United States Postal Service
2007 Audited Financial Statements

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Item 1 – Business

Overview

The United States Postal Service (we) commenced operations on July 1, 1971, as an "independent establishment of the executive branch of the Government of the United States." We are governed by an eleven-member Board of Governors. The Board is composed of nine Governors appointed by the President of the United States with the advice and consent of the Senate, the Postmaster General and the Deputy Postmaster General. Under the Postal Reorganization Act, and its successor, the Postal Accountability and Enhancement Act, Public Law 109-435 (P.L. 109-435), we have a legal mandate to offer a "fundamental service" to the American people, "at fair and reasonable rates." We fulfill this legal mandate to provide universal service at a fair price by offering a variety of classes of mail services without undue discrimination among our many customers. This means that within each class of mail our price does not unreasonably vary by customer for the levels of service we provide.

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

Our mailing services are sold through our almost 37,000 Post Offices, stations, branches, contract postal units, our website *www.usps.com* and a large network of consignees. We deliver mail to more than 148 million city, rural, Post Office box and highway delivery points. We conduct our operations primarily in the domestic market, with international operations representing less than 3% of our total revenue.

All references to years, unless otherwise stated, refer to our fiscal year beginning October 1 and ending September 30. All references to quarters, unless otherwise stated, refer to fiscal quarters within 2007.

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

Additional disclosures on our organization and finances, including our Cost and Revenue Analysis reports, Revenue, Pieces, and Weight reports, *Strategic Transformation Plan 2006–2010* and the *Comprehensive Statement on Postal Operations* may be found on our website at *www.usps.com*. Information on our website is not incorporated by reference in this document.

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

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

The new law, once fully implemented, will divide our services into two broad categories: market-dominant and competitive. Market-dominant services include, but are not limited to, First-Class Mail, Standard Mail and Periodicals. Future rate increases for these services will be subject to a price cap based on the Consumer Price Index - All Urban Consumers (CPI-U). Competitive services, such as Priority Mail, Express Mail, Bulk Parcel Post and Bulk International Mail will have greater pricing flexibility.

For our retail customers, the new law anticipates that universal service can be preserved at affordable rates. For commercial mailers, the law is intended to provide rate predictability. For employees, ratepayers, and taxpayers, the new law is designed to provide assurance that the employer portion of the Postal Service's health and retirement benefits funding obligations becomes fully funded.

P.L.109-435 also directs the U.S. Treasury to resume financial responsibility for the portion of the Civil Service Retirement System (CSRS) pensions of postal employees attributable to military service. This takes the financial burden added by P.L.108-18, estimated in 2003 at approximately $27 billion by the Office of Personnel Management (OPM), off of the Postal Service. Our CSRS obligations are now estimated by OPM to be fully funded as of September 30, 2006, pending future actuarial revaluations. P.L.109-435 also abolished a federally-mandated escrow requirement and directed that the money previously held in escrow be placed into a new Postal Service Retiree Health Benefits Fund (PSRHBF). During the next ten years we are required to make payments into the PSRHBF that average $5.6 billion per year. By 2017, we expect our retiree health benefits obligations will be substantially funded.

P.L.109-435 also reconstitutes the former Postal Rate Commission into a regulatory body, renamed the Postal Regulatory Commission (PRC). The PRC released the final regulations pertaining to the new price-setting process on October 29, 2007. The regulations consist of three parts: (1) regulations related to rate adjustments for market dominant products, including the formula for the calculation of the price cap; (2) regulations related to competitive products; and (3) establishment of a Mail Classification Schedule, which categorizes our products as either market dominant or competitive. The PRC will need to issue additional regulations pertaining to several areas, including the complaint process, reporting requirements, and commercially sensitive materials.

The Mail Classification Schedule divides mail into market dominant (herein after referred to as "mailing services") or competitive categories(herein after referred to as "shipping services"), establishes which types of mail constitute separate products, and presents a brief description of each product. The new regulations allow us to make certain classification changes much more easily than under the previous system, which enhances overall ratemaking flexibility.

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

The regulations for shipping services place no upper limit on rate changes, and the Governors of the Postal Service can adjust rates as necessary with the requirements that each competitive product must cover its attributable costs and no competitive product may be cross-subsidized by mailing services. In addition, shipping services are required to cover 5.5% of the Postal Service's total institutional cost burden.

We are allowed by P.L.109-435 to file one last rate case under the current rules, to be filed not later than December 19, 2007.

On November 15, 2007, our Governors announced that future prices will be adjusted using regulations issued by the PRC for any future rate changes.

The PRC now has its own Office of Inspector General (OIG). The Postal Service will continue to be required to provide the funding for our Office of Inspector General, the PRC, and the PRC's OIG.

Additionally, P.L.109-435 requires us, beginning in 2008, to file with the PRC a number of financial reports not previously required. These include quarterly reports containing information required by the SEC to be filed on Form 10-Q within 40 days after the end of each fiscal quarter, an annual report containing information required by the SEC on Form 10-K within 60 days after the end of each fiscal year, and current reports containing information required by the SEC on Form 8-K within the prescribed time frame. Further, P.L.109-435 requires the Postal Service to comply with the rules prescribed by the SEC implementing Section 404 of the Sarbanes-Oxley Act of 2002, which pertain to reporting on the effectiveness of our financial internal controls. The requirement to comply with the requirements of Section 404 is effective beginning with the 2010 annual report.

Since the law's enactment, we have been working to ensure that we are ready to meet its requirements. Our goal is to work with the mailing community, the PRC, and our unions and management associations to make the transition as smooth as possible for all stakeholders. To achieve this goal we have

- sought additional input through a *Federal Register* notice.
- worked with mailers on developing modern service standards and performance measurement systems.
- received input on service standards from a number of other stakeholders.
- met with the PRC and provided extensive comments to help them develop the new rules for the mailing services and shipping services rate-setting process to ensure a smooth transition for everyone involved.
- continued to work internally to prepare our systems to be ready to meet the new reporting requirements both for price-setting and regulatory reporting.

Strategy

The *Strategic Transformation Plan* provides focus and direction for all Postal Service business and operating activities. It defines our vision and establishes strategies for revenue, service, cost reduction, human capital, and sustainability.

The strategic transformation process is dynamic and adaptable. The Plan is substantially revised every three years, and is updated annually to accommodate ongoing changes in our business environment. This annual planning process incorporates an ongoing assessment of performance, refinement of strategic goals, and prioritization of programs and budgets to optimize results. Strategic targets and specific functional objectives are then deployed throughout the Postal Service.

Clearly, the most significant event to occur this year was the enactment of the Postal Accountability and Enhancement Act. Although the law did not change our fundamental mission, it did change many aspects of how we will manage our business. Many of these changes will be reflected in a revision to the *Strategic Transformation Plan*, which will be published in December 2007.

Segments

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

Services

The Postal Service is the centerpiece of the U.S. mailing industry. We provide a wide variety of services to meet almost any mailing need. Some of our major services are:

FIRST-CLASS MAIL - Includes postcards, letters, or any other advertisement or merchandise up to 13 ounces. This service (or Express Mail or Priority Mail) is required for personal correspondence, handwritten or typewritten letters and bills or statements of account.

PRIORITY MAIL - This 1–3 day nonguaranteed delivery service is typically used to send documents, gifts and merchandise.

EXPRESS MAIL - This overnight money-back guaranteed service includes tracking, proof of delivery and insurance up to $100. Delivery is offered to most destinations and is available 365 days a year with no extra charge for weekend and holiday delivery.

PERIODICALS - Offered for newspaper, magazine and newsletter distribution and requires prior authorization by the Postal Service.

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

PACKAGE SERVICES - Are offered for any merchandise or printed matter weighing up to 70 pounds. These services include Parcel Post, Bound Printed Matter, Library Mail and Media Mail.

SPECIAL SERVICES - Offer a variety of enhancements that add value to mail services by providing added security, proof of delivery, or loss recovery. These services include: Certified Mail, Registered Mail, Delivery Confirmation, Signature Confirmation and insurance up to $1,000.

MONEY ORDERS - Are offered as a safe, convenient and economical alternative to sending cash through the mail. They can be purchased at any Post Office or from any rural route carrier. Postal money orders are available for any amount up to $1,000 and are restricted to a daily purchase limit of $10,000 per customer. Money orders can be cashed at any Post Office or can be deposited or negotiated at financial institutions. Money orders are replaced if damaged, lost or stolen.

Details on our revenue by mail categories are found on the Operating Statistics Section, on page 45 of this report.

Rate and Classification Activity

Under the Postal Reorganization Act of 1970, the Postal Rate Commission, an “independent establishment of the executive branch of the Government of the United States,” made recommendations on rate and classification changes proposed by the Postal Service. Under P.L. 109-435, the PRC has an expanded and significantly different role in fostering a viable and efficient postal system. Since the enactment of the law, we, the PRC and stakeholders worked to develop rules and regulations to implement the new law with regards to rate and classification activity.

On May 3, 2006, we filed a request with the PRC to increase prices under the rules in place at that time. The request was not an across-the-board increase, but was intended to align our prices with our costs, in addition to generating additional revenue. The filing included many innovative classification proposals that have since been accepted and implemented.

The most innovative of these classification proposals was for more extensive shape-based pricing. In addition to the weight of a mailpiece, which was the primary criterion under the former pricing structure, under the new classification, the dimensions of the mailpiece are a determinant of pricing. For example, under the new shape-based pricing model, a mailpiece that weighs one ounce mailed in a large envelope would have a price of 80 cents; however, if the contents were folded and mailed in a letter size envelope the price would be 41 cents. Shape-based pricing recognizes that each shape of mailpiece has substantially different handling costs. This pricing approach encourages efficiency in that customers can reduce their postage by using a shape format that is less costly for us to handle.

