UNITED STATES
POSTAL REGULATORY COMMISSION
Washington, D.C. 20268-0001

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 June 30, 2016
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: N/A

UNITED STATES POSTAL SERVICE

(Exact name of registrant as specified in its charter)

Washington, D.C.	41-0760000
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
475 L'Enfant Plaza, S.W. Washington, D.C.	20260
(Address of principal executive offices)	(ZIP Code)

(202) 268-2000
(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 ☐ Not Applicable ☑

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐ Not Applicable ☑

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐ Not Applicable ☑

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☑

The number of shares of common stock outstanding as of 8/8/2016: N/A

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

UNITED STATES POSTAL SERVICE
STATEMENTS OF OPERATIONS
(UNAUDITED)

(in millions)	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	Nine Months Ended June 30, 2016	Nine Months Ended June 30, 2015
Revenue				
Operating revenue	$ 17,698	$ 16,520	$ 54,779	$ 52,200
Other revenue	20	35	65	86
Total revenue	**17,718**	**16,555**	**54,844**	**52,286**
Operating expenses				
Compensation and benefits	11,996	11,609	36,681	35,617
Retiree health benefits	2,287	2,209	6,815	6,598
Workers' compensation	976	(624)	2,234	868
Transportation	1,681	1,584	5,305	4,977
Other operating expenses	2,297	2,323	6,964	6,914
Total operating expenses	**19,237**	**17,101**	**57,999**	**54,974**
Loss from operations	**(1,519)**	**(546)**	**(3,155)**	**(2,688)**
Interest and investment income	8	6	23	18
Interest expense	(56)	(46)	(167)	(138)
Net loss	**$ (1,567)**	**$ (586)**	**$ (3,299)**	**$ (2,808)**

See accompanying notes to the unaudited financial statements.

UNITED STATES POSTAL SERVICE
BALANCE SHEETS

(in millions)	June 30, 2016 (Unaudited)	September 30, 2015
Current assets:		
Cash and cash equivalents	$ 8,890	$ 6,634
Restricted cash	318	233
Receivables, net	1,089	930
Supplies, advances and prepayments	131	118
Total current assets	**10,428**	**7,915**
Property and equipment, net	15,311	15,686
Other assets	405	413
Total assets	**$ 26,144**	**$ 24,014**
Current liabilities:		
Compensation and benefits	$ 3,427	$ 1,899
Retiree health benefits	32,450	28,100
Workers' compensation costs	1,419	1,401
Payables and accrued expenses	1,879	1,853
Deferred revenue-prepaid postage	2,201	3,304
Customer deposit accounts	1,173	1,201
Other current liabilities	1,096	1,053
Current portion of debt	10,100	10,100
Total current liabilities	**53,745**	**48,911**
Workers' compensation costs, noncurrent	18,171	17,410
Employees' accumulated leave, noncurrent	1,923	1,951
Other noncurrent liabilities	1,095	1,233
Noncurrent portion of debt	4,900	4,900
Total liabilities	**79,834**	**74,405**
Net deficiency:		
Capital contributions of the U.S. Government	3,132	3,132
Deficit since 1971 reorganization	(56,822)	(53,523)
Total net deficiency	**(53,690)**	**(50,391)**
Total liabilities and net deficiency	**$ 26,144**	**$ 24,014**

See accompanying notes to the unaudited financial statements.

UNITED STATES POSTAL SERVICE
STATEMENTS OF CASH FLOWS
(UNAUDITED)

(in millions)	Nine Months Ended June 30, 2016	Nine Months Ended June 30, 2015
Cash flows from operating activities:		
Net loss	$ (3,299)	$ (2,808)
Adjustments to reconcile net loss to cash provided by operations:		
Depreciation and amortization	1,307	1,313
(Gain) on disposals of property and equipment, net	(47)	(53)
Decrease in other assets	8	7
Increase (decrease) in noncurrent workers' compensation	761	(566)
(Decrease) in noncurrent deferred appropriations and other revenue	(29)	(6)
(Decrease) increase in other noncurrent liabilities	(118)	18
Changes in current assets and liabilities:		
Receivables, net	(159)	17
Other current assets	(13)	(7)
Retiree health benefits	4,350	4,278
Payables, accrued expenses and other	1,586	839
Deferred revenue-prepaid postage, prepaid box rents and other	(1,076)	70
Net cash provided by operating activities	**3,271**	**3,102**
Cash flows from investing activities:		
Change in restricted cash	(85)	1
Purchases of property and equipment	(1,006)	(880)
Proceeds from sales of property and equipment	111	65
Net cash used in investing activities	**(980)**	**(814)**
Cash flows from financing activities:		
Issuance of notes payable	6,600	5,300
Payments on notes payable	(6,600)	(5,300)
Payments on capital lease obligations and other	(35)	(46)
Net cash used in financing activities	**(35)**	**(46)**
Net increase in cash and cash equivalents	2,256	2,242
Cash and cash equivalents at beginning of period	6,634	4,906
Cash and cash equivalents at end of period	**$ 8,890**	**$ 7,148**
Supplemental cash flow disclosures:		
Cash paid for interest	$ 147	$ 137

See accompanying notes to the unaudited financial statements.

NOTES TO UNAUDITED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

Interim Financial Statements

The accompanying unaudited interim financial statements of the United States Postal Service (the "Postal Service") have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of the U.S. Securities and Exchange Commission ("SEC") Regulation S-X. These financial statements should be read in conjunction with the Postal Service's financial statements for the year ended September 30, 2015, included in its Annual Report on Form 10-K ("Annual Report") filed with the Postal Regulatory Commission ("PRC") on November 13, 2015, and do not include all information and footnotes which are normally included in the Annual Report. Except as otherwise specified, all references to years are to the fiscal year beginning October 1 and ending September 30, and quarters are quarters within fiscal years 2016 and 2015.

In the opinion of management, the accompanying unaudited interim financial statements reflect all material adjustments, including recurring adjustments, necessary to fairly present the financial position as of June 30, 2016, and the results of operations for the three and nine months ended June 30, 2016, and 2015, and cash flows for the nine months ended June 30, 2016, and 2015. Operating results for the three and nine months ended June 30, 2016, are not necessarily indicative of the results that may be expected for all of 2016.

Change in Accounting Estimate

During the three months ended June 30, 2016, the Postal Service revised the estimation technique utilized to determine its *Deferred revenue-prepaid postage* liability for a series of postage stamps. The change resulted from new information regarding customers' retention and usage habits of *Forever Stamps*, and enabled the Postal Service to update its estimate of usage and "breakage" (representing stamps that will never be used for mailing due to loss, damage or stamp collection).

As a result of this change in estimate, the *Deferred revenue-prepaid postage* liability decreased by $1.1 billion, and the adjustment was reflected in operating results by the same amount as an increase to revenue and decrease in net loss for the three and nine months ended June 30, 2016. Management believes the change improves the estimation of stamp usage and related revenue recognition. The change was accounted for as a change in accounting estimate.

Recent Accounting Standards

Accounting Standards Update 2014-09 Revenue from Contracts with Customers

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update 2014-09 *Revenue from Contracts with Customers* ("ASU 2014-09"). The new standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. As originally issued, ASU 2014-09 was effective for fiscal years and interim periods within those years beginning after December 15, 2016, with early adoption not permitted.

In July 2015, the FASB voted for a one-year deferral of the effective date of the standard to annual reporting periods beginning after December 15, 2017, with an option that would permit reporting entities to adopt the standard as early as the original effective date. The new standard may be adopted either retrospectively or on a modified retrospective basis whereby the new standard would be applied to new and existing contracts with remaining performance obligations as of the effective date, with a cumulative catch-up adjustment recorded to beginning retained earnings or net deficiency at the effective date for existing contracts with remaining performance obligations. The Postal Service is currently evaluating the impact of adopting this standard on its financial statements.

Accounting Standards Update 2014-15 Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern

In August 2014, the FASB issued Accounting Standards Update 2014-15 *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern* ("ASU 2014-15"). The new standard requires an entity to perform interim and annual assessments of its ability to continue to meet obligations as they become due within one year after the date that the financial statements are issued. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and interim periods thereafter, with early adoption permitted. The Postal Service does not believe the adoption of the new standard will have a significant impact on its reported disclosures.

Accounting Standards Update 2016-02 Leases

In February 2016, the FASB issued Accounting Standards Update 2016-02 *Leases* ("ASU 2016-02"). The new standard requires an entity to record most leases on its balance sheets but continue to recognize expenses in the statements of operations in a manner similar to current accounting practices. The new standard states that a lessee will recognize a lease liability for the obligation to make lease payments and a right-of-use asset for the right to use the underlying asset for the lease term. Expenses related to leases determined to be operating leases will be recognized on a straight-line basis, while those determined to be financing leases will generally have higher expense in the earlier periods of the lease and both interest and amortization are presented separately in the statements of operations.

ASU 2016-02 is effective for annual periods beginning after December 15, 2018, and interim periods within those years, with early adoption permitted. Entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. The Postal Service is currently evaluating the impact of adopting this standard on its financial statements and disclosures, but given the significant number of leases in place, the Postal Service expects that the adoption will have a material effect on its financial statements and disclosures.

Accounting Standards Update 2016-04 Liabilities - Extinguishments of Liabilities

In March 2016, the FASB issued Accounting Standards Update 2016-04 *Liabilities - Extinguishments of Liabilities* ("ASU 2016-04"). The new standard requires entities that sell prepaid stored-value products redeemable for goods, services or cash at third-party merchants to recognize "breakage" (i.e., the value that is ultimately not redeemed by the consumer) in a way that is consistent with how gift card breakage will be recognized under ASU 2014-09, discussed earlier.

ASU 2016-04 is effective for annual periods beginning after December 15, 2017, and interim periods within those years, with early adoption permitted. The new standard may be adopted either retrospectively or on a modified retrospective basis with a cumulative catch-up adjustment recorded to beginning retained earnings or net deficiency as of the beginning of the fiscal year the standard is effective. The standard is applicable to the Postal Service's valuation of money orders and related breakage. The Postal Service is currently evaluating the impact of adopting this standard on its financial statements and disclosures.

NOTE 2 - LIQUIDITY

The Postal Service generates its cash almost entirely through the sale of postage and other services. It holds its cash with the Federal Reserve Bank of New York and invests its excess cash, when available, in highly-liquid, short-term investments issued by the U.S. Department of Treasury. As of June 30, 2016, and September 30, 2015, the Postal Service held unrestricted cash and cash equivalents of $8.9 billion and $6.6 billion, respectively.

Debt

The Federal Financing Bank ("FFB"), a government-owned corporation under the general supervision of the Secretary of the Treasury, holds all of the Postal Service's debt, which consists of two revolving credit facilities and fixed-rate notes with various maturities. As of both June 30, 2016, and September 30, 2015, the aggregate principal balance of debt outstanding was $15.0 billion, the maximum borrowing amount allowed under the Postal Service's statutory debt ceiling. The Postal Service has reported $15.0 billion in outstanding debt each quarter since September 30, 2012.

