjusted	$ 0.52	$ 0.52	$ 1.57	$ 1.59
Diluted earnings per share:				
Reported	$ 0.51	$ 0.50	$ 1.55	$ 1.53

Adjusted	$	0.51	$	0.51	$	1.55	$	1.57
Basic earnings per share before cumulative effect of change in accounting principle:								
Reported	$	0.52	$	0.50	$	1.57	$	1.58
Adjusted	$	0.52	$	0.52	$	1.57	$	1.62
Diluted earnings per share before cumulative effect of change in accounting principle:								
Reported	$	0.51	$	0.50	$	1.55	$	1.55
Adjusted	$	0.51	$	0.51	$	1.55	$	1.59

9. Effective January 1, 2001, we adopted 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 on 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 the cumulative effect of adopting FAS 133, as follows (in millions, except per share amounts):

		Income		OCI
Adjustment to fair value of derivatives (a)	$	(42)	$	37
Income tax effects		16		(14)
Total	$	(26)	$	23
Effect on diluted earnings per share (a)	$	(0.02)		

(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.

10. In response to the September 11, 2001 terrorist attacks, the FAA issued a federal ground stop order prohibiting all flights to, from, and within the United States. Due to this order, all domestic UPS aircraft were grounded, and international flights into the United States were diverted on September 11th and 12th. We were able to transport many of our express shipments through our extensive ground network until the FAA order was lifted and our air operations resumed on the evening of September 13th. Due to the economic disruption caused by these events, we sustained significant declines in our U.S. origin package volume during the weeks following the attacks.

On September 22, 2001, President Bush signed into law the Air Transportation Safety and System Stabilization Act, a $15 billion emergency economic assistance package to mitigate the dramatic financial losses experienced by the nation's air carriers. We submitted a claim for compensation to the Department of Transportation and recognized a pre-tax amount of $37 million related to this reimbursement as a credit to the other expenses line item of other operating expenses in the third quarter of 2001 under the provisions of EITF 01-10 "Accounting for the Impact of Terrorist Attacks of September 11, 2001."

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

Revenue, Volume and Revenue Per Piece

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 September 30,					
	2002		2001		$	%
Revenue (in millions):						
U.S. domestic package:						
Next Day Air	$	1,344	$	1,310	$ 34	2.6%
Deferred		672		664	8	1.2
Ground		3,873		3,832	41	1.1
Total U.S. domestic package		5,889		5,806	83	1.4
International package:						
Domestic		238		213	25	11.7
Export		826		696	130	18.7
Cargo		120		103	17	16.5
Total International package		1,184		1,012	172	17.0
Non-package:						

UPS Logistics Group	266	188	78	41.5
UPS Freight Services	242	241	1	0.4
Other	173	151	22	14.6
Total Non-package	681	580	101	17.4
Consolidated	$ 7,754	$ 7,398	$ 356	4.8%
Average Daily Package Volume (in thousands):			#	
U.S. domestic package:				
Next Day Air	1,095	1,074	21	2.0%
Deferred	792	822	(30)	(3.6)
Ground	9,766	10,009	(243)	(2.4)
Total U.S. domestic package	11,653	11,905	(252)	(2.1)
International package:				
Domestic	753	771	(18)	(2.3)
Export	433	394	39	9.9
Total International package	1,186	1,165	21	1.8
Consolidated	12,839	13,070	(231)	(1.8)%
Operating days in period	64	63		
Average Revenue Per Piece:			$	
U.S. domestic package:				
Next Day Air	$ 19.18	$ 19.36	$ (0.18)	(0.9)%
Deferred	13.26	12.82	0.44	3.4
Ground	6.20	6.08	0.12	2.0
Total U.S. domestic package	7.90	7.74	0.16	2.1
International:				
Domestic	4.94	4.39	0.55	12.5
Export	29.81	28.04	1.77	6.3
Total International package	14.02	12.39	1.63	13.2
Consolidated	$ 8.46	$ 8.16	$ 0.30	3.7%