The PRC issued its recommendation for new rates on February 26, 2007. The PRC's recommendation modified some of the proposed pricing structure, reduced the proposed First-Class one-ounce rate of 42 cents to 41 cents, and reduced the proposed additional-ounce rate from 20 cents to 17 cents. To compensate for the revenue reductions from these changes, the PRC's recommended decision increased the rates for flats and Periodicals well above our original request. On March 19, 2007, the Governors approved

- the PRC recommended a 41 cent one-ounce First-Class Mail rate and the additional-ounce rate of 17 cents.
- issuance of the "forever stamp."
- shape-based pricing.

Consumers are now able to purchase the new "forever stamp" for the 41-cent one-ounce First-Class single-piece rate and will be able to use it forever to mail a one ounce First-Class letter, even if First-Class Mail rates increase in the future.

The majority of the price changes took effect May 14, 2007.

The Governors delayed implementation of new prices for Periodicals until July 15, 2007 and requested reconsideration by the PRC of the Standard Mail flat prices. On June 19, 2007, the Governors decided not to implement a temporary change to Standard Mail Regular and Nonprofit flat prices recommended by the PRC, and instead decided that the current Standard Mail flat prices will remain in effect.

In addition to the general rate changes discussed already, we proposed several mail classification changes and negotiated service agreements (NSAs) in 2007. The experimental classification rate for repositionable notes was extended for an additional year on July 6, 2007. A request for a permanent classification change for Premium Forwarding Service was filed with the Commission on July 31, 2007.

Information on the PRC and the recommended decisions can be found on the PRC website at http://www.prc.gov.

Intellectual Property

We own intellectual property that includes trademarks, service marks, patents, copyrights, trade secrets and other proprietary information. We routinely generate intellectual property in the course of developing and improving our systems, services and operations.

Seasonal Operations

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

Customers

We have a very diverse customer base and we are not dependent upon a single customer or small group of customers. No single customer represents more than two percent of our revenue.

Government Contracts

No material portion of our business is subject to renegotiation of profits or termination of contracts or subcontracts at the election of the U.S. government.

Research and Development

We operate a research and development facility in Virginia for design, development, and testing of postal equipment and operating systems. We also contract with independent suppliers to conduct research activities that benefit us. While research and development activities are important to our business, these expenditures are not material.

Environmental Matters

We are not aware of any federal, state or local environmental laws or regulations that will materially affect our financial results or competitive position or result in material capital expenditures. However, we cannot predict the effect of possible future environmental legislation or regulations on our operations.

Employees

At September 30, 2007, we had 684,762 career employees, substantially all of whom reside in the United States. We also had 101,167 noncareer employees.

Our labor force is primarily represented by the American Postal Workers Union (APWU), National Association of Letter Carriers (NALC), National Postal Mail Handlers Union (NPMHU) and National Rural Letter Carriers Association (NRLCA). More than 85% of our career employees are covered by collective bargaining agreements. By law, we consult with management organizations representing most of the employees not covered by collective bargaining agreements. These consultations provide an opportunity to participate directly in the planning, development and implementation of programs and policies affecting nonbargaining employees in the field. Our management organizations include the National Association of Postal Supervisors, the National League of Postmasters and the National Association of Postmasters of the United States. We participate in federal employee benefit programs as required by statute, for retirement, health and workers' compensation benefits.

Available Information

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

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

United States Postal Service
Public Affairs and Communications
475 L'Enfant Plaza, SW
Washington, DC 20260-3100.

Item 1A – Risk Factors

Our operations and financial results are subject to various risks and uncertainties, including those described below, that could adversely affect our business, financial condition, results of operations and cash flows. You should also read the rest of this report, including sections entitled "Business" and "Management's discussion and analysis of financial condition and results of operations," for a more complete understanding of the risks and uncertainties we confront.

Postal Service Brand

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

Competition

The Internet continues to dramatically change the communications market. Within the next decade further innovations in mobile commerce, broadband, interactive TV, data mining software and new printing technologies will affect the way businesses and consumers interact.

Of greatest impact on us are electronic alternatives to correspondence and transactions, particularly for First-Class Mail items such as business correspondence, bills, statements and customer payments. First-Class Mail volume has already been affected by the Internet, automatic deductions, direct deposit, telephone, fax machines and other electronic communications. The Internet and electronic commerce also have some positive impact on our business by stimulating new uses of postal services, such as package delivery and targeted ad mail.

In addition, major corporations now dominate parcel and express markets. Further, the competitive landscape for postal services is becoming more global. Foreign postal operators are moving outside their geographic borders and expanding beyond their traditional postal services into offering express delivery, logistics, financial and electronic services. More than a dozen posts, mainly European, have set up operations in the United States at more than 3,500 locations nationwide. Retail locations, sales offices and full-scale offices of exchange are offering mailing services, parcel, logistics and financial services to the American market. Despite our competitive global services, we have a disadvantage because our international air transportation rates are set by the U.S. government and are not subject to more favorable market-driven rates available to foreign posts. This has contributed to an increase in the outbound market share of our foreign competitors.

Oversight and Regulation

The PRC recently issued regulations pertaining to the new price-setting process, as required by PL 109-435. In addition, the PRC, in consultation with the U.S. Department of the Treasury and the Postal Service, is required to issue, by December 2008 regulations dictating accounting principles and practices for the Competitive Products Fund required by P.L. 109-435. In the event the PRC's application of these or other regulations delays us from instituting price or classification changes, or if we incur excessive costs in meeting PRC requirements, our results of operations could be adversely affected.

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

Bank Secrecy Act Compliance

In order to combat money laundering and terrorism, Congress enacted a series of laws from 1970 to 2001 that require banks and money services businesses to detect, deter, track, and report certain cash transactions to the U.S. Department of the Treasury. This legislation, together with amendments and promulgated rules and regulations, is known as the Bank Secrecy Act (BSA). The law specifically includes the Postal Service, because we sell postal money orders and provide international funds transfers with our Sure Money product and as such meet the definition of a money service business. As mandated by the BSA, we have established policies and procedures to ensure that we are in compliance with the provisions of the BSA. The impact of the BSA on our operations has not been material.

Do Not Mail Legislation

In 2007, Do Not Mail legislative bills were introduced in 15 state legislatures nationwide. These bills, modeled after the Do Not Call registry, are designed to limit or stop advertising mail from being mailed to households. Should a state pass *Do Not Mail* legislation it would result in lost revenue for the Postal Service. While none of the 2007 state bills passed, in seven states the 2007 legislation automatically will be carried over to the 2008 session. The bills in those seven states do not need to be re-introduced in order to be considered.

Economic Risk

The demand for all postal services is heavily influenced by changes in the economy. A slowdown in the economy would impact nearly every class of mail negatively. In recent months a steep slump in housing prices, challenging conditions in the financial and credit markets, and a recent rise in oil prices have driven down consumer confidence. These conditions may have an adverse impact on retail sales, investment, and employment. Growth in retail sales, investment spending, and employment are all drivers of mail demand.

Impact of Inflation on Revenue and Expense

P.L.109-435 is intended to benefit both residential and business customers by seeking to achieve predictable price increases tied to the rate of inflation for services defined as mailing services (primarily First-Class Mail, Standard Mail, and Periodicals). These services represent about 90% of total revenues and about 86% of our attributable costs.

While the majority of our rates are now linked directly to general inflation, our costs are not. In 2007, general inflation as measured by CPI-U was 2.8% compared with postal resource price inflation of 3.7%. Postal costs are heavily concentrated in wages, employee and retiree benefits, and transportation. They are significantly impacted by legislatively-imposed expenses and by the continuous expansion of our delivery network. Under current conditions, we believe that both volume and revenue growth, along with increasing productivity improvements, will be required to address the challenge presented by the regulatory price cap.

The labor contracts with three of our four largest unions currently include provisions granting a cost of living allowances (COLAs). These recently negotiated contracts expire in 2010 or 2011. One contract with the NRLCA is in interest arbitration. Under current contract provisions, COLAs are linked to the Consumer Price Index (CPI) and are granted semiannually. Employee compensation represents a significant portion of our annual expenses; therefore, an increase in the CPI greater than had been incorporated into our financial plans could adversely affect financial results.

We estimate that an increase in the CPI of 0.5% would cause an annualized increase in our COLAs of about $100 million.

Fuel Price Risk

Fuel prices are a significant part of our expenses. We are exposed to changes in commodity prices primarily for diesel fuel, unleaded gasoline and aircraft fuel for transportation of the mail and natural gas for heating facilities. A 1.0% change in fuel and natural gas costs would result in a $24 million increase in expense. We currently do not use derivative commodity instruments to manage the risk of changes in energy prices.

Technology

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

Privacy

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

Biohazards

Although we have implemented extensive emergency preparedness measures to keep the mail, postal employees and postal customers safe from harm due to biohazards that could be introduced into the mail stream, we must continue to be vigilant about possible biohazard threats. If a new biohazard were to arise and our measures were not sufficient to contain or otherwise mitigate the threat, our services could be disrupted. This could adversely affect our revenues, and we could be required to make substantial expenditures to address the threat, which could also adversely affect our costs of operation and financial condition.

Security

We may be required to comply with additional security requirements contained in legislation and regulations adopted to address threats to national security. For example, on August 3, 2007, the *Implementing Recommendations of the 9/11 Commission Act of 2007* (P.L.110-53) became effective. This Act requires the Transportation Security Administration (TSA) to impose additional screening requirements for cargo transported on passenger aircraft. The TSA has not yet made clear whether or how it will apply to the transportation of mail. Accordingly, we cannot predict the impact of the Act. Depending upon how the Act and other security requirements are implemented, we could be required to make significant expenditures, which could have a material adverse effect on our results of operation and/or financial condition.

Item 2 – Properties

Real Estate

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

Real Estate Inventory	2007	2006
(Actual numbers)		
Leased Facilities	25,450	25,567
Owned Facilities	8,487	8,437
GSA / Other Government Facilities	381	408
Total Real Estate Inventory	**34,318**	**34,412**
Annual Rent paid to lessors (Dollars in millions)	**$ 973**	**$ 1,002**

The majority of our small and medium-sized facilities support the retail and delivery operations located in virtually every community across this country. Our retail and delivery operations are supported by 32,695 leased or owned facilities. We also provide retail services through 4,026 Contract Postal Units and community Post Offices where the facility is owned and maintained by the contractor.