The two revolving credit facilities referenced above have interest rates determined by the U.S. Department of Treasury each business day and enable the Postal Service to draw up to $4.0 billion in total. As of June 30, 2016, and September 30, 2015, these facilities were fully drawn and were included in the current portion of debt. These annually-renewable facilities were renewed on April 20, 2016, and are scheduled to expire in April 2017.

Liquidity Concerns

The Postal Service is constrained by laws and regulations, including the *Postal Accountability and Enhancement Act*, Public Law 109-435 ("PAEA"), which restricts revenue sources and mandates certain expenses, including prefunding of the Postal Service Retiree Health Benefits Fund ("PSRHBF"). Additionally, as noted above, the Postal Service has reached the maximum borrowing capacity under its statutory debt ceiling.

Available liquidity (cash and short term investments, plus available borrowing capacity) has increased by approximately $7 billion from the reported 2012 low. This improvement would not have occurred had the Postal Service not defaulted on the annual PSRHBF prefunding payments in 2012 and subsequent years. Aside from the defaults, the improvement is largely attributable to the temporary exigent surcharge (discussed in greater detail below) which generated approximately $4.6 billion in incremental revenue from January 2014 through April 10, 2016, as well as aggressively managing capital expenditures and operating expenses under management's control. Despite this increase in the Postal Service's liquidity, unrestricted cash remains insufficient to support an organization that has already defaulted on $28.1 billion in PSRHBF payments, projects continuing losses and has approximately $74 billion in annual operating expenses.

The Postal Service has incurred cumulative net losses of $60.1 billion since the beginning of 2007 through June 30, 2016. As a result of these losses and its liquidity concerns, the Postal Service does not have sufficient liquidity to meet all of its existing legal obligations when due, pay down its debt and make critical investments in its infrastructure that have been deferred in recent years.

Mail Migration to Alternatives
The ongoing decline in the volume of *First-Class Mail*, which generates a higher contribution than other mail classes, continues to contribute to Postal Service losses. This decline is largely the result of changes in consumers' and businesses' use of mail resulting from the continuing migration to electronic communication and transactional alternatives, which has been exacerbated by lingering effects of the Great Recession. The effect of this decline is compounded by the increase in the number of delivery points, which, when combined with the impact of the reduction in hard-copy mail volume, has resulted in a drop in the average number of pieces delivered per delivery point per day from 5.5 pieces in 2007 to 3.8 pieces in 2015, a decline of 31%.

Expiration of Exigent Surcharge
In December 2013, after a successful appeal by the Postal Service to the U.S. Court of Appeals for the District of Columbia Circuit (the "Court") of an earlier decision in which the PRC denied outright the request of the Postal Service for exigent price relief, the PRC decided that the Postal Service could collect a 4.3% exigent surcharge on most Market-Dominant services beginning in January 2014. This original authorization by the PRC allowed the Postal Service to collect the exigent surcharge until such time as it produced $3.2 billion in incremental revenue, a figure the PRC determined was lost due to the Great Recession's suppression of mail volume. This incremental revenue was considered additional to the revenue that the Postal Service would have generated solely from a 1.7% price increase based on the Consumer Price Index for All Urban Consumers ("CPI-U").

The Postal Service again appealed the PRC's decision to the Court, arguing that the PRC attributed far too little lost mail volume to the Great Recession and that the exigent surcharge should remain in effect for a longer period of time. In June 2015, the Court issued its decision and remanded the case back to the PRC for further review. Although the Court largely upheld the PRC's analytical framework, it vacated one key aspect of the methodology for calculating mail volume lost due to the Great Recession and suggested the PRC reconsider another element of its methodology. On July 29, 2015, the PRC announced that it had authorized the Postal Service to collect over $1.4 billion in additional incremental revenue from the surcharge, bringing the total allowed to just over $4.6 billion. That decision was also appealed to the Court and remains pending.

The Postal Service reduced the prices of applicable Market-Dominant services on April 10, 2016, the date the incremental revenue limit from the surcharge was reached.

Business Model Challenges/Constraints
The Postal Service continues to incur significant losses, in part due to the PAEA-mandated PSRHBF prefunding requirement. Such a requirement to prefund retiree healthcare obligations is not imposed on most other federal entities or private-sector businesses that offer retiree health benefits.

In addition to the $28.1 billion of prefunding payments that were due but not paid during the years 2012 through 2015, the Postal Service accrued expenses of $1.5 billion and $4.4 billion for the three and nine months ended June 30, 2016, respectively, for its required prefunding payment of $5.8 billion due by September 30, 2016. The Postal Service anticipates that it will be forced to default on this payment, as it will not have sufficient liquidity to pay this obligation and to make other payments necessary to continue to fulfill other statutory obligations, including the obligation to provide universal mail service to the nation.

As of the date of this report, the Postal Service has not incurred any penalties or negative financial consequences as a result of its prior PSRHBF prefunding payment defaults. In addition to the prefunding requirement, the Postal Service continues to pay the employer share of health insurance premiums for its retirees, which was $837 million and $784 million for the three months ended June 30, 2016, and 2015, respectively, and $2.5 billion and $2.3 billion for the nine months ended June 30, 2016, and 2015, respectively.

With the exception of the exigent surcharge discussed above, Market-Dominant services, which account for approximately 74% of the Postal Service's annual operating revenues, are subject to a price cap based on the CPI-U. While the vast majority of revenues are constrained by the price cap, costs are not statutorily constrained. Contractual obligations granting general wage increases, step increases, cost-of living-adjustments ("COLA"), along with increases in costs for mandatory federal benefits programs, such as health and retirement benefits, have continued to escalate expenses. Additionally, the Postal Service adds nearly 1 million delivery points each year.

Although 2016 is the final year of statutorily-fixed amounts of PSRHBF prefunding payments, the statute requires that the Office of Personnel Management ("OPM") perform an actuarial valuation no later than 2017 to determine the amount of additional payments into the fund that will be required to amortize the unfunded liability of the PSRHBF by 2056.

Mitigating Circumstances

The Postal Service's status as an independent establishment of the executive branch that does not receive tax dollars for its operations presents unique requirements and restrictions, but also potentially mitigates some of the financial risk that would otherwise be associated with a cash shortfall. With annual total revenue of approximately $69 billion, a financially-sound Postal Service continues to be vital to U.S. commerce.

The U.S. economy benefits greatly from the Postal Service and the many businesses that provide the printing and mailing services that it supports. Disruption of the mail would cause undue hardship to businesses and consumers, and in the event of a cash shortfall, the U.S. government would likely prevent the Postal Service from significantly curtailing or ceasing operations. The Postal Service continues to inform the Administration, Congress, the PRC and other stakeholders of the immediate and long-term financial challenges it faces and the legislative changes that are required to restore its financial stability.

NOTE 3 - RELATED PARTIES

As disclosed throughout this report, the Postal Service has significant transactions with other U.S. government entities, which are considered related parties for accounting purposes.

The following table presents related-party assets and liabilities as of June 30, 2016, and September 30, 2015:

(in millions)	**June 30, 2016**	**September 30, 2015**
Related-party assets:		
Receivables and advances[1]	$ 28	$ 100
Carrying amount of revenue forgone installment receivable[2]	405	413
Related-party liabilities:		
Current portion of debt	$ 10,100	$ 10,100
Other current liabilities[3]	34,961	29,871
Noncurrent portion of debt	4,900	4,900
Other noncurrent liabilities[4]	18,208	17,473

[1] Included within *Receivables, net* in the accompanying Balance Sheets.
[2] Included within *Other assets* in the accompanying Balance Sheets.
[3] Amounts include PSRHBF obligations and current workers' compensation obligations.
[4] Amounts include noncurrent workers' compensation obligations.

The following table presents related-party revenue and expenses for the three and nine months ended June 30, 2016, and 2015:

	Three Months Ended June 30,		Nine Months Ended June 30,	
(in millions)	2016	2015	2016	2015
Related-party operating revenue[1]	$ 224	$ 244	$ 758	$ 739
Related-party operating expenses[2]	$ 4,838	$ 4,560	$ 14,399	$ 13,414
Related-party interest income[3]	$ 8	$ 6	$ 23	$ 17
Related-party interest expenses[4]	$ 49	$ 46	$ 145	$ 135

[1] Included within *Operating revenue* in the accompanying unaudited Statements of Operations.

[2] Included within *Operating expenses* in the accompanying unaudited Statements of Operations.

[3] Imputed on the revenue forgone installment receivable or generated on cash equivalents held with the Federal Reserve Bank of New York or short-term investments in U.S. Treasury instruments. Included within *Interest and investment income* in the accompanying unaudited Statements of Operations.

[4] Incurred on debt issued to the FFB, and included within *Interest expense* in the accompanying unaudited Statements of Operations.

NOTE 4 - PROPERTY AND EQUIPMENT, NET

Assets within *Property and equipment, net* in the accompanying Balance Sheets are recorded at cost, which includes the interest on borrowings used to finance construction of major capital additions, less allowances for depreciation and amortization. Interest capitalized during both the three and nine months ended June 30, 2016, and 2015, was not significant. Fixed assets are depreciated over estimated useful lives ranging from 3 to 40 years using the straight-line method.

For the three months ended June 30, 2016, and 2015, depreciation and amortization expense was $435 million and $444 million, respectively. For both the nine months ended June 30, 2016, and 2015, depreciation and amortization expense was $1.3 billion. These items are included within *Other operating expenses* in the accompanying unaudited Statements of Operations.

Assets classified as held for sale were approximately $49 million and $65 million as of June 30, 2016, and September 30, 2015, respectively, and are included within *Property and equipment, net* in the accompanying Balance Sheets. Impairment charges were de minimis for both the three and nine months ended June 30, 2016, and 2015.

NOTE 5 - COMMITMENTS AND CONTINGENCIES

Commitments

In April 2016, the Postal Service reached a new three-year collective bargaining agreement with the National Rural Letter Carriers' Association ("NRLCA") which was ratified by the NRLCA membership. The new contract includes general wage increases totaling 3.8% (1.2% of which is retroactive to November 2015) with a COLA base month of July 2014 (no retroactive COLA payments), a reduction in the employer share of health insurance premiums, beginning in the 2017 plan year, and the creation of a new non-career employee category to provide weekend and holiday parcel deliveries. The contract will expire on May 20, 2018.

In May 2016, the Postal Service agreed to extend contract negotiations on new collective bargaining agreements with both the National Association of Letter Carriers ("NALC") and the National Postal Mail Handlers Union, AFL-CIO ("NPMHU"). The contracts with NALC and NPMHU each expired on May 20, 2016, and the respective parties mutually agreed to extend negotiations beyond the deadline.

In July 2016, an interest arbitration decision was issued and an arbitrated contract was awarded that established a collective bargaining agreement between the Postal Service and the American Postal Workers Union, AFL-CIO ("APWU"). The contract, which will expire on September 20, 2018, was the result of a legally-mandated binding arbitration process that was required when the parties reached impasse in negotiating a new collective bargaining agreement after the prior agreement expired in May 2015. The new contract includes general wage increases totaling 3.8% (1.2% of which is retroactive to November 2015) with a COLA base month of July 2014 (no retroactive COLA payments), a reduction in the employer share of health insurance premiums, beginning in the 2017 plan year, and annual increases in uniform and work clothing allowances. The award also converted approximately 5,000 non-career positions to career positions.