	Nine Months Ended September 30,			
	2002	2001	$	%
Revenue (in millions):				
U.S. domestic package:				
Next Day Air	$ 3,993	$ 4,076	$ (83)	(2.0)%
Deferred	2,067	2,091	(24)	(1.1)
Ground	11,640	11,596	44	0.4
Total U.S. domestic package	17,700	17,763	(63)	(0.4)
International package:				
Domestic	689	665	24	3.6
Export	2,366	2,173	193	8.9
Cargo	327	298	29	9.7
Total International package	3,382	3,136	246	7.8
Non-package:				
UPS Logistics Group	726	503	223	44.3
UPS Freight Services	699	491	208	42.4
Other	508	431	77	17.9
Total Non-package	1,933	1,425	508	35.6
Consolidated	$ 23,015	$ 22,324	$ 691	3.1%
Average Daily Package Volume (in thousands):			#	
U.S. domestic package:				
Next Day Air	1,089	1,097	(8)	(0.7)%

Deferred	838	861	(23)	(2.7)
Ground	9,848	10,067	(219)	(2.2)
Total U.S. domestic package	11,775	12,025	(250)	(2.1)
International package:				
Domestic	762	783	(21)	(2.7)
Export	431	397	34	8.6
Total International package	1,193	1,180	13	1.1
Consolidated	12,968	13,205	(237)	(1.8)%
Operating days in period	191	191		
Average Revenue Per Piece:			$	
U.S. domestic package:				
Next Day Air	$ 19.20	$ 19.45	$ (0.25)	(1.3)%
Deferred	12.91	12.72	0.19	1.5
Ground	6.19	6.03	0.16	2.7
Total U.S. domestic package	7.87	7.73	0.14	1.8
International:				
Domestic	4.73	4.45	0.28	6.3
Export	28.74	28.66	0.08	0.3
Total International package	13.41	12.59	0.82	6.5
Consolidated	$ 8.38	$ 8.17	$ 0.21	2.6%

Operating Profit

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

	Three Months Ended September 30,		Change	
	2002	2001	$	%
Operating Segment				
U.S. domestic package	$ 809	$ 895	$ (86)	(9.6)%
International package	65	(4)	69	1,725.0
Non-package	76	52	24	46.2
Consolidated Operating Profit	$ 950	$ 943	$ 7	0.7%

	Nine Months Ended September 30,		Change	
	2002	2001	$	%
Operating Segment				
U.S. domestic package	$ 2,570	$ 2,706	$ (136)	(5.0)%
International package	157	59	98	166.1
Non-package	198	163	35	21.5
Consolidated Operating Profit	$ 2,925	$ 2,928	$ (3)	(0.1)%

U.S. Domestic Package Operations

U.S. domestic package revenue increased $83 million, or 1.4%, for the quarter. This increase was driven by a 2.1% increase in revenue per piece, and partially offset by a 2.1% decline in average daily package volume. The decline in volume was primarily a result of the continued weakness in the U.S. economy, combined with the impact of volume diversion to competitors prior to the agreement reached on a new six-year contract with the International Brotherhood of Teamsters. The decline in volume was most pronounced in the period surrounding the July 31, 2002 expiration date of the existing contract. Next day air volume benefited from a favorable comparison with the prior year, due to the events of September 11, 2001 (See Note 10).

For the nine months, U.S. domestic package revenue declined $63 million, or 0.4%, driven by a 2.1% decline in volume and partially offset by a 1.8% increase in revenue per piece. The decrease in volume was influenced by the factors noted above.

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 has been 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 has been 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 since February 2002. It replaced a fixed fuel surcharge of 1.25%, which was originally implemented prior to 2001. 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. Based on published rates, the average fuel surcharge for the third quarter of 2002 was 0.75% and for the nine months was 0.66%.