Retail and Delivery Facilities	2007	2006
(Actual numbers)		
Post Offices	27,276	27,318
Classified Branches	1,508	1,522
Classified Stations	3,379	3,457
Carrier Annexes	532	578
Contract Postal Units	3,131	3,014
Community Post Offices	895	937
Total Retail and Delivery Facilities	**36,721**	**36,826**

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

Processing Facilities	2007	2006
(Actual numbers)		
Processing and Distribution Centers	269	269
Customer Service Facilities	195	195
Bulk Mail Centers	21	21
Logistics and Distribution Centers	14	11
Annexes	66	66
Surface Transfer Centers	14	17
Airmail Processing Centers	29	77
Remote Encoding Centers	10	12
International Service Centers	5	5
Total Processing Facilities	**623**	**673**

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

Vehicles

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

Vehicle Inventory	2007	2006
(Actual numbers)		
Delivery and Collection Vehicles (1/2 - 2 1/2 ton)	195,211	190,932
Mail Transport Vehicles (Tractors and Trailers)	6,824	7,484
Administrative Vehicles and Other Vehicles	6,169	6,296
Service Vehicles (Maintenance)	5,539	5,623
Inspection Service and Law Enforcement Vehicles	3,482	3,212
Mail Transport Vehicles (3 - 9 ton)	2,297	2,457
Total Vehicles	**219,522**	**216,004**

Item 3 – Legal proceedings

We are subject to various claims and liabilities that arise in the normal course of postal operations. These claims generally relate to labor, tort and contract disputes and are regularly reviewed by management, and where significant, by the Audit and Finance Committee of the Board of Governors, and/or the full Board of Governors. In our evaluation, no single claim is material to our financial statements taken as a whole.

Item 4 – Submission of matters to a vote of security holders

Not applicable to the United States Postal Service. As an “independent establishment of the executive branch of the Government of the United States,” we do not issue stock or other voting securities.

Financial Review
Part II

Item 5 – Market for registrant's common equity, related stockholder matters and issuer purchases of equity securities

Not applicable to the United States Postal Service. As an "independent establishment of the executive branch of the Government of the United States," we do not issue stock or other securities.

Item 6 – Selected financial data

See the *Financial History Summary* and *Selected Quarterly Financial Data* sections of this report.

Item 7 – Management's discussion and analysis of financial condition and results of operations

Cautionary Statements

Forward-looking statements contained in this report, represent our best estimates of the trends we know about, the trends we anticipate, and the trends we believe are relevant to our future operations. However, actual results may be different from our estimates. Certain forward-looking statements are included in this report and use such words as "may," "will," "expect," "believe," "plan," or other similar terminology. These statements reflect our current expectations regarding future events and operating performance as of the date of this report. These forward-looking statements involve a number of risks and uncertainties.

The following are some of the factors that could cause actual results to differ materially from those expressed in, or underlying, our forward-looking statements: effectiveness of operating initiatives; success in advertising and promotional efforts; changes in national and local business and economic conditions, including their impact on consumer and business confidence; fluctuations in currency exchange and interest rates; labor and other operating costs; oil, fuel and other transportation costs; the effects of war and terrorist activities; competition, including pricing and marketing initiatives and new service offerings by our competitors; consumer preferences or perceptions concerning our service offerings; spending patterns and demographic trends; availability of qualified personnel; severe weather conditions; effects of legal claims; cost and deployment of capital; changes in laws and regulations; costs and delays associated with new regulations imposed by the PRC; and changes in applicable accounting policies and practices. The foregoing list of important factors is not all-inclusive. We have no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Critical Accounting Policies

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

The three critical accounting policies that we believe are either the most judgmental, or involve the selection or application of alternative accounting policies, and are material to our financial statements are those relating to workers' compensation costs, deferred revenue for prepaid postage, and contingent liabilities. Management has discussed the development and selection of these critical accounting policies and estimates with the Audit and Finance Committee of our Board of Governors and with the Board's independent public accounting firm. In addition, retirement and health benefits costs for our employees and retirees represent a significant portion of our expenses. Any changes in laws or regulations affecting the amounts, timing, or administration of these benefits could have a material effect on our financial position and results of operations. For additional information, see Note 2, *Summary of significant accounting policies,* in the Notes to the Financial Statements.

Results of Operations

Our financial results in 2007 were a net loss of $5,142 million compared to net income of $900 million in 2006. These results were significantly impacted by P.L. 109-435.

In 2007, our total revenue was $74,973 million, compared to $72,817 million in 2006. All classes of mail, with the exception of Periodicals, showed increases mainly as a result of the May rate increase. Standard Mail revenue had the largest increase, $902 million, or 4.5%.

As shown in the chart below, P.L. 109-435 added $6.8 billion in net additional expenses in 2007. Without this legislation we would have reported net income of $1,634 million. The major impact of the law was to increase retiree health benefits expense by $8,358 million compared to 2006. As discussed later in this section, other changes to operating expenses included a decrease in compensation and benefits expense of $479 million, and an increase in transportation expenses of $457 million.

On April 6, 2007, we transferred $2,958 million, representing the entire amount of funds held in escrow, as required by P.L.108-18, to the PSRHBF. Since we no longer hold these funds, there was a substantial decrease in interest income for the second half of the year and this will continue into the future.

Financial Impacts under P.L.109-435		September 30, 2007
(Dollars in millions)		
Net Income before legislation	$	1,634
P.L.109-435 Impacts:		
2006 escrow transferred into PSRHBF		(2,958)
2007 PSRHBF expense		(5,400)
CSRS savings		1,582
Net Loss	**$**	**(5,142)**

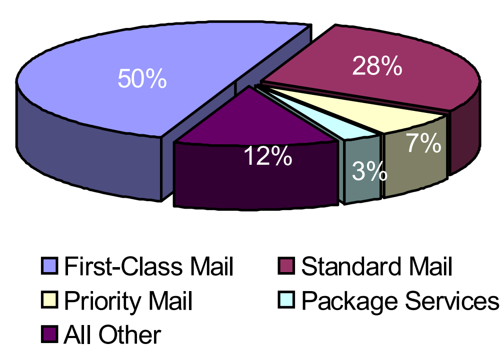
Revenue and Volume

Total revenue for 2007 was $74,973 million, an increase of $2,156 million or 3.0% from last year. The first quarter was affected favorably from the carryover effect of the January 2006 rate increase and a portion of the third quarter and all of the fourth quarter benefited from the May 2007 rate increase. Mail volume for 2007 was 212.2 billion pieces, a decrease of 904 million pieces or 0.4%. Although the volume decrease was modest, the mix of services provided was less favorable than in previous years. Without the rate increase this level of volume would have resulted in lower revenue due to the change in service mix.

Revenue	2007	2006	2005
(Dollars in millions)			
First-Class Mail	$ 37,564	$ 37,039	$ 36,062
Standard Mail	20,779	19,877	18,953
Priority Mail	5,233	5,042	4,634
Package Services	2,306	2,259	2,201
Periodicals	2,188	2,215	2,161
Express Mail	951	918	872
International	2,036	1,794	1,765
Other *	3,916	3,673	3,345
Total Revenue	**$ 74,973**	**$ 72,817**	**$ 69,993**

** Special services revenue, other income and investment income included in "Other" category.*

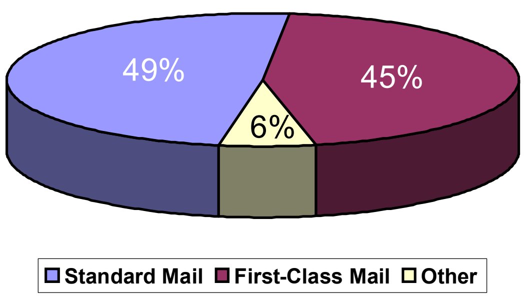
2007 Revenue



Mail Volume By Type	2007	2006	2005
(Pieces in millions)			
First-Class Mail	95,898	97,617	98,071
Standard Mail	103,516	102,460	100,942
Priority Mail	897	924	887
Package Services	1,163	1,175	1,166
Periodicals	8,796	9,023	9,070
Express Mail	55	56	55
International	833	793	852
Other *	1,076	1,090	700
Total Mail Volume by Type	**212,234**	**213,138**	**211,743**

** Free mail for the blind and Mailgrams included in the "Other" category.*

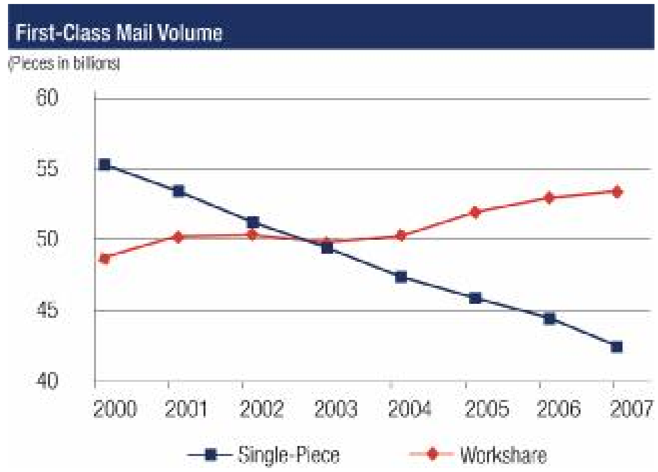
2007 Mail Volume



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

First-Class Mail revenue increased $525 million or 1.4%, while volume decreased by 1.7 billion pieces, or 1.8% in 2007. The revenue increase was mainly a result of the May rate change. An increase of 530 million pieces in workshare First-Class letters and cards partially offset the continuing decline in single-piece volume, which was down more than 2 billion pieces, or 4.7%. The long-term continued decline in single-piece volume reflects the impact of electronic diversion as businesses, nonprofit organizations, governments, and households continue to move their correspondence and transactions to electronic alternatives, such as Internet bill payment, automatic deduction, and direct deposit. While most Americans still view mail as more secure and more private than Internet-related activities, consumers of all demographic groups are becoming increasingly comfortable with electronic alternatives.