Contingencies

The Postal Service's contingent liabilities consist primarily of claims resulting from labor, employment, environmental matters, property damage and injuries on Postal Service properties, and issues arising from Postal Service contracts, personal claims and traffic accidents. Each quarter, the Postal Service evaluates each new claim to determine if it is probable of an unfavorable outcome and if the amount of the potential resolution is reasonably estimable. If so, a liability for the amount is recorded. Preexisting claims are also reviewed and adjusted quarterly for resolutions or revisions to prior estimates.

The Postal Service has made adequate provision for probable losses arising from all claims. The following table presents contingent liabilities by current and noncurrent portions and by category, as of June 30, 2016, and September 30, 2015:

(in millions)	**June 30, 2016**	**September 30, 2015**
Current/noncurrent portions of contingent liabilities:		
Current portion[1]	$ 172	$ 132
Noncurrent portion[2]	504	594
Total contingent liabilities	**$ 676**	**$ 726**
Contingent liabilities by category:		
Labor and employment matters	$ 571	$ 637
Asset retirement obligations	47	47
Tort matters	54	38
Contractual matters	4	4
Total contingent liabilities	**$ 676**	**$ 726**

[1] Included within *Payables and accrued expenses* in the accompanying Balance Sheets.
[2] Included within *Other noncurrent liabilities* in the accompanying Balance Sheets.

In addition to accruals for probable losses in the financial statements, the Postal Service also has claims which it deems reasonably possible of an unfavorable outcome, which are not accrued for in the financial statements. These ranged in amount from $225 million to $975 million at June 30, 2016, and from $185 million to $686 million at September 30, 2015. The Postal Service is from time to time involved in other litigation incidental to the conduct of its business, none of which is expected to be material to its financial condition or operations.

NOTE 6 - RETIREMENT PLANS

The majority of career employees participate in one of two U.S. government pension programs, the Civil Service Retirement System ("CSRS") and the Federal Employees Retirement System ("FERS"), which are administered by OPM. Each employee's participation in either plan is based on the starting date of employment with the Postal Service or other U.S. government entity.

As government-sponsored benefit plans, the CSRS and FERS are not subject to the provisions of the *Employee Retirement Income Security Act of 1974*, as amended. Likewise, because the Postal Service cannot direct the costs, benefits or funding requirements of these plans, it accounts for program expenses under multiemployer plan accounting rules. As such, the Postal Service records contributions to the plans as an expense in the period in which each contribution is due.

PAEA suspended the Postal Service's CSRS contributions that would otherwise have been required under Title 5, Section 8334(a)(1) of the U.S. Code. In 2017, OPM will determine if additional funding is required for the benefit of the Postal Service's CSRS retirees. As a result, the Postal Service's employer contribution rate for CSRS was zero for the three and nine months ended June 30, 2016, and 2015.

For most FERS employees, OPM set the Postal Service's contribution rates at 13.7% and 13.2% of base salary for 2016 and 2015, respectively. FERS employees may also participate in the Thrift Savings Plan ("TSP"), a defined contribution retirement savings and investment plan administered by the Federal Retirement Thrift Investment Board, whereby the Postal Service contributes 1% of basic pay and matches voluntary employee contributions up to an additional 4% of basic pay. Additionally, the Postal Service's portion of FICA taxes is included within retirement expense.

Retirement expenses were $1.7 billion and $1.6 billion for the three months ended June 30, 2016, and 2015, respectively, and $5.0 billion and $4.7 billion for the nine months ended June 30, 2016, and 2015, respectively. Retirement expenses are included within *Compensation and benefits* in the accompanying unaudited Statements of Operations.

NOTE 7 - HEALTH BENEFITS PLANS

The Federal Employees Health Benefits ("FEHB") Program covers nearly all career employees and also covers non-career employees and retirees who meet certain eligibility requirements. OPM administers FEHB and allocates the cost of funding the program to participating U.S. government employers. The Postal Service cannot direct the costs, benefits or funding requirements of FEHB plans, and therefore accounts for program expenses using multiemployer plan accounting rules by recording contributions to the plans as an expense in the period in which the contributions are due. Although OPM determines the actual health benefits premium costs, the allocation of these costs between the Postal Service and most of its employees is determined through agreements with Postal Service labor unions.

The Postal Service offers its own separate healthcare plan to certain non-career employees who are ineligible for FEHB.

Active Employees

The Postal Service paid approximately 74% and 75% of healthcare premium costs during the nine months ended June 30, 2016, and 2015, respectively. Postal Service employee healthcare expense was $1.2 billion during each of the three months ended June 30, 2016, and 2015, respectively. Postal Service employee healthcare expense was $3.7 billion and $3.6 billion during the nine months ended June 30, 2016, and 2015, respectively. These expenses are included within *Compensation and benefits* in the accompanying unaudited Statements of Operations.

Retirees

Retirees who participated in the FEHB for the five years immediately preceding their retirement may continue to participate in the program during retirement. The Postal Service pays a portion of FEHB premiums for retirees (or their qualifying survivors, if applicable) who retired on or after July 1, 1971. For employees who began their federal civilian service before that date but retired after it, a prorated contribution is determined. The Postal Service's share of premium costs for retirees and qualifying survivors is set by law and is not subject to negotiation with its labor unions.

Premium Expense

Postal Service expenses for FEHB retiree premiums were $837 million and $784 million for the three months ended June 30, 2016, and 2015, respectively, and $2.5 billion and $2.3 billion for the nine months ended June 30, 2016, and 2015, respectively. The Postal Service will continue to directly pay its share of FEHB premiums for retirees through 2016. In accordance with the PAEA, the PSRHBF will begin funding the Postal Service's share of retiree health benefit premiums in 2017.

PSRHBF Prefunding

The PAEA requires that the Postal Service prefund retiree health benefits by paying designated amounts into the PSRHBF during years 2007 through 2016. This prefunding requirement is not imposed on most federal entities or private sector businesses.

The Postal Service has recorded $32.5 billion as of June 30, 2016, for the unpaid PSRHBF prefunding obligations from past defaults and the accrual through June 30, 2016, for a portion of the $5.8 billion payment due by September 30, 2016, as a current liability in *Retiree health benefits* in the accompanying Balance Sheets. PAEA contains no provisions addressing a payment default.

PAEA requires that OPM perform an actuarial valuation no later than 2017 to determine the amount the Postal Service must pay into the PSRHBF to amortize the unfunded liability over a period of 40 years through 2056. This is in addition to the PAEA requirement that the Postal Service fund the actuarially-determined "normal cost" of retiree health benefits (i.e., the present value of the retiree health benefits attributable to the current years' service).

NOTE 8 - WORKERS' COMPENSATION

Postal Service employees injured on the job are covered by the Federal Employees' Compensation Act ("FECA"), administered by the Department of Labor's ("DOL") Office of Workers' Compensation Programs, which makes all decisions regarding injured workers' eligibility for benefits. The Postal Service reimburses the DOL for all workers' compensation benefits paid to or on behalf of Postal Service employees and beneficiaries, plus an administrative fee.

Workers' Compensation Liability

The Postal Service records a liability for its workers' compensation obligations for employees who have been injured on the job and are eligible for benefits. To determine the actuarial valuation of new and existing cases, the Postal Service uses an estimation model that combines four generally-accepted actuarial valuation techniques based upon past claim-payment experience and exposure to claims as measured by total employee hours worked.

Changes in the liability are primarily attributable to the combined impacts of routine changes in actuarial assumptions, new compensation and medical cases, the progression of existing cases and changes in inflation rates, including long-term COLA rates for compensation claims and medical rates for medical claims.

To determine the fair value of the liability each quarter, the Postal Service first estimates the future total cost of workers' compensation claims based on the dates of claim-related injuries, frequency or severity of the injuries, the pattern of historical payments to beneficiaries and the expected trend in future costs. The Postal Service then calculates the amount that would need to be invested at current discount (interest) rates to fully fund the future total cost of claims, and this calculated present value is the fair value of workers' compensation liability.

This liability calculation is highly sensitive to changes in discount rates. For example, a 1% increase in the discount rate would decrease the June 30, 2016, liability and related expense by approximately $2.2 billion. Likewise, a 1% decrease in the discount rate would increase the June 30, 2016, liability and related expense by approximately $2.7 billion.

The following table details the applicable inflation and discount rates as of June 30, 2016, and September 30, 2015:

	June 30, 2016	September 30, 2015
Compensation claims liability:		
Discount rate	1.8%	2.4%
Wage inflation	2.6%	2.7%
Medical claims liability:		
Discount rate	1.8%	2.4%
Medical inflation	5.5%	5.7%

Workers' Compensation Expense

The impacts of changes in discount rates and inflation rates, as well as the actuarial valuation of new cases and revaluation of existing cases, which reflects compensation and medical claim payments, are components of total workers' compensation expense as recorded in the accompanying unaudited Statements of Operations. As described above, the Postal Service pays an administrative fee to the DOL, which is also a component of workers' compensation expense. The following table presents the components of workers' compensation expense for the three and nine months ended June 30, 2016, and 2015:

	Three Months Ended June 30,		Nine Months Ended June 30,	
(in millions)	**2016**	**2015**	**2016**	**2015**
Impact of discount rate changes	$ 668	$ (950)	$ 1,214	$ 268
Actuarial valuation of new cases and revaluation of existing cases	290	309	966	549
Administrative fee	18	17	54	51
Total workers' compensation expense	**$ 976**	**$ (624)**	**$ 2,234**	**$ 868**

NOTE 9 - FAIR VALUE MEASUREMENT

The Postal Service defines fair value as the price that would be received upon sale of an asset or the price that would be paid to transfer a liability between unrelated parties. The carrying amounts of certain current assets and liabilities held by the Postal Service, including cash, accounts receivable, accounts payable and accrued expenses, approximate fair value due to their short-term nature. Noncurrent receivables and noncurrent debt are measured using a fair value hierarchy model consisting of *Level 1*, *Level 2* and *Level 3* inputs as defined in authoritative accounting literature. Assets within *Property and equipment,* *net* are recorded at cost and measured at fair value on a nonrecurring basis if they are determined to be impaired or classified as assets held for sale.

For the periods ended June 30, 2016, and September 30, 2015, no significant transfers between *Level 1* and *Level 2* assets or liabilities occurred. The carrying amount and fair value of the revenue forgone installment receivable and the noncurrent portion of debt are presented for disclosure purposes only in the following table:

	June 30, 2016		September 30, 2015	
(in millions)	**Carrying Amount**	**Fair Value**	**Carrying Amount**	**Fair Value**
Revenue forgone installment receivable*	$ 405	$ 529	$ 413	$ 511
Noncurrent portion of debt	$ 4,900	$ 5,561	$ 4,900	$ 5,394

* The carrying amount is included within *Other assets* (which includes items in addition to revenue forgone) in the accompanying Balance Sheets.