U.S. domestic package operating profit decreased $86 million, or 9.6%, for the quarter ($136 million, or 5.0%, year-to-date) primarily due to the decrease in average daily volume discussed previously and an increase in operating expenses (discussed further below). In the third quarter of 2001, we recorded a credit to expense related to the Air Transportation Safety and System Stabilization Act, which benefited this segment by $14 million (See Note 10).

International Package Operations

For the third quarter, international package revenue improved $172 million, or 17%, due primarily to volume growth for our export products and strong revenue per piece improvements, a portion of which can be attributed to the impact of currency. This volume growth was driven primarily by the Europe and Asia-Pacific regions, each of which saw export volume increases of 15%. In total, international package average daily volume increased 1.8% and average revenue per piece increased 13.2% (6.9% currency-adjusted).

For the nine months ended September 30, 2002, revenue was up $246 million, or 7.8%, and was driven by the growth in export volume discussed above. On a year-to-date basis, international package average daily volume increased 1.1% and average revenue per piece increased 6.5% (5.3% currency-adjusted).

The improvement in operating profit for our international package operations was $69 million for the quarter, $11 million of which was due to currency fluctuations. Year-to-date, operating profit was up $98 million, or 166%, $6 million of which was due to currency fluctuations. In general, the increase in operating profit was primarily due to strong export volume growth and revenue per piece increases. International package operating profit also benefited by $2 million for the quarter, and $9 million year-to-date, from the elimination of goodwill amortization in 2002, as discussed in Note 8. In the third quarter of 2001, we recorded a credit to expense related to the Air Transportation Safety and System Stabilization Act, which benefited this segment by $23 million (see Note 10).

Non-Package Operations

Non-package revenue increased $101 million, or 17.4%, for the quarter and $508 million, or 35.6%, for the year-to-date period. For the quarter, 6.3% of this revenue growth was due to acquisitions and the remaining 11.1% was due to organic growth of the business. For the year-to-date period, 29.8% of revenue growth was due to acquisitions, while 5.9% was due to organic growth.

UPS Logistics Group revenue was up 41.5% for the quarter of which approximately half was due to acquisitions, primarily our UNI-DATA subsidiary in Germany, acquired last August. On a year-to-date basis, Logistics Group revenue was up 44.3% of which over half was due to acquisitions. UPS Freight Services revenue growth was flat during the quarter, as the comparison to the prior year was hindered by the exclusion of the FedEx brokerage business that was sold earlier this year. Adjusting for the impact of this event, Freight Services would have reported a mid single digit revenue increase. On a year-to-date basis, Freight Services revenue grew $208 million, or 42.4%, primarily due to having nine full months of revenue from Fritz, which was acquired in May 2001.

The increase in non-package operating profit for the quarter, and year-to-date, was primarily due to higher operating profits from our Freight Services business combined with a $19 million reduction in

goodwill expense ($42 million year-to-date) as a result of the elimination of goodwill amortization in 2002, as discussed in Note 8.

Operating Expenses and Operating Margin

Consolidated operating expenses increased by $349 million, or 5.4%, for the quarter. Compensation and benefits increased by 5.0% during the quarter, primarily due to increased costs associated with health and retirement benefits. Other operating expenses increased by 6.3% during the quarter, largely due to increased advertising expenses and the $37 million reduction to expense in 2001 for the reimbursement associated with the Air Transportation Safety and System Stabilization Act (See Note 10).

Operating expenses increased by $694 million, or 3.6%, for the year-to-date period. The non-package segment accounted for the majority of these increases (up $473 million), principally due to acquisitions that we completed during the first nine months of 2001.

Our operating margin, defined as operating profit as a percentage of revenue, decreased from 12.7% during the third quarter of 2001 to 12.3% during the third quarter of 2002. This decline is primarily due to a 170 basis point decline in the operating margin for our U.S. domestic package segment, which experienced a volume-driven decline in profit.