First-Class Mail revenue increased $977 million in 2006 as volume decreased slightly. An increase of approximately 1 billion pieces or 2.1% in workshare First-Class letters partially offset the continuing decline in single-piece volume, which was down 1.5 billion pieces or 3.3%.



In 2007, Standard Mail revenue increased by $902 million or 4.5%, while volume increased 1.1 billion pieces or 1.0%. Standard Mail volume has grown each of the last five years. For the third consecutive year, Standard Mail volume has exceeded First-Class Mail volume. While Standard Mail has increased in volume each year since 2002, growth was tempered this year by a decline in Enhanced Carrier Route volume of more than 800 million pieces. Standard Mail revenue and volume is expected to show year-over-year increases into the foreseeable future.

In 2006, Standard Mail revenue increased $924 million compared with 2005 on 1.5% volume growth.

Spurred by the May 2007 rate increase, Priority Mail revenue increased $191 million or 3.8%. Volume, however, decreased by 27 million pieces, or 2.9%. Priority Mail volume decreased during the last three quarters of 2007 after an extended period of growth. Priority Mail is a price-sensitive service and we anticipate several quarters of slight revenue growth on stagnant volumes, before this service rebounds.

Priority Mail revenue increased $408 million, or 8.8%, in 2006. Volume also increased, growing 4.1% in 2006, in spite of the January 2006 rate increase.

Package Services revenue increased $47 million or 2.1% in 2007, while its volume decreased 12 million pieces or 1.0% compared to 2006. This volume decrease in Package Services ended four straight years of growth.

Package Services revenue increased $58 million on a volume increase of 9 million pieces, or 0.8% in 2006. The Parcel Select component of Parcel Post was adversely affected by three major parcel consolidators, which ceased operations in 2006.

Periodicals volume decreased 227 million pieces or 2.5% in 2007. This resulted in a revenue decrease of $27 million or 1.2% in spite of the rate increase.

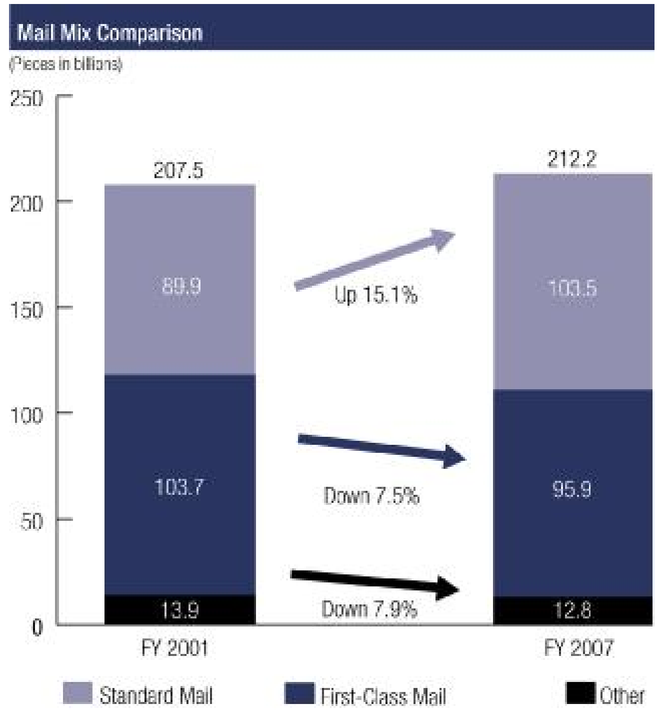
Although Periodicals volume declined 0.5% in 2006 revenue increased $54 million due to the 2006 rate increase. The volume decline continued a long-term trend.

In 2007, Express Mail revenue increased $33 million or 3.6%, while volume decreased one million pieces or 1.8% compared to 2006. Express Mail is our most price-sensitive service and price increases in January 2006 and May 2007 will likely result in lower volume for this service in the foreseeable future.

Express Mail revenue increased $46 million while volume increased 475,000 pieces in 2006. This was the second consecutive year of volume increases for Express Mail after four years of declines.

Our international products portfolio was simplified in conjunction with the May 2007 price implementation. Eight products were reduced to four, eliminating redundancy and reducing customer confusion. International product names are now linked to their domestic counterparts. New packaging further reduced complexity, while cutting waste and better positioning our brand. The international products portfolio now comprises Global Express Guaranteed, Express Mail International, Priority Mail International, and First-Class Mail International services. The product simplification has had a significant effect on international volume and revenue. International revenue grew by $242 million or 13.5%, while volume grew 40 million pieces, or 5.0%, in 2007. In addition, Foreign Postal Transactions and International Mail fees grew by $38 million or 16.3%.

In 2006, International Mail revenue increased $29 million or 1.6%. The 2006 rate increase offset a volume decline of 59 million pieces or 6.9% compared to 2005.



The chart above shows the change in the mail mix since 2001. If the mail mix in 2007 were as it was in 2001, we would have had an estimated additional $3 billion in revenue in 2007.

Operating Expenses

Operating expenses are comprised of Compensation and Benefits, Retiree Health Benefits, Transportation, Supplies and Services, Depreciation and Amortization, and Other Expenses.

In 2007 total operating expenses of $80,105 million were $8,424 million or 11.8% more than 2006. Compensation and benefits, along with retiree health benefits made up 80.2% of our operating expenses. Retiree health benefits increased $8,447 million or 516% in 2007, driven by requirements of P.L. 109-435. See Note 4, *Postal Accountability and Enhancement Act, Public Law 109-435 (P.L. 109-435)*, in the Notes to the Financial Statements for more information. The new law also suspended our retirement payments to the CSRS fund which, along with a reduction in the estimate of our workers' compensation liability, led to a $479 million or 0.9% decrease in total compensation and benefit expenses. A $457 million or 7.6% increase in transportation expenses also contributed to the increase in expenses.

In 2006, operating expenses of $71,681 million were $3,400 million or 5.0% more than 2005. The increase was driven primarily by a 4.2% increase in compensation and benefits and an 11.2% increase in transportation expenses.

Operating Expenses (Dollars in millions)	2007	2006	2005
Compensation and Benefits	$ 54,186	$ 54,665	$ 52,449
Retiree Health Benefits	10,084	1,637	1,495
Transportation	6,502	6,045	5,437
Other Expenses	9,333	9,334	8,900
Total Operating Expenses	**$ 80,105**	**$ 71,681**	**$ 68,281**

Compensation and Benefits

Personnel compensation and benefits comprised 67.6% of our total operating expenses in 2007. These costs were $479 million or 0.9% below 2006. The decrease was due primarily to elimination of the employer's share of the CSRS contribution resulting from the enactment of the new law. Reductions in complement and workers' compensation costs also contributed to the decrease in expenses.

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

In 2006, personnel compensation and benefits comprised 76.3% of our total operating expenses. These costs increased $2,216 million or 4.2% in 2006. The 2006 growth was primarily due to contractual pay increases, COLA, and health benefits payments for current employees. Our 2006 health benefits expense for current employees increased by $245 million to $5,345, or 7.5% of total operating expenses. Workers' compensation increased $441 million over 2005. This accounted for almost 20% of the total personnel compensation and benefits growth in 2006.

Compensation and Benefits Expenses (Dollars in millions)	2007	2006	2005
Compensation	$ 41,695	$ 40,577	$ 39,299
Retirement	5,737	7,006	6,810
Health Benefits	5,401	5,345	5,100
Workers' Compensation	880	1,279	838
Other	473	458	402
Total	**$ 54,186**	**$ 54,665**	**$ 52,449**

In addition to labor and benefits rates, workhours are a major driver of our compensation and benefits expense. In 2007, mail processing, customer service and city delivery workhours decreased by 36 million compared to 2006, partially offsetting the higher labor rates.

Rural delivery experienced an increase of three million workhours. The rural delivery workhour growth was driven by the addition of more than one million new rural delivery points. Other workhours decreased by three million compared to 2006.

In 2006, growth in compensation and benefits was slightly tempered by a reduction of almost five million workhours or 0.3%. In 2006, mail processing, customer service and city delivery workhours decreased seven million hours compared to 2005, while rural delivery experienced an almost seven million increase in workhours. As was the case in 2007, the 2006 rural delivery workhour growth was driven by the addition of more than one million new delivery points and by increased mail volume.

Workhours have been reduced in seven of the last eight years, with only 2005 showing a slight increase. Since 2000, we have cumulatively eliminated 1,083 million workhours, which has been the single largest contributor to the ongoing achievement of our savings targets.

Workhours by Function	2007	2006	2005
(Workhours in thousands)			
City Delivery	462,040	468,918	471,071
Mail Processing	315,825	332,269	336,210
Customer Services & Retail	233,791	246,538	247,512
Rural Delivery	189,709	186,164	179,549
Other, including Plant, Operational Support, and Administrative	221,636	224,840	228,911
Total Workhours	**1,423,001**	**1,458,729**	**1,463,253**

Collective bargaining agreements with all major postal unions expired in November 2006. Negotiations with three of four major unions resulted in new agreements. The American Postal Workers Union negotiated a four-year agreement. The National Postal Mail Handlers Union agreed to a new five-year agreement. And, the National Association of Letter Carriers also agreed to a new five-year agreement. These agreements include general salary increases, COLAs and, starting in 2008, a reduction in the Postal Service's share of health benefit premiums. Our negotiations with the National Rural Letter Carriers Association (NRLCA) ended without an agreement and we have entered into the binding arbitration process.

As mentioned above, COLA base changes were included in the new agreements. Our annualized COLA for 2007 was $686 per eligible employee. APWU and NPMHU members received this COLA in 2007. The agreement with NALC included a lump sum payment of $686 per eligible employee in lieu of COLA.

Our nonbargaining employees receive pay increases through a pay-for-performance program that makes meaningful distinctions in performance. These employees do not receive automatic salary increases, nor do they receive COLAs or locality pay.