For its revenue forgone installment receivable, the Postal Service recognizes the imputed interest it is owed as interest income and estimates the value of the receivable using the interest method, which converts future cash flows to a single discounted amount using an interest rate for similar assets, a *Level 2* input. To determine the fair value of this noncurrent asset, the Postal Service calculates a net present value of anticipated annual installment payments to be received using a discount rate based on the 20-year Treasury Constant Maturity Rate, which was 1.96% and 2.60% as of June 30, 2016, and September 30, 2015, respectively.

Because no active market exists for the Postal Service's debt with the FFB, the fair value of the noncurrent portion of this liability has been estimated using expected future payments at risk-adjusted discount rates provided by the FFB, a *Level 3* input. For the current portion of debt, carrying amount approximates fair value.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CAUTIONARY STATEMENTS

The following *Management's Discussion and Analysis of Financial Condition and Results of Operations* and other parts of this report describe the principal factors affecting the financial results, liquidity, capital resources and critical accounting estimates of the United States Postal Service ("Postal Service," "USPS," "we," "our" and "us"). Our results of operations may be impacted by risks and uncertainties discussed here and in our Annual Report on Form 10-K for the year ended September 30, 2015, ("Annual Report") filed with the Postal Regulatory Commission ("PRC") on November 13, 2015. Such factors, many of which we cannot control or influence, may cause actual results to differ materially from those currently contemplated.

Unless otherwise noted, our operating results for the three and nine months ended June 30, 2016, and 2015, are presented in accordance with accounting principles generally accepted in the United States ("GAAP"). These results are not necessarily indicative of the results to be expected for the year ended September 30, 2016, and should be read in conjunction with our Annual Report. All references to years in this report, unless otherwise stated, refer to fiscal years beginning October 1 and ending September 30. All references to quarters, unless otherwise stated, refer to quarters within fiscal years 2016 and 2015.

Forward-looking statements contained in this report represent our best estimates of known and anticipated trends believed relevant to future operations. However, actual results may differ significantly from current estimates. Certain forward-looking statements included in this report use such words as "may," "will," "could," "expect," "believe," "plan," "estimate," "project" or other similar terminology. These forward-looking statements, which involve a number of risks and uncertainties, reflect current expectations regarding future events and operating performance as of the date of this report. We have no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

OVERVIEW

With our mandate to provide universal postal services to the nation, we serve individuals and commercial customers in the U.S. as well as internationally. Our operations include an extensive and integrated retail, processing, transportation and delivery network.

The *Postal Accountability and Enhancement Act* ("PAEA") classifies our products into two broad categories: Market-Dominant and Competitive "products," however, we use the term "services" in this document for consistency with other descriptions of services offered. The PAEA also established certain requirements that affect our financial results, most notably the mandate that we prefund retiree health benefits through the Postal Service Retirement Health Benefits Fund ("PSRHBF").

We have successfully implemented initiatives that have reduced our costs by billions of dollars while offering broader services. However, legal restrictions on pricing, service diversification and operations restrict our ability to fully implement our strategic objectives and cover our costs to provide secure, reliable and affordable postal services to the nation. We continue to implement certain strategies to achieve financial stability and reduce our debt. Strategically we focus on a four-pronged approach to attain profitability:

1. Maintaining liquidity and reducing operating expenses to reflect current and future mail volume,
2. Delivering high levels of performance and affordable services,
3. Informing stakeholders during Congressional testimony and industry engagement activities about the changes necessary to our legal and regulatory framework to enable long-term financial sustainability, and
4. Identifying and creating innovative services, promotions and capabilities that enable revenue growth, and investing prudently in infrastructure necessary to maintain and improve our services offered.

RESULTS OF OPERATIONS

SUMMARY

The major factors that impact our operating results include overall customer demand, the mix of postal services and contribution associated with those services, volume of mail and packages processed through our network and our ability to manage our cost structure in line with declining levels of mail volume, growth in more labor-intensive Shipping and Packages volume and an increasing number of delivery points. We operate as a single segment and report our performance as such.

Three Months Ended June 30, 2016

Operating revenue for the three months ended June 30, 2016, increased $1.2 billion, or 7.1%, compared to the same period last year. This increase was primarily due to the effects of a $1.1 billion non-cash change in accounting estimate, discussed below in *Change in Accounting Estimate*, and an increase in our Shipping and Packages revenue of $645 million, or 18.1%. Excluding the effect of the non-cash change in accounting estimate, revenue growth for the three months ended June 30, 2016, was $117 million, or 0.7%.

This increase in operating revenue was partially offset by the expiration of the exigent surcharge on April 10, 2016, which we estimate resulted in reducing operating revenue by approximately $450 million, compared to the same period last year. The expiration of the exigent surcharge most significantly impacted revenue associated with *First-Class Mail* and *Standard Mail*, impacting certain other Market-Dominant services to a lesser extent.

Operating expenses for the three months ended June 30, 2016, increased $2.1 billion, or 12.5%, compared to the same period last year. This increase was largely due to the unfavorable change in workers' compensation expense of $1.6 billion resulting from lower discount rates compared to the same period last year. The increase in operating expenses was also due to higher compensation and benefits expense of $387 million, resulting primarily from an increase in the amount of labor hours used to support higher package volumes, and an increase in transportation costs of $97 million driven by an increase in air transportation to support the Shipping and Packages volume growth and our strategic efforts to continue to improve our delivery service.

This resulted in a net loss of $1.6 billion for the three months ended June 30, 2016, compared to a net loss of $586 million for the same period last year, an increase in net loss of $981 million.

Nine Months Ended June 30, 2016

Operating revenue for the nine months ended June 30, 2016, increased $2.6 billion, or 4.9%, compared to the same period last year. This increase was primarily due to an increase in our Shipping and Packages revenue of $1.8 billion, or 15.8%, which benefited from the calendar year 2015 holiday season, and by the impact of the $1.1 billion non-cash change in accounting estimate. Excluding the effect of the non-cash change in accounting estimate, revenue growth for the nine months ended June 30, 2016, was $1.5 billion, or 2.9%.

This increase in operating revenue was partially offset by the expiration of the exigent surcharge on April 10, 2016, the impact of which we estimate resulted in reducing operating revenue by approximately $450 million, compared to the same period last year. The expiration of the exigent surcharge most significantly impacted revenue associated with *First-Class Mail* and *Standard Mail*, impacting certain other Market-Dominant services to a lesser extent.

Operating expenses for the nine months ended June 30, 2016, increased $3.0 billion, or 5.5%, compared to the same period last year. This increase was primarily due to an increase in workers' compensation expense of $1.4 billion, as discount rates declined in the nine months ended June 30, 2016, compared to the same period last year. The increase in operating expenses was also due to increased compensation and benefits expense of $1.1 billion, resulting primarily from an increase in labor hours used to support higher package volumes, and an increase in transportation costs of $328 million driven by an increase in air, and to a lesser extent, highway transportation in support of the Shipping and Packages volume growth and our strategic efforts to continue to improve our delivery service.

This resulted in a net loss of $3.3 billion for the nine months ended June 30, 2016, compared to a net loss of $2.8 billion for the same period last year, an increase in net loss of $491 million.

Change in Accounting Estimate

We recognize revenue for postage at the time a piece of mail is processed and delivered, not when we receive cash for the sale of a postage stamp. We estimate the amount of postage stamps that we have sold but customers have not yet used and include this amount as a liability in our Balance Sheets as *Deferred revenue-prepaid postage*. The majority of this liability consists of our estimate of sold but unused *Forever Stamps*, the non-denominated postage stamps we introduced in 2007. Since their introduction, we have sold approximately $47 billion in *Forever Stamps* to the public.

We have developed and validated the usage portion of our deferred revenue estimate through complex mathematical and statistical methods, including regression analysis of postage stamp usage trends. Small differences in inputs can lead to significant differences in our estimate of the liability. "Breakage" represents the small portion of sold *Forever Stamps* that we estimate will never be used by customers due to loss, damage or stamp collection. Assumptions regarding estimated usage and breakage of a particular postage stamp issue cannot be refined until each "series" of postage stamps nears the end of its life cycle.

In the three months ended June 30, 2016, we analyzed data that was not previously available on consumer behavior and usage patterns of *Forever Stamps*, specifically postage stamps nearing completion of their lifecycle. This new data, which allowed us to account for approximately $31 billion in *Forever Stamps* sold from 2011 through June 30, 2016, resulted in an update of the usage and breakage inputs we included in the statistical estimation process. We believe this change improved the estimation of stamp usage and related revenue recognition.

As a result of this analysis, we recorded a decrease in *Deferred revenue-prepaid postage* of $1.1 billion as of June 30, 2016, and an increase in revenue and decrease in our net loss by the same amount for the three and nine months ended June 30, 2016. This change relates solely to changes in our estimates of stamp usage and breakage and, in accordance with GAAP, we consider the change a change in accounting estimate. This adjustment had no impact on our current liquidity nor did it lessen the severity of our liquidity outlook.

Non-GAAP Controllable Income (Loss)

In the day-to-day operation of our business, we focus on costs within our control, such as work hours and transportation. We calculate controllable income (loss), a non-GAAP measure, by excluding items we cannot control, such as PSRHBF expenses, workers' compensation expenses caused by actuarial revaluation and discount rate changes, retirement expenses caused by actuarial revaluation, and adjustments for non-recurring items, such as the change in accounting estimate. Controllable income (loss) should not be considered a substitute for net income and other GAAP reporting measures.

The following table reconciles GAAP net loss to controllable income (loss) for the three and nine months ended June 30, 2016, and 2015:

	Three Months Ended June 30,		Nine Months Ended June 30,	
(in millions)	**2016**	**2015**	**2016**	**2015**
Net loss	**$ (1,567)**	**$ (586)**	**$ (3,299)**	**$ (2,808)**
PSRHBF prefunding expense	1,450	1,425	4,350	4,275
Change in workers' compensation liability related to fluctuations in discount rates	668	(950)	1,214	268
Other change in workers' compensation liability[1]	(102)	(86)	(102)	(494)
Actuarial revaluation of retirement liability[2]	60	—	181	—
Change in accounting estimate	(1,061)	—	(1,061)	—
Controllable income (loss)	**$ (552)**	**$ (197)**	**$ 1,283**	**$ 1,241**

[1] This is a net amount that includes changes in assumptions, as well as the valuation of new claims and revaluation of existing claims, less claim payments for the applicable periods.

[2] Determined by OPM in 2015 to amortize the $3.6 billion unfunded FERS retirement obligation based on actuarial valuations and assumptions. Payments are to be made in equal installments over the next 30 years. The 2015 expense of $241 million was recorded in full at year-end 2015.

OPERATING REVENUE AND VOLUME

First-Class Mail and *Standard Mail* continued to provide the majority of our revenue for the three months ended June 30, 2016, despite long-term trends away from hard copy communication to electronic media. *First-Class Mail* generated 37% of our revenue and 40% of our volume, while *Standard Mail* generated 23% of revenue and 52% of volume.

While we continue to experience strong results in our Shipping and Packages business, it represented only 24% of our revenues for the three months ended June 30, 2016, compared to *First-Class Mail*, which represented 37%. Furthermore, Shipping and Packages generated only 3% of our volume for the three months ended June 30, 2016. For 2015, Shipping and Packages revenues would have needed to increase by 260% in order to make up for the impact of the contribution provided by the volume losses of *First-Class Mail* for that year, as the costs to process and deliver Shipping and Packages services were, and continue to be, substantially higher than the costs for *First-Class Mail*.