For the first nine months of the year, our operating margin decreased from 13.1% in 2001 to 12.7% during 2002. This decline was also affected by the decrease in domestic profitability discussed above.

Investment Income/Interest Expense

The decrease in investment income of $14 million for the third quarter of 2002 ($82 million year-to-date) is primarily due to a combination of lower interest rates and lower balances available for investment in 2002. The $15 million decline in interest expense for the third quarter and year-to-date is primarily the result of lower interest rates on variable rate debt.

Net Income and Earnings Per Share

Net income for the third quarter of 2002 was $578 million, an increase of $10 million from $568 million in the third quarter of 2001, resulting in an increase in diluted earnings per share from $0.50 in 2001 to $0.51 in 2002. Adjusting for the effects of goodwill amortization, our net income for the third quarter of 2001 would have been $586 million, or $0.51 per diluted share (see Note 8).

Net income for the first nine months of 2002 was $1.752 billion, a decrease of $2 million from $1.754 billion in the first nine months of 2001. However, due to a decrease in the weighted average shares outstanding, diluted earnings per share increased from $1.53 in 2001 to $1.55 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 effects of goodwill amortization, our net income for the first nine months of 2001 would have been $1.821 billion, or $1.59 per diluted share.

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 $2.65 billion at September 30, 2002.

As part of our continuing share repurchase program, $1.0 billion was authorized for share repurchases in February 2002, of which $719 million was still available as of September 30, 2002.

We maintain two commercial paper programs under which we are authorized to borrow up to $7.0 billion. Approximately $1.22 billion was outstanding under these programs as of September 30, 2002. The entire balance outstanding has been classified as a current liability. The average interest rate on the amount outstanding at September 30, 2002 was 1.72%. 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 September 30, 2002.

We maintain two credit agreements with a consortium of banks. These agreements provide revolving credit facilities of $1.25 billion each, with one expiring on April 24, 2003 and the other on April 27, 2005. 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 September 30, 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. No amounts were outstanding under this program at September 30, 2002.

We have a $2.0 billion shelf registration statement under which we may issue debt securities in the United States. There was approximately $1.48 billion issued under this shelf registration statement at September 30, 2002. As of September 30, 2002, $838 million in notes have been issued under the UPS Notes program. These notes have various terms and maturities, all with fixed interest rates. The notes are callable at various stated times after issuance, and $200 million of the notes have been called since the inception of the program. As of September 30, 2002, $638 million in UPS Notes were outstanding.

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.

In May 2002, we began settlement discussions with the IRS pursuant to mediation conducted by a judge of the Tax Court. Although these settlement discussions are still in process, we and the IRS have reached a tentative basis for settlement of all outstanding tax issues related to EV package insurance. If this tentative basis for settlement becomes final, we expect to receive a refund or credit of some of the amount we previously paid to the IRS.

Many steps are required before the amount of any refund or credit associated with the EV package insurance issues is determined or before a settlement would become final. These steps will likely take at least several months and could take substantially longer. There can be no assurance that the tentative basis for settlement will not materially change, or that it or any other settlement will be

approved and finalized. If we are unable to finalize a settlement, we intend to vigorously defend the remanded proceedings in the Tax Court.

There are other outstanding tax issues that are unrelated to EV package insurance for each tax year covered by the tentative basis for settlement. These issues are described below. The IRS will not issue refunds for a given tax year until all matters for that tax year are resolved. Accordingly, we will not be able to determine the availability, timing or amount of any potential refunds until these unrelated tax issues are concluded.

Therefore, since contingencies continue to exist and we cannot accurately predict the availability, timing or amount of a possible refund or credit, we are not in a position to reverse any portion of the tax assessment charges that we recorded after the August 1999 Tax Court decision.