Retirement Expense

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

The expenses of all of our retirement programs are included in compensation and benefits expense. Our retirement expenses for current employees represented 7.2% of our total operating expenses in 2007 and 9.8% in 2006. The decrease in 2007 was mainly due to the enactment of P.L. 109-435, which suspended our CSRS retirement contribution as of October 14, 2006.

As described in Note 2, *Summary of significant accounting policies,* in the Notes to the Financial Statements, we account for our participation in the retirement programs of the U.S. government under multiemployer plan accounting rules, in accordance with Financial Accounting Standard Board Statement 87, *Employers' Accounting for Pension Costs*. Although the Civil Service Retirement and Disability Fund (CSRDF) is a single fund and does not maintain separate accounts for individual agencies, the following table provides OPM's estimation of the funding status of the CSRS and FERS programs for Postal Service participants as of September 30, 2006. This is the most recent data provided by OPM.

Present Value Analysis of Retirement Programs as calculated by OPM (9/30/06 latest data available)	CSRS	FERS	Total
(Dollars in billions)			
Present Value of Benefits	$ 193.7	$ 86.6	$ 280.3
Present Value of Contributions *	3.2	37.3	40.5
Current Fund Balance	207.6	58.0	265.6
Surplus	$ 17.1	$ 8.7	$ 25.8
Transferred to PSRHBF in 2007	(17.1)	-	(17.1)
Adjusted Surplus	$ -	$ 8.7	$ 8.7

** Expected employer and employee contributions*

Health Benefits

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

The drivers of our active employee health care costs are the number of employees electing coverage and the premium costs of the plans they select. In 2007, health benefit expenses for active employees were $5,401 million, an increase of $56 million over 2006. This was 6.7% of our total operating expenses. The 2006 expense of $5,345 million was 7.5% of our total operating expenses and increased by $245 million or 4.8%, over 2005.

Premiums for each plan participating in FEHBP are determined annually by OPM. OPM announced average premium increases effective in January 2007 were 1.8%, 6.6% in January 2006 and 7.9% in January 2005. In September 2007, OPM announced an average premium increase of 2.0% for January 2008. The low level of premium increases in 2007 and those announced for 2008 are the result of lower plan costs and the application of plan reserves to lower premiums.

Retiree Health Benefits

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

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

Under P.L. 109-435, OPM will continue to charge us for our portion of the premiums for postal retirees currently participating in FEHBP and we will continue to expense these payments as they become due until 2017. The major drivers of our retiree health benefits premium costs are the number of current participants on the rolls, the mix of plans selected by retirees, the premium costs of those plans, and the apportionment of premium costs to the federal government for retiree service prior to 1971. Retiree health benefit premium expense, exclusive of the expense for the PSRHBF, has increased every year. The 5.4% increase in 2007 was smaller than in prior years due to lower premium costs and the application of plan reserves to lower premiums. In 2006, retiree health benefit expenses increased 9.5%. The number of Postal Service annuitants and survivors has grown to approximately 450,000 in 2007 compared to 448,000 in 2006 and 444,000 in 2005. The average monthly apportionment, the percentage of retiree premiums charged to the Postal Service, has increased from 64.7% in 2005 to 69.1% in 2007.

A summary of the retiree health benefits expense for 2007, 2006 and 2005 is included in the table below.

Retiree Health Benefits Expense

(Dollars in millions)	2007	2006	2005
Employer Premium Expense	$ 1,726	$ 1,637	$ 1,495
Transfer of 2006 Escrow to PSRHBF	2,958	-	-
P.L. 109-435 Scheduled Payment	5,400	-	-
Total	$ 10,084	$ 1,637	$ 1,495

Beginning in 2008, P.L. 109-435 also requires that OPM provide, and that we report, certain information concerning the obligations, costs, and funding status of the PSRHBF. The OPM estimate was prepared in accordance with Federal Accounting Standards Advisory Board (FASAB) Statement of Federal Financial Accounting Standards (SFFAS) No. 5. SFFAS 5 requires the use of the aggregate Entry Age Normal actuarial cost method. As discussed below, this method is different from the one we used in calculating our obligation in 2006. The following table provides some of the required P.L. 109-435 disclosures.

Present Value Analysis of Retiree Health Benefits Fund as calculated by OPM (Medical Inflation Assumption @ 7%)		
(Dollars in millions)		
Obligations at Inception*	$	74,815
Plus Interest @ 6.25%		4,676
Plus Normal Payments		3,175
Less Premium Payments		1,880
Subtotal		80,786
Contributions & Transfers**		25,458
Earnings @ 5%		287
Ending Obligations 9/30/07	$	55,041

** OPM calculated the beginning obligation as of 9/30/06.*

*** Contributions and transfers of $2,958 million, $17,100 million and $5,400 million were made April 6, 2007, June 29, 2007, and September 28, 2007, respectively.*

Because there are several areas of judgment involved in calculating this obligation, estimates can vary widely depending on the assumptions used. Utilizing the same underlying data that was used in preparing the estimate in the chart above, the September 30, 2007 obligation could range from $49 billion to $69 billion, solely by varying the inflation rate by plus or minus 1%.

As an "independent establishment of the executive branch of the Government of the United States," we are required to account for our participation in FEHBP using multiemployer plan accounting rules. If we were not a participant in the federal government plan and not subject to the provisions of P.L.109-435, we would be required to record and disclose our obligation for future health benefit obligations under FAS 106. In 2006, we contracted with an independent actuarial firm to estimate our future retiree health benefit obligations under FAS 106. The FAS 106 methodology is different from the one used by OPM to calculate our estimated 2007 obligation. Because there are several areas of judgment involved in calculating this obligation, estimates can vary widely based on the assumptions used. Our assumptions used for long-term medical inflation premiums in calculating our liability ranged from 5% to 6%. Based on September 30, 2006 data, we estimated that if we sponsored our own plan at similar costs and benefits to the federal plans, the 2006 value of future payments would be between $50 billion and $58 billion. The range in the estimate exists only because long-term medical inflation assumptions differed by 1%.

Workers' Compensation

Our employees are covered by the Federal Employees' Compensation Act, administered by the Department of Labor's Office of Workers' Compensation Programs (OWCP), which makes all decisions regarding injured workers' eligibility for benefits. However, we pay all workers' compensation claims from postal funds.

We record as a liability the present value of all future payments we expect to make to those employees receiving workers' compensation. At the end of 2007, we estimate our total liability for future workers' compensation costs at $7,771 million, a decrease of $92 million or 1.2% from 2006. In 2006 our liability increased $342 million or 4.5% from 2005.

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

As discussed in detail in Note 11, *Workers' compensation,* in the Notes to the Financial Statements, we utilized a calculation performed by an independent actuary to estimate our liability for 2007. This calculation combined two generally accepted actuarial valuation techniques: the paid loss development method and the incremental frequency/severity method. Both of these methods were used to separately estimate a liability for compensation and medical claims. Adoption of this new approach required that we reconsider all the assumptions that go into estimating liability for both claim types. We changed a number of assumption changes that were individually insignificant, but that were, in our judgment, necessary to produce the most realistic estimate in the new model.

We also engaged a separate independent actuary to evaluate the discount and inflation rates used in estimating our liability and made changes to these rates in 2007 as well. As discussed in more detail in Note 11, *Workers' compensation*, in the Notes to the Financial Statements, the actuarial model used in 2007 uses separate inflation and discount rates for compensation and medical claims, while the model used in 2006 and prior years used net discount rates for both claim types.

The net effect of the adoption of new actuarial valuation techniques and new inflation and discount rates was a reduction in 2007 expenses of $685 million.

In 2006, the number of paid medical claims and the number of paid compensation claims decreased 2.3% and 1.7% respectively. Although the number of paid claims decreased, the actual cost of claims increased $45 million over 2005, again influenced by the annual March COLA, which raised the payments to all compensation claimants on the rolls 3.5%. The $45 million increase in the cost of claims also was the driver behind the $342 million increase in our total liability.

The lower number of claims in 2007 and 2006 is a result of our efforts to prevent workplace injuries and our joint initiative with OWCP to increase the number of injured employees returned to work. In the final year of a five-year program, we successfully met and exceeded our goal to outplace 1,000 employees from workers' compensation rolls. There have been a total of 1,029 successful outplacements and rehabilitations. This program has long-term effects on the cost of workers' compensation by reducing the base costs.

Transportation Expenses

Transportation expenses for 2007 were $6,502 million, an increase of $457 million, or 7.6%, compared to 2006. Transportation costs are largely made up of air and highway transportation.

Transportation Expense	2007	2006	2005
(Dollars in millions)			
Air Transportation	$ 2,990	$ 2,771	$ 2,445
Highway Transportation	3,150	2,977	2,658
Other Transportation	362	297	334
Total Transportation Expense	**$ 6,502**	**$ 6,045**	**$ 5,437**

AIR TRANSPORTATION

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

Air transportation expenses for 2006 were $2,771 million, an increase of $326 million, or 13.3% from 2005. In 2006 the increase was due to increased fuel charges and increased mail volume on our cargo carriers.

HIGHWAY TRANSPORTATION

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

In 2006, our highway transportation expenses were $2,977 million, an increase of $319 million, or 12.0% over 2005. These increases were primarily driven by diesel fuel prices and contractual rate increases.

OTHER TRANSPORTATION

Other transportation expenses for 2007 were $362 million, an increase of $65 million, or 21.9% mainly driven by international terminal dues settlements to foreign postal administrations and Expedited Mail delivery transactions compared to 2006. Terminal dues settlements are the fees we pay to foreign postal administrations for the outbound international mail that they deliver for us.

In 2006, other transportation expenses were $297 million, a decrease of $37 million, or 11.1%, primarily as a result of our decision to reduce the use of rail to transport mail and shift this mail onto highway routes.

Other Expenses

Other operating expenses of $9,333 million for 2007 were one million less than last year's comparable amount, as shown in the table that follows.