Although revenue and volume are closely linked to the strength of the U.S. economy and changes in how our customers use the mail, we have been active in addressing growth opportunities. We continue to concentrate on our customers' needs and have increased our marketing investment, as well as focusing on mail and package innovation. However, we also recognize that revenue growth is constrained by laws and regulations restricting the types of products, services and prices we can offer to our customers and the speed with which we can bring them to market.

To address the long-term trend that technological change and the lingering effects of the Great Recession have had on our *First-Class Mail* revenue and volume, we have focused on providing new services, growing e-commerce and implementing marketing campaigns that have helped us grow our Shipping and Packages business. By offering day-specific delivery, improved tracking and text alerts and up to $50 of free insurance on most *Priority Mail* packages, we have demonstrated our responsiveness to our customers.

As described below, we implemented price increases on certain Market-Dominant and Competitive services in January 2014 and May 2015. We also implemented price increases on certain Competitive services, effective January 2016.

The PRC authorized us to collect an exigent surcharge on most Market-Dominant services beginning in January 2014 until it produced incremental revenue of just over $4.6 billion, a figure the PRC determined was lost due to the Great Recession's suppression of mail volume. The limit on the exigent surcharge was reached on April 10, 2016, and we therefore reduced the prices of applicable Market-Dominant services on that date. As a result of the expiration of the surcharge, we expect our revenue and cash flow to decline, from what it otherwise would be, by approximately $500 million for the remainder of 2016, and by almost $2 billion per year thereafter, unless the PRC's decision to limit our recovery in the fashion described above is modified again or reversed through the pending appeal.

The following table summarizes our operating revenue and volume for the three and nine months ended June 30, 2016, and 2015, by each service line:

	Three Months Ended June 30,		Nine Months Ended June 30,	
(in millions)	**2016**	**2015**	**2016**	**2015**
Operating Revenue:				
First-Class Mail[1]	$ 6,493	$ 6,872	$ 21,280	$ 21,612
Standard Mail[2]	4,069	4,138	13,319	13,317
Shipping and Packages[3]	4,200	3,555	13,177	11,378
International	660	638	2,169	2,137
Periodicals	369	399	1,152	1,202
Other[4]	846	918	2,621	2,554
Total operating revenue before change in accounting estimate	**$ 16,637**	**$ 16,520**	**$ 53,718**	**$ 52,200**
Change in accounting estimate	$ 1,061	—	$ 1,061	—
Total operating revenue	**$ 17,698**	**$ 16,520**	**$ 54,779**	**$ 52,200**
Volume:				
First-Class Mail[1]	14,624	15,133	46,954	47,724
Standard Mail[2]	19,115	18,790	60,671	60,661
Shipping and Packages[3]	1,220	1,074	3,895	3,420
International	229	218	776	723
Periodicals	1,428	1,485	4,247	4,438
Other[5]	117	95	378	329
Total volume	**36,733**	**36,795**	**116,921**	**117,295**

[1] Excludes *First-Class Mail Parcels*.

[2] Excludes *Standard Mail Parcels*.

[3] Includes *Priority Mail*, *Priority Mail Express, USPS Retail Ground*, Parcel Select, *Parcel Return Service*, *Standard Parcels*, Package Services, *First-Class Mail Parcels* and *First-Class Package Service.*

[4] Other revenue includes *PO Box* services, *Certified Mail*, Return Receipts, Insurance, Other Ancillary Services, Shipping and Mailing Supplies, Collect on Delivery, Registered Mail, Stamped Envelopes and Cards, money orders and Other services.

[5] Other volume includes U.S. Postal Service internal mail and free mail provided to certain groups by law.

First-Class Mail

First-Class Mail, as presented in the table above, includes cards, letters, and flats, and is priced the same regardless of the distance the mail travels. Although *First-Class Mail* is our most profitable service category, volume has trended lower over the past years due to the continuing migration toward electronic communication and electronic transaction alternatives.

For the three months ended June 30, 2016, *First-Class Mail* revenue fell by $379 million, or 5.5%, on a volume decline of 3.4%, compared to the same period last year. The decline in revenue was greater than the decline in volume for the period due to the impact of the exigent price surcharge expiring on April 10, 2016. We estimate that approximately $260 million of the decline in *First-Class Mail* revenue was attributable to the surcharge expiration.

For the nine months ended June 30, 2016, *First-Class Mail* revenue fell by $332 million, or 1.5%, on a volume decline of 1.6%, compared to the same period last year. Likewise, we estimate that approximately $260 million of this decline in *First-Class Mail* revenue was attributable to the surcharge expiration.

Standard Mail

Standard Mail is mail not required to be mailed as *First-Class Mail* or *Periodicals*, and may include advertising, newsletters, catalogs, small marketing parcels and other printed matter. *Standard Mail* volume is reflective of the cyclical nature of the U.S. economy and competition from other forms of advertising. Price increases for *Standard Mail* are generally capped at the rate of inflation because they are classified by law as Market-Dominant.

For the three months ended June 30, 2016*, Standard Mail* revenue fell by $69 million, or 1.7%, despite volume growth of 1.7%, compared to the same period last year. This volume growth was largely attributable to an increase in political and election mail, which alone accounted for 274 million of the volume increase of 325 million pieces. However, revenue declined due to the expiration of the exigent surcharge, which we estimate contributed to approximately $155 million in lower *Standard Mail* revenue, compared to the same period last year.

For the nine months ended June 30, 2016*, Standard Mail* revenue and volume were both essentially unchanged, compared to the same period last year. Political and election mail revenue and volume declined for the nine months ended June 30, 2016, compared to the same period last year, as the revenue and volume associated with the 2016 primary election season did not exceed the revenue and volume associated with the November 2014 mid-term elections. Were it not for the effects of political and election mail, *Standard Mail* revenue and volume would have each increased for the nine months ended June 30, 2016. Furthermore, we estimate that the incremental revenue decline in *Standard Mail* due to the expiration of the exigent surcharge was approximately $155 million, compared to the same period last year.

Shipping and Packages

For the three months ended June 30, 2016, Shipping and Packages revenue grew by 18.1% on volume growth of 13.6%, compared to the same period last year. For the nine months ended June 30, 2016, Shipping and Packages revenue grew by 15.8% on volume growth of 13.9%, compared to the same period last year. The following table summarizes our operating revenue and volume for Shipping and Packages for the three and nine months ended June 30, 2016, and 2015, by each service:

	Three Months Ended June 30,		Nine Months Ended June 30,	
(in millions)	**2016**	**2015**	**2016**	**2015**
Shipping and Packages Revenue:				
Priority Mail	$ 1,979	$ 1,789	$ 6,312	$ 5,867
Parcel Services[1]	1,151	827	3,601	2,605
First-Class Packages[2]	693	563	2,066	1,718
Package Services	170	175	590	599
Priority Mail Express	207	201	608	589
Total Shipping and Packages revenue	**$ 4,200**	**$ 3,555**	**$ 13,177**	**$ 11,378**
Shipping and Packages Volume:				
Priority Mail	252	241	799	772
Parcel Services[1]	583	474	1,865	1,495
First-Class Packages[2]	252	229	770	707
Package Services	125	121	436	419
Priority Mail Express	8	9	25	27
Total Shipping and Packages volume	**1,220**	**1,074**	**3,895**	**3,420**

[1] Includes *Parcel Select*, *Parcel Return*, *Standard Parcels*.

[2] Includes *First-Class Mail Parcels* and *First-Class Package Services*.

Our Shipping and Packages business has continued to show solid revenue and volume growth as a result of our successful efforts to compete in the ground shipping services and "last mile" e-commerce fulfillment markets, including through Sunday delivery. Volume also experienced end-to-end growth as consumers continued to utilize online shopping, which provided a surge in package volume with a record number of packages delivered during the calendar year 2015 holiday season. To accommodate this surge in volume and avoid service disruptions during the holiday season, we increased Sunday delivery service and added non-career employees for the season in accordance with our labor agreements.

Priority Mail

Priority Mail enables shipping in 1-3 business days for packages weighing up to 70 pounds. *Priority Mail* accounts for our largest portion of Shipping and Packages revenue, representing approximately 47.1% of the total for the three months ended June 30, 2016. Similarly, for the nine months ended June 30, 2016, *Priority Mail* represented 47.9% of our total Shipping and Packages revenue.

For the three months ended June 30, 2016, *Priority Mail* revenue grew by 10.6% on volume growth of 4.6%, compared to the same period last year. For the nine months ended June 30, 2016, *Priority Mail* revenue grew by 7.6% on volume growth of 3.5%, compared to the same period last year. The January 2016 price increase in Competitive services also contributed to higher revenues for both the three and nine months ended June 30, 2016.

Parcel Services

Our Parcel Services category includes *Parcel Select*, *Parcel Return* and *Standard Parcels*, which are Competitive services largely consisting of "last mile" deliveries. For the three months ended June 30, 2016, revenue from Parcel Services increased by 39.2%, compared to the same period last year. Similarly, for the nine months ended June 30, 2016, revenue from this category increased by 38.2%, compared to the same period last year.

This category showed strong volume growth of 23.0% and 24.7% for the three and nine months ended June 30, 2016, respectively, compared to the same period last year, driven by the continuing growth of e-commerce which largely affects our *Parcel Select* service. However, this category is one of our lowest-priced services, and as a result, provided a relatively low level of contribution compared to many of our other services.

First-Class Packages

First-Class Packages includes *First-Class Package Service*, an under-one-pound Competitive service targeted to commercial customers, and *First-Class Parcels*, a Market-Dominant under-13-ounce retail package product. This category offers commercial customers that ship primarily lightweight fulfillment parcels the lowest-priced expedited end-to-end package option in the marketplace.

For the three months ended June 30, 2016, First-Class Packages revenue increased 23.1% and volume grew by 10.0%, compared to the same period last year. For the nine months ended June 30, 2016, First-Class Packages revenue increased 20.3% and volume grew by 8.9%, compared to the same period last year. Within the category, we experienced a shift in volume from *First-Class Package Service* to *First-Class Parcels*, as customers responded to the January 2016 price increase in Competitive services.

Package Services

Customers use our Package Services category for shipping merchandise or bound printed matter, including library and media mail, weighing up to 70 pounds. For the three months ended June 30, 2016, Package Services revenue decreased by 2.9%, although volume increased by 3.3%, compared to the same period last year. Likewise, for the nine months ended June 30, 2016, Package Services revenue decreased by 1.5%, although volume grew by 4.1%, compared to the same period last year. This category has been affected by certain large mailers' increased use of drop shipments offset by a lower price per piece on bound printed matter, causing a divergence in revenue and volume results.

International Mail

Our International Mail category includes several service lines that enable customers, both domestic and abroad, to send international mail and packages, including postcards, envelopes, flats and packages with either standard or express delivery options.