The IRS has proposed adjustments, unrelated to the EV package insurance 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 $37 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 $173 million in additional income tax expense. For the 1985 through 1994 tax years, unpaid interest on these adjustments through September 30, 2002 could aggregate up to approximately $509 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-two 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 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-two cases have been consolidated for pre-trial purposes in a multi-district litigation proceeding ("MDL Proceeding") in federal court in New York. The Court has ruled on the pending motions to dismiss, granting our motion to dismiss with respect to all of the plaintiffs' tort claims and all of their breach of contract claims prior to August 26, 1994. Claims asserted under specific federal statutes, and breach of contract claims commencing on August 26, 1994, may proceed at this time. UPS intends to continue to seek dismissal of these remaining claims.

The defendants in the MDL Proceeding, including UPS, have stipulated to conditional certification of a plaintiff class in most of the lawsuits challenging the EV insurance program for UPS shippers. Class certification is a procedural step that allows claims to be resolved at one time as to all potential claimants; it does not depend on or reflect the merits of the underlying claims. Defendants may move later to set aside or modify the class certification.

The cases subject to the class certification stipulation will proceed to a single trial before the federal court presiding over the MDL Proceeding, instead of being returned for trial to the numerous federal courts around the country from which they were transferred. In addition, plaintiffs in the five cases with pending motions to remand to state court have withdrawn these motions.

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.

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"). On October 7, 2002, the Teamsters ratified a new master agreement with UPS that runs through July 31, 2008. The new agreement is retroactive to August 1, 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 becomes amendable on November 1, 2006. 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.

In November 2002, we announced rate increases, to take effect on January 6, 2003, that are in line with previous rate increases. We increased rates for standard ground shipments an average of 3.9% for commercial deliveries. The ground residential surcharge increased $0.05 to $1.25 over the commercial ground rate. The additional delivery area surcharge added to residential deliveries in certain less accessible areas increased to $0.25 to $1.75. Rates for UPS Hundredweight will increase 5.9%. In addition, we increased rates for UPS Next Day Air an average of 3.4% and increased rates for deferred services by 4.5%. 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. The indexed-based fuel surcharge remains in effect, and is currently at 1.25%.

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 September 30, 2002, we had unfunded loan commitments totaling $710 million, consisting of standby letters of credit of $41 million and other unfunded lending commitments of $669 million.

New Accounting Pronouncements

Effective January 1, 2002, we adopted FASB Statement No. 142 "Goodwill and Other Intangible Assets" (FAS 142). Under the provisions of FAS 142, goodwill and intangible assets with indefinite lives are no longer amortized, but rather are subjected to periodic impairment testing. The transitional impairment test required by FAS 142 is a two-step process. The first step involves estimating the fair

value of each reporting unit that has goodwill assigned to it and comparing the estimated fair value to the reporting unit's carrying value. A second step is required if the reporting unit's estimated fair value is less than its carrying value. The second step of the impairment test involves estimating the fair value of the goodwill and comparing that estimate to the goodwill's carrying value. A shortfall of the goodwill's fair value below carrying value represents the amount of goodwill impairment.

We have completed the first step of the impairment testing described above, but we have not completed the second step. Our approach to determining fair value is primarily based on the use of a discounted cash flow methodology. Pursuant to the results of the first step, there is an indication we may have some limited impairment within our Non-Package segment. The amount of impairment will be determined upon completion of the second step of the impairment test, which will occur by year-end 2002.

Goodwill amortization ceased upon the implementation of FAS 142 on January 1, 2002. See Note 8 to the accompanying consolidated financial statements for a summary of the impact goodwill amortization had on 2001 income and earnings per share.

In June 2002, the FASB issued Statement No. 146 "Accounting for Costs Associated with Exit or Disposal Activities" (FAS 146). FAS 146 provides guidance on the recognition and measurement of liabilities associated with exit or disposal activities and requires that such liabilities be recognized when incurred. This statement is effective for exit or disposal activities initiated on or after January 1, 2003. We are currently evaluating the potential impact of this statement.