Other Operating Expenses	2007	2006	2005
(Dollars in millions)			
Supplies and Services	$ 2,594	$ 2,643	$ 2,557
Depreciation and Amortization	2,152	2,149	2,089
Rent and Utilities	1,700	1,721	1,590
Vehicle Maintenance Service	760	709	586
Information Technology and Communications	630	649	652
Rural Carrier Equipment Maint. Allowance	495	485	449
Other	1,002	978	977
Total Other Operating Expenses	**$ 9,333**	**$ 9,334**	**$ 8,900**

In 2006 other expenses increased $434 million or 4.9%. The increase was driven by higher fuels costs, which increased both utilities and vehicles maintenance services. The latter category includes the fuels used by our carriers to deliver mail in the community.

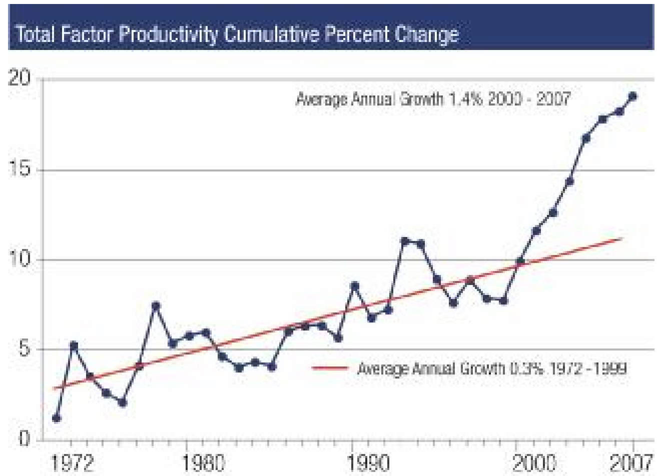
Productivity

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

During 2007, TFP improved 1.7%, which is equivalent to $1.2 billion in expense savings. This marks the eighth consecutive year of TFP growth, a cumulative growth of 12.1%, and an overall expense reduction equivalent to $8.2 billion during this time period. Productivity gains are a result of effective workforce management, efficient use of material (supplies and services to include transportation), and maximizing the return on capital investments (mainly automation). During 2006, TFP grew 0.4%.

The aggregate workload for FY 2007 declined 0.2%. This was mainly due to a sharp decline in weighted mail volume, driven by the 4.7% decline in First-Class single-piece mail volume. Despite the workload decrease, resources were managed effectively, resulting in a 2.5% decline compared to last year.

The following graph shows the TFP cumulative trend from 1971 through 2007.



Service and Performance

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

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

EXFC Service Performance Scores	Quarter 1	Quarter 2	Quarter 3	Quarter 4
(Percentage delivered on time)				
Overnight Delivery	95	95	96	96
2-Day Delivery	91	91	93	94
3-Day Delivery	86	88	91	93

CSM is an independently administered survey of customer opinions about key areas of service to residential customers. Customer satisfaction levels remained constant across the last four quarters, which included the implementation of a rate increase in May of 2007. The following table displays the residential satisfaction results for the last four quarters.

Customer Satisfaction Measurement	Quarter 1	Quarter 2	Quarter 3	Quarter 4
(Percentage)				
Service rated excellent, very good or good	92	92	92	92

P.L. 109-435 mandates that we, in consultation with the PRC, establish a set of “modern service standards” for mailing services within one year after the date of enactment of the law. We have worked with the PRC to finalize the new standards and have issued a *Federal Register* notice seeking public input on the proposed new standards.

Capital Resources and Liquidity

CAPITAL INVESTMENTS

The Board of Governors approves the budget for investments in capital each year. The Board also approves all major capital projects, generally defined as projects greater than $25 million. At the beginning of 2007, there were 37 Board-approved projects in progress, which represent $6.2 billion in approved capital funding. During the year, the Board approved four new projects, which totaled $1.7 billion in additional capital funding. A total of ten projects representing $1.1 billion in approved capital funding were completed and one project was canceled. The year ended with 30 open projects that amount to $6.8 billion in approved capital.

While the funding for a project is authorized in one year, the commitment or contract to purchase or build may take place over several years. By year-end, approximately $5.6 billion had been committed to these 30 projects. Actual capital cash outlays will occur over several years. Through the end of 2007, approximately $4.0 billion has been paid for the 30 projects.

Of the 30 active Board-approved projects, 20 are for mail processing equipment, eight for facilities and two for other projects: retail equipment and human resources shared services. In 2007, capital commitments for all projects were $2.6 billion. See Note 7, *Leases and other commitments*, in the Notes to the Financial Statements for additional information.

Noteworthy projects approved in 2007 include:

Phase One of the Flat Sequencing System (FSS), which will deploy 100 systems to between 30 and 60 facilities. The FSS sorts flat mail to carrier delivery point sequence at a rate of 40,000 pieces per hour with a two-pass operational throughput of nearly 18,000 pieces per run hour. The FSS will fully automate the Delivery Point Sequencing of flat mail for selected delivery sites, which will reduce the time carriers spend in-office sorting flat mail.

We purchased 5,856 carrier route vehicles. This vehicle purchase completed a three-part acquisition plan to provide vehicles to rural routes as agreed with the NRLCA.

We will also acquire 211 additional delivery barcode sorters (DBCS) and 797 stacker modules for existing DBCS machines. The additional equipment will increase the percentage of letter mail processed in automated operations and provide labor savings in manual sorting operations.

Our capital plan supports future needs by developing and implementing new automation equipment that will increase our operating efficiency and generate a high return on investment. These programs are expected to reduce workhours in our distribution, processing and delivery operations. We plan to continue to invest funds to maintain our infrastructure, including facilities, vehicles and technology systems.

Our facilities program will continue to address life, health, safety, operational needs and security. We expect to maintain our infrastructure through high priority replacement projects and ongoing repair and alteration projects.

LIQUIDITY

Our liquidity is the cash we have with the U.S. Treasury and the amount of money we can borrow on short notice if needed. Our note purchase agreement with the Federal Financing Bank, renewed in 2007, provides for revolving credit lines of $4.0 billion. These credit lines enable us to draw up to $3.4 billion with two days notice and up to $600 million on the same business day the funds are needed. Under this agreement we can also use a series of other notes with varying provisions to draw upon with two days notice. This arrangement provides us the flexibility to borrow short-term or long-term, using fixed- or floating-rate debt that is either callable or noncallable. These arrangements with the Federal Financing Bank provide us with adequate tools to effectively fund our cash requirements and manage our interest expense and risk. See Note 5, *Debt and related interest*, in Notes to the Financial Statements for additional information about our debt obligations.

The amount we can borrow is limited by certain statutory limits. Our total debt outstanding cannot exceed $15 billion and the net increase in debt at year-end for any fiscal year cannot exceed $3 billion. Both of these limits preceded P.L. 109-435, and the amounts were not altered by the law. The new law, however, did remove separate annual borrowing limits within the $3 billion annual limit. Prior to enactment of the new law, there were separate limits for debt issued for capital expenditures and debt issued to defray operating expenses. P.L. 109-435 also imposed a new requirement that we identify borrowing for shipping services and borrowing for mailing services. The new law also instructs that until such time as accounting practices and principles for determining such borrowings are finalized by the PRC, the Postal Service must make such identification using the best information available at the time. During 2007, since rules had yet to be determined, we used information that we determined to be the best available. We estimated that borrowing for competitive product represented $438 million, calculated as 10.4% of our total year-end debt outstanding with the Federal Financing Bank.

Looking forward, our liquidity will be comprised of the approximately $1 billion of cash that we have entering 2008, the cash flow that we generate from operations and the $3 billion that we can borrow if necessary. As was the case in 2007, for 2008 we do not expect cash flow from operations to supply adequate cash to fund our capital investments and P.L. 109-435 payment requirements. Consequently, we anticipate increasing debt next year by approximately $1 billion.

The majority of our revenue is earned in cash. The majority of our cash outflow is to support our biweekly payroll. Consequently, we are dependent on our ability to continue to generate cash from operations to satisfy our liquidity requirements. Cash flow from operations is at a seasonal peak in our first quarter and seasonal low in our fourth quarter. We make significant cash payments in the fourth quarter for workers' compensation and retiree health benefits. Consequently we incurred $4.2 billion debt at the end of 2007 to fund approximately $6.3 billion in payments. This debt will be repaid in the first half of 2008 from operating cash receipts. It should also be noted that $3.9 billion of the current liabilities on our balance sheet at September 30, 2007 represents items for which we have already collected cash, but have a remaining obligation to perform a future service.

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

Schedule of Commitments	Retiree Health Benefits	Leases
(Dollars in millions)		
2008	$ 5,600	$ 862
2009	5,400	846
2010	5,500	801
2011	5,500	738
2012	5,600	673
After 2012	22,800	5,574
Total Commitments	$ 50,400	$ 9,494

Cash Flow

CASH FLOWS FROM OPERATING ACTIVITIES

Net cash used in operating activities was $2.6 billion in 2007 compared to $3.8 billion provided by operating activities in 2006. The year-to-year decrease of $6.4 billion was driven mainly by the $8.4 billion in payments to the PSRHBF in 2007, as required by P.L. 109-435, partially offset by the $1.6 billion in CSRS payments that we are no longer required to make. This is also reflected in our 2007 net loss of $5.1 billion compared to 2006 net income of $900 million. Additional cash was provided in 2007 by an increase in other noncurrent liabilities of $275 million primarily contingent liabilities, an increase in compensation and benefits liabilities of $347 million and increased collections of accounts receivable of $80 million. These cash flow increases were partially offset by decreases in payables and accrued expenses of $73 million, and customer deposit accounts and outstanding money orders of $186 million.

In 2006, net cash provided by operating activities of $3.8 billion was $38 million more than 2005. Increases in cash payments for compensation and transportation expenses were offset by increases to non-cash liabilities such as accrued payroll and leave of $304 million and workers' compensation of $342 million. Also contributing was $169 million of increased collections in accounts receivable in 2006, increased investment income of $81 million, $55 million of additional money orders outstanding at year-end, and a decrease in the interest expense payment on deferred retirement obligations of $32 million.