For the three months ended June 30, 2016, International Mail revenue increased 3.4% and volume increased by 5.0%, compared to the same period last year. For the nine months ended June 30, 2016, International Mail revenue increased 1.5% and volume increased 7.3%, compared to the same period last year.

For both the three and nine months ended June 30, 2016, the January 2016 price increases have positively affected revenue from *First-Class International Package Service* and other international Competitive services, compared to the same periods last year. Although we continue to experience an increase in lower-priced inbound mail volume, much of that from tracked letter packets and parcels related to international e-commerce, outbound mail volume continues to decrease, despite the fact that the U.S. dollar has stabilized during the 2016 periods relative to other currencies.

Periodicals

Our *Periodicals* class of mail is designed for newspapers, magazines and other periodical publications whose primary purpose is transmitting information to an established list of subscribers or requesters. For the three months ended June 30, 2016, *Periodicals* revenue decreased 7.5% and volume decreased by 3.8%, compared to the same period last year. For the nine months ended June 30, 2016, *Periodicals* revenue decreased 4.2% and volume decreased by 4.3%, compared to the same period last year. Trends in hard-copy reading behavior and shifts of advertising away from print have depressed this segment for years. *Periodicals* revenue is not expected to rebound as electronic content continues to grow in popularity with the public.

Other

Other services include ancillary services such as *Certified Mail*, *PO Box* services and *Return Receipt* services. Also included in this category are money orders and passport services.

For the three months ended June 30, 2016, Other services revenue decreased by 7.8% despite a volume increase of 23.2%, compared to the same period last year. This divergence was due to an increase in volume of services that produce no revenue for us, which includes signature on delivery, insurance, and U.S. Postal Service internal mail. For the nine months ended June 30, 2016, Other services revenue increased by 2.6% and volume increased by 14.9%, compared to the same period last year. We experience our highest volume of the year in this category during the first quarter of each year, which affects our results for the nine months ended June 30, 2016.

OPERATING EXPENSES

In an effort to align our resources with anticipated types of services and mail volume, we continue to aggressively manage operating expenditures under management's control.

Our mail processing and distribution network was originally designed to provide overnight delivery service of *First-Class Mail* within specified delivery areas for a much higher volume of mail than we are required to process and deliver today, and the network's legacy capabilities are excessive relative to today's mail volume. Consequently, many of our processing and distribution facilities continue to operate at less than full capacity. Our challenge to contain costs is also compounded by the continuing increase in the number of delivery points, which, when combined with the impact of lower hard copy mail volume, has resulted in a drop in the average number of pieces delivered per delivery point per day from approximately 5.5 pieces in 2007 to 3.8 pieces in 2015, a reduction of approximately 31%.

Compensation and Benefits

Compensation and benefits expenses consist of costs related to our active career and non-career employees. The following table presents the compensation and benefits expense for the three and nine months ended June 30, 2016, and 2015:

	Three Months Ended June 30,		**Nine Months Ended June 30,**	
(in millions)	**2016**	**2015**	**2016**	**2015**
Compensation	$ 8,996	$ 8,781	$ 27,679	$ 27,122
Retirement	1,671	1,552	5,048	4,675
Employee health benefits	1,246	1,188	3,702	3,574
Other	83	88	252	246
Total compensation and benefits	**$ 11,996**	**$ 11,609**	**$ 36,681**	**$ 35,617**

Compensation

Compensation expense increased 2.4% for the three months ended June 30, 2016, compared to the same period last year. The increase was primarily due to an increase in total work hours. For the three months ended June 30, 2016, total work hours were 285 million, an increase of approximately 6 million work hours, or 2.2%, from the 279 million total work hours for the three months ended June 30, 2015.

Compensation expense increased 2.1% for the nine months ended June 30, 2016, compared to the same period last year. The increase was primarily due to an increase in total work hours. For the nine months ended June 30, 2016, total work hours were 872 million, an increase of approximately 23 million work hours, or 2.7%, from the 849 million total work hours for the nine months ended June 30, 2015. These increases in work hours were largely due to an increased workload from higher package volumes, an increased number of Sunday deliveries, and increased utilization through the addition of nearly 5,000 non-career employees as of June 30, 2016, compared to the same period last year. Efforts to improve service and the additional work day due to the leap year also contributed to the work hour increase for the nine months ended June 30, 2016.

The number of career employees also increased by approximately 11,000 as of June 30, 2016, compared to the same date last year, primarily reflecting the conversion of non-career employees to career status. Although these recently-converted career employees are compensated at higher rates than non-career employees, these conversions to career status are at the lower tier career employee rate, in accordance with the provisions of our labor agreements. The additional use of these lower wage employees (both non-career and employees newly-converted from non-career to career) has provided an offset to upward wage pressures from salary increases and rising benefit costs.

In April 2016, we reached a new three-year collective bargaining agreement with the National Rural Letter Carriers' Association ("NRLCA") which was ratified by the NRLCA membership. The new contract includes general wage increases totaling 3.8% (1.2% of which is retroactive to November 2015) with a cost-of-living adjustment ("COLA") base month of July 2014 (no retroactive COLA payments), a reduction in the employer share of health insurance premiums, beginning in the 2017 plan year, and the creation of a new non-career employee category to provide weekend and holiday parcel deliveries. The contract will expire on May 20, 2018.

In May 2016, we agreed to extend contract negotiations on new collective bargaining agreements with both the National Association of Letter Carriers ("NALC") and the National Postal Mail Handlers Union, AFL-CIO ("NPMHU"). Our contracts with NALC and NPMHU each expired on May 20, 2016, and the respective parties mutually agreed to extend negotiations beyond the deadline.

In July 2016, an interest arbitration decision was issued that resulted in an award which established a collective bargaining agreement between the American Postal Workers Union, AFL-CIO ("APWU") and us. The award, which will expire on September 20, 2018, was the result of a legally-mandated binding arbitration process that was required when the parties reached impasse in negotiating a new collective bargaining agreement after the prior agreement expired in May 2015. The contract includes general wage increases totaling 3.8% (1.2% of which is retroactive to November 2015) with a COLA base month of July 2014 (no retroactive COLA payments), a reduction in the employer share of health insurance premiums, beginning in the 2017 plan year, and annual increases in uniform and work clothes allowances. The award also converted approximately 5,000 non-career positions to career positions.

Retirement

The majority of career employees participate in one of two U.S. government pension programs based on the starting date of their employment with a U.S. government employer. All expenses of the retirement programs, except for retiree health benefits, are included in compensation and benefits expense. For additional information, see *Item 1. Financial Statements, Notes to Unaudited Financial Statements, Note 6 - Retirement Plans*.

Retirement expense increased 7.6% for the three months ended June 30, 2016, compared to the same period last year, and 8.0% for the nine months ended June 30, 2016, compared to the same period last year. The most significant factors contributing to this increase were: the increase in the number of employees who participated in FERS; the increase in our employer contribution rate from 13.2% to 13.7% of basic pay for most participants; and an increase in the supplemental expense related to the actuarial revaluation of our FERS liability that we did not expense until the end of 2015.

The employer contribution rate increase became effective in October 2015, and is expected to increase our annual retirement expense by approximately $150 million. This government-wide increase, determined by OPM, underscores the need for USPS-specific calculations of our retirement liabilities based on the demographics and economic assumptions of our workforce. We estimate that using the government-wide assumptions results in higher expenses than using USPS-specific assumptions.

In September 2015, OPM notified us that our FERS account for our retirees was underfunded by $3.6 billion as of September 30, 2014, when calculated using government-wide economic and demographic assumptions. To fund this supplemental liability, OPM directed us to make additional payments to FERS of $241 million per year for 30 years beginning in 2015, and as a result, we accrued $60 million for the three months ended June 30, 2016, and $181 million for the nine months ended June 30, 2016, for this obligation. Because OPM did not provide notification until September 2015, we expensed the full-year amount in the fourth quarter 2015. As of the date of this report, we have not paid any portion of this obligation and have submitted a *Request for Reconsideration* to OPM, recommending that OPM utilize Postal Service-specific salary growth and demographic assumptions, rather than government-wide assumptions in calculating our FERS liability.

Employee Health Benefits

Employee health benefits expense increased 4.9% for the three months ended June 30, 2016, compared to the same period last year, and 3.6% for the nine months ended June 30, 2016, compared to the same period last year, due to a sharp increase in premiums for the 2016 calendar year. On average, healthcare premiums rose 8.0% for the 2016 plan year, which affected the three months ended June 30, 2016, although this increase was partially offset by the lower contribution rate of healthcare premiums that we funded, and the shift of certain employees from "Family Coverage" to a "Self Plus One" option under the Federal Employees Health Benefits ("FEHB") Program.

Our share of healthcare premiums for our employees represented 74.2% and 74.8% of the total healthcare premium cost for the three months ended June 30, 2016, and 2015, respectively. Our share of healthcare premiums for our employees represented 74.4% and 75.1% of the total healthcare premium cost for the nine months ended June 30, 2016, and 2015, respectively, consistent with our contractual agreements; however, the effects of the quarterly decrease in our share were offset by a higher number of eligible employees in the FEHB program and higher premium costs.

Retiree Health Benefits

We participate in federal employee benefit programs for retirement, health and workers' compensation benefits. Under PAEA, we are obligated to fully fund the employer's portion of the established health benefits of retirees and our current employees (as discussed in *Item 1. Financial Statements*, *Notes to Unaudited Financial Statements*, *Note 7 - Health Benefits Plans* and *Note 2 - Liquidity*). The components of retiree health benefits expense for the three and nine months ended June 30, 2016, and 2015, were as follows:

	Three Months Ended June 30,		Nine Months Ended June 30,	
(in millions)	**2016**	**2015**	**2016**	**2015**
Accrual for prefunding payment to PSRHBF	$ 1,450	$ 1,425	$ 4,350	$ 4,275
Employer premium expense	837	784	2,465	2,323
Total retiree health benefits expense	**$ 2,287**	**$ 2,209**	**$ 6,815**	**$ 6,598**

Retiree health benefits expense increased 3.6% for the three months ended June 30, 2016, compared to the same period last year, and 3.3% for the nine months ended June 30, 2016, compared to the same period last year. The increase is due in part to higher employer premium expense, which is separate from the accrual for the PSRHBF prefunding payment. Employer premium expense increased by 6.8% and 6.1% for the three and nine months ended June 30, 2016, respectively, compared to the same periods last year. Separately, the nine-month accrual for the PSRHBF increased by 1.8%, compared to the same period last year, due to the mandated annual prefunding amount due by September 30, 2016, which increased by $100 million to $5.8 billion in 2016 from $5.7 billion last year.

Under PAEA, we continue to expense and pay the premiums for our retirees participating in FEHB until September 30, 2016, after which the payments of the premiums will be made from the PSRHBF. Retiree health benefits premium costs are primarily impacted by the number of retirees and survivors receiving health benefits, the mix of plans selected by retirees, the premium costs of those plans, and the portion of premium costs allocated to the U.S. government for retiree service prior to 1971. As of June 30, 2016, approximately 490,000 of our retirees participated in the plan, an amount essentially unchanged compared to the same period last year.