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

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 September 30, 2002 are similar to those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2001. During the first nine months of 2002, we issued a total of $346 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 notes are callable at various stated times after issuance, and $200 million of the notes were called in the first nine months of 2002.

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

	September 30, 2002	December 31, 2001
Energy Derivatives	$ 31	$ (27)
Currency Derivatives	—	4
Interest Rate Derivatives	(66)	(74)
Investment Derivatives	221	214

	$ 186	$ 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.

Item 4. Controls and Procedures

During the 90-day period prior to the filing date of this report, management, including the Company's Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based upon, and as of the date of, that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures were effective, in all material respects, to ensure that information required to be disclosed in the reports the Company files and submits under the Exchange Act is recorded, processed, summarized and reported as and when required.

There have been no significant changes in the Company's internal controls or in other factors that could significantly affect internal controls subsequent to the date the Company carried out its evaluation. There were no significant deficiencies or material weaknesses identified in the evaluation and therefore, no corrective actions were taken.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

For a discussion of legal proceedings affecting us and our subsidiaries, please see Note 4 to our unaudited consolidated financial statements contained herein.

Item 6. Exhibits and Reports on Form 8-K

(A) Exhibits:

99.1—Certificate of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

99.2—Certificate of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(B) Reports on Form 8-K:

The Company filed a Form 8-K Current Report on July 11, 2002 (Date of Earliest Event Reported: July 10, 2002), providing an update to second quarter operating and financial performance and an update to ongoing labor negotiations.

The Company filed a Form 8-K Current Report on July 12, 2002 (Date of Earliest Event Reported: July 12, 2002), reporting second quarter financial results and the planned registration of a secondary public offering associated with the inclusion of the Company's Class B common stock in the Standard & Poor's 500 Index.

The Company filed a Form 8-K Current Report on July 17, 2002 (Date of Earliest Event Reported: July 16, 2002), reporting that the Company had reached a tentative agreement with the International Brotherhood of Teamsters on a new six-year labor contract to replace the agreement expiring on July 31, 2002.

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: November 14, 2002 By: /s/ D. SCOTT DAVIS

D. Scott Davis
Senior Vice President, Treasurer and
Chief Financial Officer
(Duly Authorized Officer and
Principal Financial Officer)

United Parcel Service, Inc. and Subsidiaries

Certifications

I, Michael L. Eskew, certify that:

1. I have reviewed this quarterly report on Form 10-Q of United Parcel Service, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial

condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

   a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b. evaluated the effectiveness of the registrant's disclosures controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

   c. presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):

   a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

   b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ MICHAEL L. ESKEW

Michael L. Eskew
Chairman and Chief Executive Officer

United Parcel Service, Inc. and Subsidiaries

Certifications

I, D. Scott Davis, certify that:

1. I have reviewed this quarterly report on Form 10-Q of United Parcel Service, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

   a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b. evaluated the effectiveness of the registrant's disclosures controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

   c. presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):

   a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

   b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ D. SCOTT DAVIS

D. Scott Davis
Chief Financial Officer

QuickLinks

Exhibit 99.1

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906 OF THE
SARBANES-OXLEY ACT OF 2002**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and in connection with the Quarterly Report on Form 10-Q of United Parcel Service, Inc. (the "Corporation") for the period ended September 30, 2002, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, the Chairman of the Board and Chief Executive Officer of the Corporation, certifies that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Corporation.

/s/ MICHAEL L. ESKEW

Michael L. Eskew
Chairman and Chief Executive Officer
November 14, 2002

Exhibit 99.2

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906 OF THE
SARBANES-OXLEY ACT OF 2002**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and in connection with the Quarterly Report on Form 10-Q of United Parcel Service, Inc. (the "Corporation") for the period ended September 30, 2002, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, the Chief Financial Officer of the Corporation, certifies that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Corporation.

/s/ D. SCOTT DAVIS

D. Scott Davis
Chief Financial Officer
November 14, 2002