CASH FLOWS FROM INVESTING ACTIVITIES

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

Net cash used in investing activities was $5.5 billion in 2006 compared to $2.3 billion in 2005. The increase reflects increased investment for mail processing equipment, retail equipment, and building improvements. The 2006 increase also reflects the placement of $3.0 billion into a restricted cash account (mentioned above) as required by P.L. 108-18.

CASH FLOWS FROM FINANCING ACTIVITIES

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

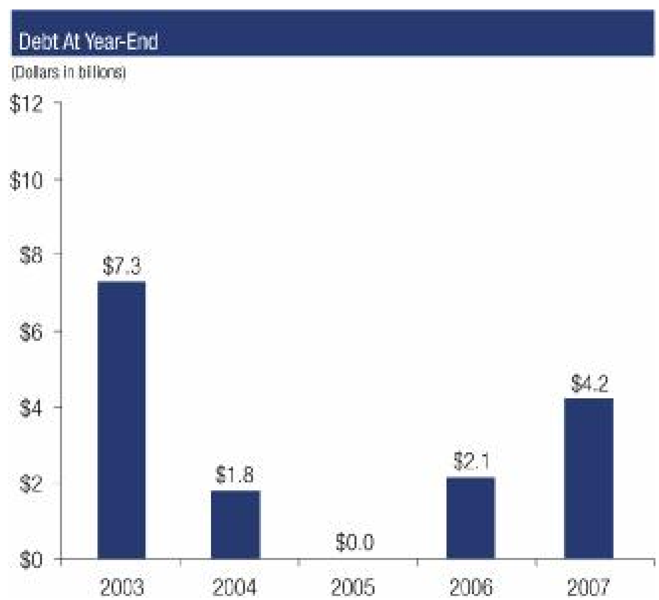
In 2006 after funding our escrow requirements for P.L.108-18, we borrowed $2.1 billion to fund capital investments and provide operating cash for future operations.

Financing Activities

DEBT

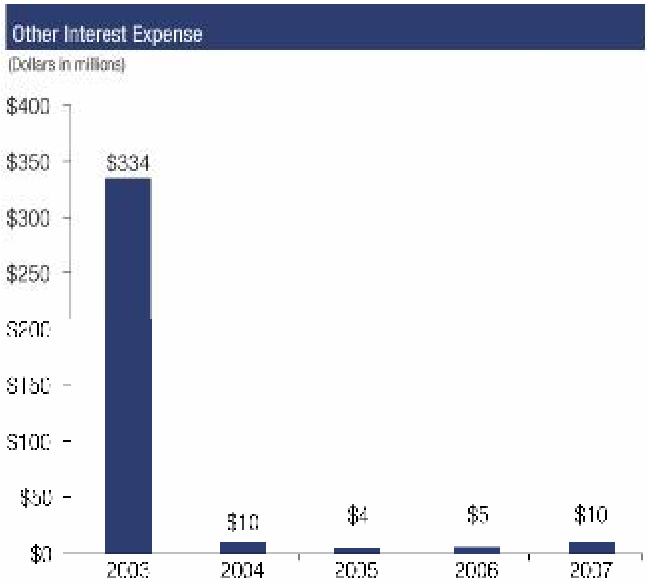
As an “independent establishment of the executive branch of the Government of the United States,” we receive no tax dollars for ongoing operations. We are self-supporting, and have not received an appropriation for operational costs since 1982. We fund our operations chiefly through cash generated from operations. However, unlike companies in the private sector, we are not permitted to raise capital through the equity markets. Historically our only long-term source of outside capital is through borrowing from the Federal Financing Bank. Under the provisions of P.L. 109-435, however, the Postal Service has the statutory authority to earn profits and retain earnings.

The amount we borrow is largely determined by the difference between our cash flow from operations and our capital cash outlays. Our capital cash outlays consist of the funds invested back into the business for new facilities, new automation equipment and new services. Throughout most of 2007 and 2006, we were debt-free, borrowing only to meet year-end cash disbursement requirements. On September 30, 2007, we had $4.2 billion in debt outstanding, a $2.1 billion increase from last year.



INTEREST EXPENSE

Our debt since 2004 has consisted of short-term debt obligations, which provided us with the flexibility to repay debt with available cash on a daily basis. A major benefit of the short-term obligations was the reduction in interest expense payable to the Federal Financing Bank. As a result, our interest expense on borrowings has been at the lowest levels since the early 1970’s.



Other interest expense excludes interest on deferred retirement obligations and the 2003 debt repurchase expense.

INTEREST AND INVESTMENT INCOME

When we determine that our available funds exceed our current needs, we invest those funds with the U.S. Treasury's Bureau of Public Debt in overnight securities issued by the U.S. Treasury. With marginal debt to repay, and increased cash on hand during recent years, we earned investment income of $169 million in 2007, $140 million in 2006, and $60 million in 2005.

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

Interest and Investment Income (Dollars in millions)	2007	2006	2005
Investment Income	$ 169	$ 140	$ 60
Imputed interest on accounts receivable from the U.S. government	25	25	25
Other Interest	1	2	1
Total	**$ 195**	**$ 167**	**$ 86**

Legislative Update

APPROPRIATIONS

Although we are self-funded and do not receive an appropriation for our operations, we have received appropriations to reimburse us for certain statutorily-mandated services.

In September 2007, the President signed P.L.110-92 making continuing appropriations for 2008. The measure provides funding for the federal government through November 16, 2007 at essentially the same levels as that provided in 2007. For the Postal Service, this includes $29 million for revenue forgone and $80 million for free mail for the blind.

These amounts are subject to change because the 2008 appropriations process has not yet been finalized. See Note 12, *Revenue Forgone,* in the Notes to Financial Statements for additional information.

DO NOT MAIL LEGISLATION

In 2007, Do Not Mail legislative bills were introduced in 15 state legislatures nationwide. These bills, modeled after the Do Not Call registry, are designed to limit or stop advertising mail from being mailed to households. We oppose legislation that would limit mailing or interfere with the availability of an affordable, universal postal system. Our response to Do Not Mail legislation is to provide information to stakeholders, including the American public, on the value of mail, including the impact the mailing industry has on the U.S. economy, and the fact that mail supports the free exchange of ideas, a cornerstone of our democracy.

We are working on educating the American public on ways that they can manage their mail. Consumers currently have options that allow them to limit the catalogs they receive, temporarily halt advertising mail through the Direct Marketing Association's "Mail Preference Service", and stop unwanted credit card solicitations by signing on a number of web sites.

In addition, we have been working closely with the mailing industry on ways to help the industry maintain accurate mailing address lists. Several working groups within the Postal Service and within the mailing industry are examining ways in which Intelligent Mail can be used to help keep addresses as current as possible. For example, the list of all residential and business addresses will now be updated every three months on First-Class Mail service; this is a change from the previous twice-a-year updates, and for the first time, Move Update services will occur every three months for Standard Mail service.

We are also educating direct marketers on the need to send targeted direct mailpieces to consumers who are interested in their products and services. By using existing data, mailers can customize mailings and send cost-efficient targeted mailing campaigns. A consumer choice approach to mailings will not only increase the value of the mail, but will provide a greater return on investment for mailers.

Should a state pass *Do Not Mail* legislation it would result in lost revenue for the Postal Service. While none of the 2007 state bills passed, in seven states the 2007 legislation automatically will be carried over to the 2008 session. The bills in those seven states do not need to be re-introduced in order to be considered.

AVIATION SECURITY

On August 10, 2007, President Bush signed the Implementing Recommendations of the 9/11 Commission Act of 2007 (P.L. 110-53) into law. This law mandates the screening of half of all air cargo on passenger planes within 18 months, and 100% of all such cargo after three years.

The screening must provide a level of security commensurate with the level of security for the screening of passenger-checked baggage. Screening is defined as physical examination or the use of non-intrusive methods of assessing whether cargo poses a threat to transportation security. Methods of screening identified in the law include X-ray systems, explosive detection systems, explosives trace detection, explosive detection canine teams certified by the TSA, or a physical search together with manifest verification. The TSA may approve additional methods, such as a program to certify the security methods used by shippers.

The precise effects of the law, however, are uncertain and will depend on how the TSA implements the law, as well the screening methods that are approved.

Evolutionary Network Development

The Evolutionary Network Development process systematically identifies potential operations and network changes to create a more flexible postal distribution and transportation network. For network changes, our focus has been to reduce redundancy inherent in maintaining different transportation networks for different mail classes. A successful transportation network must be flexible and allowed to adapt to provide low cost, reliable service in a fluctuating market.

Outlook

The long-predicted slowdown in macroeconomic growth arrived in 2007 with gross domestic product (GDP) growth of 2.1%. The outlook for 2008 calls for continued sluggish growth. Though still a minority, a growing number of economists are predicting a recession. This concern is fueled by continuing high energy prices, prolonged weakness in the housing market, and tighter credit. Virtually all economists are anticipating weak growth. Based on Global Insight's forecast, we anticipate that GDP growth will be around 2.0% in 2008.

Several other factors also weigh heavily on the business outlook of the Postal Service. Growth in retail sales, employment and investment, all drivers of mail demand, is expected to be weak in 2008.

We project revenue to increase by $3.2 billion, or 4.3% to $78.2 billion in 2008 on a slight volume increase. This expected revenue increase is due primarily to the May 2007 price increase.

As a result of the May 2007 price increase, First-Class Mail revenue is expected to rise between 2% and 3% range while volume is expected to decline less than 1% during 2008. Electronic alternatives to mail will continue to decrease First-Class Mail volume. We expect single-piece First-Class letters and flats will once again decline by more than one billion pieces. This may be offset to some degree by growth in First-Class workshare letters and flats. The outlook for single-piece First-Class Mail is less robust because of the expected slowdown in retail sales.