These costs are reflected as *Retiree health benefits* in the accompanying unaudited Statements of Operations, and consist of payments to OPM for our share of FEHB retiree premiums paid during the period, plus accrued prefunding payments to the PSRHBF. Because the amounts scheduled to be paid into the PSRHBF are set by legislation, our retiree health benefits expense represents more than the full normal cost of the benefits earned by our employees.

Workers' Compensation

Our employees injured on the job are covered by the Federal Employees' Compensation Act ("FECA"), administered by the Department of Labor's ("DOL") Office of Workers' Compensation Programs, which makes all decisions regarding injured workers' eligibility for benefits. Our workers' compensation expense reflects the impacts of changes in discount and inflation rates, as well as the actuarial valuation of new workers' compensation cases and revaluation of existing ones. We reimburse the DOL for all workers' compensation benefits paid to or on behalf of our employees and their beneficiaries, plus an administrative fee.

Workers' Compensation Expense

For the three months ended June 30, 2016, the portion of workers' compensation expense attributable to the impact of discount rate changes was a $668 million increase, compared to a $950 million reduction in expense for the same period last year, a net increase of $1.6 billion. For the nine months ended June 30, 2016, the portion of workers' compensation expense attributable to the impact of discount rate changes was a $1.2 billion increase, compared to a $268 million increase for the same period last year, an overall increase of $946 million. This portion of workers' compensation expense was affected by activity outside of management's control, specifically declining interest rates during the three and nine months ended June 30, 2016, compared to the same periods last year. Notably, the 2016 periods experienced precipitous declines in interest rates immediately following the United Kingdom's June 23, 2016, vote by referendum to withdraw from the European Union, commonly referred to as "Brexit," which affected financial markets across the globe.

For the three months ended June 30, 2016, the portion of workers' compensation expense due to the actuarial valuation of new and existing cases was $290 million, compared to $309 million for the same period last year, a decrease of $19 million. For the nine months ended June 30, 2016, the portion of workers' compensation expense due to the actuarial valuation of new and existing cases was $966 million, compared to $549 million for the same period last year, an increase of $417 million. This $549 million portion of the expense for the nine months ended June 30, 2015, reflected a one-time change in accounting estimate under GAAP that was recognized during the first quarter of 2015, which reduced workers' compensation expense by $353 million for the nine months ended June 30, 2015.

Changes in actuarial valuation are primarily attributable to the combined impacts of routine changes in actuarial estimation, new compensation and medical cases, the progression of existing cases and updated COLA assumptions, which are largely outside of management's control. Workers' compensation expense was also impacted by higher medical claim experience during nine months ended June 30, 2016.

Under FECA, workers' compensation claims for many types of injuries cannot be settled through lump-sum payments, and in some instances with regard to those claims, compensation may be paid over many years. Federal law grants cost-of-living adjustments to those claims, and these factors result in substantially higher costs to us than would likely result if we managed our own claims. Additionally, since we do not manage the FECA program, we have no ability to control the significant administrative costs associated with managing the claims and payments process.

Compound-Drug Costs

In recent years, our workers' compensation liability has increased substantially due to DOL's failure to control compound-drug costs. In 2013, our compound-drug costs totaled $9 million. However, in 2015, these costs increased to $99 million -- an eleven-fold increase in only two years. In March 2016, the U.S. Postal Service Office of Inspector General issued a report concluding that those increases were attributable to DOL's failure to control the pharmacy-compound invoicing process. As the report recognized, we have no control over that process, which the DOL exclusively administers.

We have, however, repeatedly urged DOL to address the problem. For example, in October 2015, we formally asked DOL to adjust its annual charge-back invoice and we withheld a $69 million payment for new compound-drug costs. DOL ultimately refused to adjust the bill, and we paid the $69 million as we were legally required to do. Nevertheless, we have continued to press DOL to adopt additional safeguards over the billing process and to reign in compound-drug costs. For the 2016 charge-back year (July 1, 2015 - June 30, 2016), DOL paid approximately $165 million in compound-drug costs on behalf of Postal Service claimants. This represents a 67% increase over 2015 costs and nearly a 1,700% increase over the $9 million cost in 2013.

Transportation

The components of transportation expense for the three and nine months ended June 30, 2016, and 2015, were as follows:

	Three Months Ended June 30,		Nine Months Ended June 30,	
(in millions)	**2016**	**2015**	**2016**	**2015**
Highway	$ 871	$ 864	$ 2,857	$ 2,717
Air	647	530	1,903	1,614
International	151	180	501	616
Other	12	10	44	30
Total transportation expenses[1]	**$ 1,681**	**$ 1,584**	**$ 5,305**	**$ 4,977**

[1] Transportation expense includes only the costs we incur to transport mail and other products between our facilities and does not include actual delivery costs to final destination points.

Highway and air transportation expense increased due in large part to package volume growth and our strategic efforts to continue to improve our delivery service results. These increased transportation costs were buffered by an approximately 19% reduction in average diesel fuel prices, affecting our highway network, and an approximately 14% reduction in average jet fuel prices, affecting our air network. International transportation expenses, which represent expenses related only to outbound services, decreased primarily due to a decline in *Priority Mail International* and *Priority Mail Express International* volumes.

Other Operating Expenses

The following table details other operating expenses for the three and nine months ended June 30, 2016, and 2015:

	Three Months Ended June 30,		Nine Months Ended June 30,	
(in millions)	**2016**	**2015**	**2016**	**2015**
Supplies and services	$ 664	$ 684	$ 2,027	$ 2,011
Depreciation and amortization	435	444	1,307	1,313
Rent and utilities	375	384	1,160	1,212
Vehicle maintenance service	149	155	469	457
Delivery vehicle fuel	90	108	265	330
Information technology and communications	226	208	596	564
Rural carrier equipment maintenance	115	120	361	387
Miscellaneous other	243	220	779	640
Total other operating expenses	**$ 2,297**	**$ 2,323**	**$ 6,964**	**$ 6,914**

LIQUIDITY AND CAPITAL RESOURCES

We held unrestricted cash and cash equivalents of $8.9 billion and $6.6 billion as of June 30, 2016, and September 30, 2015, respectively. Our average daily cash balance during the three months ended June 30, 2016, was $8.9 billion, which represents approximately 32 days of operating cash. We define days of cash available as unrestricted cash divided by estimated average cash disbursements per business day (usually 251 cash disbursement days per year). However, due to the timing of our payroll cycles, we disbursed approximately $1.8 billion in cash to fund bi-weekly payroll during the first days of July 2016, thus reducing the balance of unrestricted cash and cash equivalents we held immediately after the close of the quarter.

CASH FLOW ANALYSIS

Although our cash balances have increased, they remain insufficient to support an organization with approximately $74 billion in annual operating expenses. Further, we have been unable to make $28.1 billion in legally-obligated PSRHBF payments since 2011. Our operations will require significant capital investment over the next few years to modernize and improve our processing and delivery infrastructure in order to be able to continue to meet our statutory obligation to provide prompt, reliable and efficient postal services to the nation. Furthermore, given our inability to raise cash through the issuance of additional debt, our current level of available liquidity may be insufficient to support our operations in the event of another significant downturn in the U.S. economy.

Operating Activities

Cash provided by operating activities increased by $169 million, or 5.4%, for the nine months ended June 30, 2016, compared to the same period last year. This increase is primarily attributable to timing differences associated with accrued payroll resulting in an approximately $250 million higher accrual for compensation and benefits as of June 30, 2016, compared to June 30, 2015.

Exigent Surcharge

As described previously in *Operating Revenue and Volume*, we began collecting an exigent surcharge on most Market-Dominant products in January 2014, and continued to do so until we recovered over $4.6 billion of incremental revenue from the surcharge. On April 10, 2016, we reduced the prices of applicable Market-Dominant products in compliance with the PRC's decision. As a result of this price reduction, we expect our annual operating revenue and cash flow to decline, from what it otherwise would be, by approximately $500 million for the remainder of 2016, and by almost $2 billion per year thereafter, absent a modification or reversal of the PRC's decision through the pending appeal or legislative action.

May 2015 Price Increase

On May 7, 2015, the PRC approved price increases and classifications for *Standard Mail*, *Periodicals* and *Package Services*. Previously, the PRC had approved price adjustments for certain *First-Class Mail* services and special services. The average price increases on these Market-Dominant services were slightly below the CPI-U price cap of 1.966%. The price increases for Market-Dominant services became effective May 31, 2015. We estimate this price increase generates $750 million in annualized revenue and cash flow.

January 2016 Price Increase

On October 16, 2015, we filed a notice with the PRC of our intent to increase certain Competitive services prices by an average of 9.5%. The PRC approved this plan and the increase went into effect on January 17, 2016. We estimate that this increase will generate approximately $250 million in additional revenue and cash flow for the remainder of 2016, and $1 billion per year thereafter.

Investing Activities

We invested $1.0 billion in the purchase of property and equipment for the nine months ended June 30, 2016, an increase of $126 million compared to the same period last year. We currently estimate that cash outlays for capital assets will amount to approximately $300 million for the remainder of 2016, and over $6 billion for the period of 2017 through 2020 to fund some of our much needed investment in building improvements, vehicles, equipment and other capital projects. Although our future projections include these capital cash outlays, future cash flow from operations alone may not generate the cash needed for such necessary capital expenditures.

In order to conserve cash, we reduced our capital expenditures by approximately 43% from an annual average of approximately $1.5 billion in years 2009 through 2011 to an annual average of approximately $850 million in years 2012 through 2015. However, as noted above, beginning in 2016 we have increased our planned capital expenditures in order to address our aging facilities and vehicles and to upgrade our equipment to remain competitive in the marketplace and to ensure that we will be able to continue to meet our statutory obligation to provide prompt, efficient and reliable postal services to the nation.

Our delivery fleet includes approximately 142,000 delivery vehicles that are at least 20 years old and at, or near, the end of their useful lives. Repair and maintenance costs for these vehicles have risen significantly in recent years. We have deferred facilities maintenance, other than for health and safety reasons, to save cash. Investments in sorting and handling equipment are needed to fully capitalize on business opportunities in the growing package delivery market, and we must also continue to invest in letter sorting equipment that is at or near the end of its useful life.

Financing Activities

Except as described otherwise in this quarterly report, the nature and amounts of our payment obligations under our debt, capital and operating lease agreements, purchase commitments and other liabilities as of June 30, 2016, have not materially changed from those described in our Annual Report.

On September 30, 2012, we reported that we had reached the maximum borrowing amount allowed under our statutory debt ceiling, and the amount of debt we have reported each quarter has not changed since then. Our debt is borrowed from the Federal Financing Bank ("FFB"), a government-owned corporation under the general supervision of the Secretary of the Treasury, and consists of fixed-rate notes and two revolving credit facilities with various maturities with an aggregate principal balance of $15.0 billion as of June 30, 2016, and September 30, 2015. September 30, 2012, was also when we reported cash balances of $2.3 billion, our lowest annual cash balances reported during the past four years. Our liquidity has slowly increased since this low point.

The two revolving credit facilities have interest rates determined by the U.S. Department of Treasury each business day and enable us to draw up to $4.0 billion in total. As of June 30, 2016, and September 30, 2015, these facilities were fully drawn and were included in the current portion of debt. These annually-renewable facilities were renewed on April 20, 2016, and are scheduled to expire in April 2017.

LIQUIDITY OUTLOOK

With the anticipated continued migration to electronic communication and transactional alternatives, we continue to pursue legislation to reform our business model and streamline our burdensome regulatory structure. Such changes might include the adoption of USPS-specific economic and demographic assumptions for calculating our pension liabilities, restoring the exigent rate surcharge by making it a part of our rate base, and giving us some additional product flexibility.

Additionally, reform is needed to establish a set of healthcare plans within the FEHB that would fully integrate with Medicare for current and future retirees. We believe such reform would make our retiree health benefits system affordable by virtually eliminating the unfunded liability previously noted. Although we continue to inform the Administration, Congress, the PRC and other stakeholders of the immediate and long-term financial challenges we face, we have no assurances that our requests will result in meaningful reform in the foreseeable future.

Remainder of 2016

Increases in employee health benefits, retirement costs and retiree health benefits are expected to add approximately $800 million to 2016 annual expenses. Additionally, as described elsewhere in this report, the PAEA mandates that we make a $5.8 billion prefunding payment to PSRHBF by September 30, 2016. Given our liquidity concerns, we anticipate that we will be unable to make this payment and also fulfill our other statutory obligations, including the obligation to provide universal mail service to the nation.

2017 and Beyond

In 2017, our obligations pertaining to retiree health benefits and the Civil Service Retirement System ("CSRS") will change according to law. OPM will determine the amount of annual payments we will need to make to amortize the PSRHBF and CSRS unfunded liabilities, and we estimate these payments will be approximately $2.9 billion and $1.5 billion, respectively, beginning in 2017. Also in 2017, the PSRHBF will begin funding the Postal Service's share of retiree health benefit premiums, and we will begin paying the "normal costs" of retiree health benefits (i.e., the present value of the estimated retiree health benefits attributable to active employees' current year of service), which we estimate will be approximately $3.1 billion per year. Although the total amount of these projected cash outlays on our 2017 obligations will be approximately $1.5 billion less than our 2016 mandated obligations for these items, we anticipate that without legislative action, it is unlikely that we will be able to make all legally-required payments in 2017, given our liquidity concerns.

Contingency Plans

Our status as an independent establishment of the executive branch that does not receive tax dollars for our operations presents unique requirements and restrictions, but also potentially mitigates some of the financial risk that would otherwise be associated with a cash shortfall. With annual total revenue of approximately $69 billion, generated almost entirely through the sale of our services, a financially-sound Postal Service continues to be vital to U.S. commerce.

In the event that circumstances leave us with insufficient cash, we would be required to implement contingency plans to ensure that mail deliveries continue. These measures may require us to prioritize payments to our employees and suppliers ahead of some payments to other U.S. government entities, as has been done in the past. Without structural change to our business model and legislative change, the factors discussed above will continue to negatively impact us resulting in continuing losses and liquidity challenges for the foreseeable future.

LEGISLATIVE UPDATE

LEGISLATION

On July 12, 2016, the House Oversight and Government Reform Committee (the "Oversight Committee") unanimously passed the *Postal Service Reform Act of 2016* (H.R. 5714). The bipartisan measure would institute separate, Postal Service-only plans within FEHB that are fully integrated with Medicare, require Postal Service-specific demographic and economic assumptions in calculating pension liabilities, reinstate half of the exigent surcharge, and authorize us to provide non-postal services to state, local and tribal governments. The measure would also reduce the number of Governors on the Board from nine to five and empower the Postmaster General to implement our strategic direction and pricing and product strategy, as approved by the Governors.

Also on July 12, 2016, the Oversight Committee passed the *Postal Service Financial Improvement Act of 2016* (H.R. 5707), which would require a percentage of the PSRHBF to invest in certain types of index fund investments using one or more qualified professional asset managers. The measure would also establish a PSRHBF Investment Committee to advise the Secretary of the Treasury in setting investment guidelines and selecting professional asset managers.

APPROPRIATIONS

On July 7, 2016, the U.S. House of Representatives passed the *Fiscal 2017 Financial Services and General Government Appropriations* bill (H.R. 5485), which includes $41 million in appropriated funds to us for revenue forgone on "free and reduced mail" for the blind and for overseas absentee ballots. A provision requiring six-day mail delivery frequency remains in the bill.

BOARD OF GOVERNORS NOMINATIONS

As previously reported, the President has nominated six individuals to serve on our Board of Governors, and the U.S. Senate Committee on Homeland Security and Governmental Affairs has voted to advance each of these nominations. These six nominees continue to await a confirmation vote by the full U.S. Senate, the timing of which remains uncertain.

RELATED PARTY TRANSACTIONS

As disclosed throughout this report, we have significant transactions with other U.S. government entities, which are considered related parties for reporting purposes. For a more detailed description, see *Item 1. Financial Statements*, *Notes to Unaudited Financial Statements*, *Note 3 - Related Parties*.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

The accounting policies deemed either the most judgmental or which involve the selection or application of alternative accounting policies, and are material to the interim financial statements, are described in *Critical Accounting Estimates* contained in *Management's Discussion and Analysis of Financial Condition and Results of Operations* of the Annual Report. We regularly discuss the development and selection of accounting policies and estimates with the Audit and Finance Committee of the Board of Governors.

During the three months ended June 30, 2016, we revised the estimation technique utilized to estimate our *Deferred revenue-prepaid postage* liability for *Forever Stamps*. The change resulted from new information regarding customer's retention and usage habits of applicable postage. This revision enabled the Postal Service to update its estimate of stamps that will never be used for mailing. As a result of this change, *Deferred revenue-prepaid postage* was decreased by $1.1 billion. The change was accounted for as a change in accounting estimate, and was therefore reflected in operating results as an increase to revenue in the three and nine months ended June 30, 2016.

RECENT ACCOUNTING STANDARDS

See *Item 1. Financial Statements*, *Notes to Financial Statements*, *Note 1 - Basis of Presentation*, *Recent Accounting Standards* for a description of recently announced accounting standards.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

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

We also have provision in our debt agreements that allow us to prepay our $15.0 billion debt at any time at a price determined by the Secretary of the Treasury, based on prevailing interest rates in the Treasury Security market at the time of repayment.

See *Item 7A. Quantitative and Qualitative Disclosures about Market Risk* in the Annual Report for additional information.

ITEM 4. CONTROLS AND PROCEDURES

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

DISCLOSURE CONTROLS

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in quarterly and annual reports is recorded, processed, summarized, and reported within the time frames specified by PAEA, and that this information is accumulated and communicated to our management, including the Postmaster General and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

We carried out an evaluation under the supervision and with the participation of management, including the Postmaster General and Chief Financial Officer, of the effectiveness of the design and operation of disclosure controls and procedures as of June 30, 2016. Based upon and as of the date of the evaluation, the Postmaster General and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

INTERNAL CONTROLS

We have made no changes in our internal control over financial reporting during the three months ended June 30, 2016, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

For a discussion of legal proceedings affecting us, please refer to *Item 1. Financial Statements*, *Notes to Unaudited Financial Statements*, *Note 2 - Liquidity*, *Liquidity Concerns*, *Expiration of Exigent Surcharge* and *Note 5 - Commitments and Contingencies*, as well as our Annual Report.

ITEM 1A. RISK FACTORS

No material changes have transpired in our risk factors from those disclosed in *Item 1A. Risk Factors* of our Annual Report.

ITEM 6. EXHIBITS

Exhibit Number	Description
31.1	Certification of Principal Executive Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities and Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities and Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Signatures

Pursuant to the requirements of the Postal Accountability and Enhancement Act of 2006, the United States Postal Service has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

United States Postal Service

/s/Megan J. Brennan
Megan J. Brennan
Postmaster General and Chief Executive Officer

Date: August 8, 2016

/s/Joseph Corbett
Joseph Corbett
Chief Financial Officer and Executive Vice President

Date: August 8, 2016

Exhibit 31.1

CERTIFICATION PURSUANT TO
RULES 13a-14(a) AND 15d-14(a) UNDER THE SECURITIES AND EXCHANGE ACT OF 1934,
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002.

I, Megan J. Brennan, certify that:

1. I have reviewed this quarterly report on Form 10-Q of the United States Postal Service (Postal Service);

2. Based on my knowledge, this 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 report;

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

4. The Postal Service's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Postal Service and have:

    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Postal Service, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c. Evaluated the effectiveness of the Postal Service's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d. Disclosed in this report any change in the Postal Service's internal control over financial reporting that occurred during the Postal Service's most recent fiscal quarter (the Postal Service's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Postal Service's internal control over financial reporting; and

5. The Postal Service's other certifying officer and I have disclosed based on our most recent evaluation of internal control over financial reporting, to the Postal Service's independent registered accounting firm and the audit and finance committee of the Postal Service's Board of Governors (or persons performing the equivalent functions):

    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Postal Service's ability to record, process, summarize and report financial information; and

    b. Any fraud, whether or not material, that involves management or other employees who have significant role in the Postal Service's internal control over financial reporting.

Date: August 8, 2016

/s/Megan J. Brennan

Megan J. Brennan

Postmaster General and Chief Executive Officer

Exhibit 31.2

CERTIFICATION PURSUANT TO
RULES 13a-14(a) AND 15d-14(a) UNDER THE SECURITIES AND EXCHANGE ACT OF 1934,
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002.

I, Joseph Corbett, certify that:

1. I have reviewed this quarterly report on Form 10-Q of the United States Postal Service (Postal Service);

2. Based on my knowledge, this 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 report;

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

4. The Postal Service’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Postal Service and have:

    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Postal Service, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c. Evaluated the effectiveness of the Postal Service’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d. Disclosed in this report any change in the Postal Service’s internal control over financial reporting that occurred during the Postal Service’s most recent fiscal quarter (the Postal Service’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Postal Service’s internal control over financial reporting; and

5. The Postal Service’s other certifying officer and I have disclosed based on our most recent evaluation of internal control over financial reporting, to the Postal Service’s independent registered accounting firm and the audit and finance committee of the Postal Service’s Board of Governors (or persons performing the equivalent functions):

    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Postal Service’s ability to record, process, summarize and report financial information; and

    b. Any fraud, whether or not material, that involves management or other employees who have significant role in the Postal Service’s internal control over financial reporting.

Date: August 8, 2016

/s/Joseph Corbett

Joseph Corbett

Chief Financial Officer and Executive Vice President

Exhibit 32.1

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

In connection with the Quarterly Report of the United States Postal Service (Postal Service) on Form 10-Q for the period ended June 30, 2016, (the Report), I, Megan J. Brennan, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 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 Postal Service.

Dated: August 8, 2016

/s/Megan J. Brennan

Megan J. Brennan

Postmaster General and Chief Executive Officer

Exhibit 32.2

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

In connection with the Quarterly Report of the United States Postal Service (Postal Service) on Form 10-Q for the period ended June 30, 2016, (the Report),I, Joseph Corbett, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 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 Postal Service.

Dated: August 8, 2016

/s/Joseph Corbett
Joseph Corbett
Chief Financial Officer and Executive Vice President