Standard Mail revenue is expected to grow between 6% and 7% while volume grows by less than 1%. Though less profitable than First-Class Mail, we believe that Standard Mail revenue and volume will continue to increase. In particular, automated regular bulk rate mail should see healthy increases while Enhanced Carrier Route mail will have only modest increases.

Priority Mail serves a very competitive market and is considerably more price-sensitive than First-Class Mail. We anticipate that Priority Mail revenue will increase between 5% and 7% on an expected volume decrease of 2% to 3%. We also anticipate that volume will remain relatively stable over the next several years.

Express Mail is our most price-sensitive product. As a result of 2006 and 2007 price increases, we anticipate that Express Mail revenue will fall approximately 10%, while volume falls by about 15%. There is much uncertainty in the express mail market. The demand for Priority Mail and Express Mail products is heavily influenced by competitors' prices that include fuel surcharges. Therefore, uncertainty with regard to future fuel prices contributes an added degree of uncertainty to the projection of Priority Mail and Express Mail volumes.

Package Services volume is expected to decline by less than 1% in 2008 while revenue grows by 6% to 8%. Although the component mix of this product is changing, we do not anticipate any significant changes of the product volume in the foreseeable future.

Periodicals revenue is projected to increase in the 10% range on a volume decline of 2% to 3% in 2008. We expect the modest year-over-year declines in Periodicals volume to continue. In addition to the effects of the economy mentioned above, the reading habits of Americans are changing. The decline in Periodicals volume, in conjunction with population growth, is a clear indicator of the effect of electronic media.

The competitive landscape for postal services is increasingly global in terms of customer choices and service providers. International Mail volume in 2008 will be affected by both the 2007 rate simplification and new rate implementation. We anticipate these two revenue-enhancing strategies may combine for a revenue increase of up to 5%.

Network Growth

We estimate that network growth in 2008 will continue at the 2007 level of 1.8 million delivery points per year. Expansion of the delivery network, while increasing the number of customers served, also causes continuing upward cost pressures.

Despite the recent slowdown in the housing market, long-term trends for housing can be expected to track long-term trends in population. Household growth will translate into a continuing expansion of our delivery network. As the population and delivery network continue to grow, we expect First-Class Mail volume to continue to decline. This combination of trends will continue to challenge us to build other postal business and increase productivity to continue to finance the nation's universal delivery system.

Expense Growth

Total expenses for 2008 are estimated at $78.8 billion, a 2.0% reduction from 2007 expenses of $80 billion. This reduction in expenses is primarily due to the effects of legislation P.L.109-435 that occurred in 2007. P.L. 109-435 increased expenses by $6.8 billion in 2007, as we began funding the PSRHBF. This impact included the $2.958 billion payment from escrow, which was expensed in 2007 and placed into the PSRHBF. Excluding this one time escrow payment, personnel costs in 2008 are estimated to increase by approximately $650 million or 1.1%, primarily driven by cost-of-living adjustments, contractual pay increases, and increases in health benefits costs. This will be offset by a planned reduction of 28 million work hours. This work hour reduction target is equal to approximately 14,000 full-time equivalent employees. Contract agreements are in place with all unions through at least 2010 except the NRLCA. Personnel costs in 2008 including retiree health benefits are expected to account for 79% of total expenses.

Nonpersonnel costs, excluding transportation, are estimated to increase by about $350 million, a 3.8% increase primarily driven by projected inflation. Transportation costs are also estimated to increase by $350 million, or 5.4%, compared with 2007, due to contractual obligations and expected increases in energy prices.

We cannot estimate the additional costs associated with modifying any of our systems that will be required to separately report the financial activity of shipping services at this time. Additional costs as a result of the new financial reporting requirements, costs of complying with new PRC regulations, and the cost of compliance with the requirements of Section 404 of the Sarbanes-Oxley Act have not yet been determined.

Item 7A – Quantitative and qualitative disclosures about market risk

Market Risk Disclosure

In the normal course of business, we are exposed to market risk from changes in commodity prices, certain foreign currency exchange rate fluctuations and interest rates. We do not use derivative financial instruments to manage market risks. Additionally, we do not purchase or hold derivative financial instruments for speculative purposes.

Interest Rate Risk

We have not used derivative financial instruments to manage risk related to interest rate fluctuations for debt instruments.

We estimate that a 1.0% increase in interest rates would have an insignificant impact on our financial statements due to the structure of our investment portfolio.

Labor Contracts

As discussed in Item 1A, *Risk Factors*, the contracts with three of our four largest unions include provisions granting cost-of-living allowances linked to changes in the CPI.

Item 8 – Financial statements and supplementary data

Our audited Statements of Operations, Balance Sheets, Statements of Changes in Net Capital, and Statements of Cash Flows are included in the Financial Statements section of this report.

Item 9 – Changes in and disagreements with accountants on accounting and financial disclosure

None

Item 9A – Controls and procedures

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

Disclosure Controls

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

Internal Controls

There have been no significant changes during the year covered by this report in our internal control over financial reporting or in other factors that could significantly affect the internal control over financial reporting.

Item 9B – Other information

We were not required to file reports on Form 8-K during the fourth quarter of the fiscal year ended September 30, 2007.

Financial Review
Part III

Item 10 – Directors and executive officers and corporate governance

Board of Governors

James C. Miller III
Chairman

Alan C. Kessler
Vice Chairman

Mickey D. Barnett
Member

James H. Bilbray
Member

Carolyn Lewis Gallagher
Member

Louis J. Giuliano
Member

Thurgood Marshall, Jr.
Member

Katherine C. Tobin
Member

Ellen C. Williams
Member

John E. Potter
Postmaster General and Chief Executive Officer

Patrick R. Donahoe
Deputy Postmaster General and Chief Operating Officer

Executive Committee

John E. Potter
Postmaster General and Chief Executive Officer

Patrick R. Donahoe
Deputy Postmaster General and Chief Operating Officer

Anita J. Bizzotto
Chief Marketing Officer and Executive Vice President

Mary Anne Gibbons
Senior Vice President and General Counsel

Linda A. Kingsley
Senior Vice President, Strategy and Transition

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

H. Glen Walker
Chief Financial Officer and Executive Vice President

Other Officers

Kathleen Ainsworth
Vice President, Delivery and Retail

Nicholas F. Barranca
Vice President, Product Development

Sylvester Black
Vice President, Area Operations (Western)

Megan J. Brennan
Vice President, Area Operations (Eastern)

Susan M. Brownell
Vice President, Supply Management

Ellis A. Burgoyne
Vice President, Area Operations (Southwest)

William A. Campbell
Judicial Officer

Michael J. Daley
Vice President, Area Operations (Pacific)

Thomas G. Day
Senior Vice President, Intelligent Mail and Address Quality

Marie Therese Dominguez
Vice President, Government Relations

Jo Ann Feindt
Vice President, Area Operations (Great Lakes)

William P. Galligan
Senior Vice President, Operations

Deborah Giannoni-Jackson
Vice President, Employee Resource Management

Joanne B. Giordano
Vice President, Public Affairs and Communications

Timothy C. Haney
Vice President, Area Operations (Northeast)

Stephen M. Kearney
Vice President, Pricing and Classification

Delores J. Killette
Vice President, Consumer Advocate

Susan M. LaChance
Vice President, Employee Development and Diversity

Jerry D. Lane
Vice President, Area Operations (Capital Metro)

Alexander Lazaroff
Chief Postal Inspector

Other Officers (continued)

Lynn Malcolm
Vice President, Controller

Walter F. O'Tormey
Vice President, Engineering

Anthony M. Pajunas
Vice President, Network Operations

Robert J. Pedersen
Vice President, Treasurer

Susan M. Plonkey
Vice President, Customer Service

Tom A. Samra
Vice President, Facilities

David L. Solomon
Vice President, Area Operations (New York Metro)

Douglas A. Tulino
Vice President, Labor Relations

Paul E. Vogel
Senior Vice President and Managing Director, Global Business

Jerry W. Whalen
Vice President, Sales

Terry J. Wilson
Vice President, Area Operations (Southeast)

George W. Wright
Vice President, Chief Technology Officer (acting)

Code of Ethics

The Standards of Ethical Conduct for Employees of the Executive Branch at 5 Code of Federal Regulations (C.F.R.) §2635 apply to all postal service employees. The Standards were issued in 1993 by the U.S. Office of Government Ethics, and replaced the individual agency standards then applicable to all employees of the executive branch. Our employees are also covered by the Supplemental Standards of Ethical Conduct for Employees of the United States Postal Service at 5 C.F.R. §7001. The Standards and Supplemental Standards are detailed and contain many examples to help employees recognize and resolve ethical issues. We give employees a summary of the standards, and other ethical conduct materials at initial employee orientation training and other times during the year. We also provide annual ethics training for all employees who file a financial disclosure report. To support our employees on ethical issues, we maintain a dedicated phone line and e-mail address for providing ethical advice.

Item 11 – Executive compensation

The Postal Service releases information concerning executive compensation to the extent required by the Freedom of Information Act (FOIA), 5 United States Code (U.S.C.) 552. Postal Service regulations implementing the FOIA are located at 39 C.F.R. 265.

Item 12 – Security ownership of certain beneficial owners and management related stockholder matters

Not applicable to the United States Postal Service. As an "independent establishment of the executive branch of the Government of the United States," we do not issue equity securities.

Item 13 – Certain relationships and related transactions

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

Item 14 – Principal accountant fees and services

In 2002, the Board of Governors selected Ernst & Young LLP as its independent auditor to perform external auditing services. The competitively awarded five-year contract, with an option of renewal of up to 36 months, had an estimated value of $11.7 million covering the financial statement audits for fiscal years 2003 - 2007. The enactment of P.L.109-435 expands the scope in work requirements of these audit services; however, we are unable to quantify the estimated additional contract value at this time. As with previous contracts for external audit services, Ernst & Young LLP will not perform consulting work for us for the duration of the contract.

ERNST & YOUNG
Quality In Everything We Do

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McLean, VA 22102

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Report of Independent Auditors

Board of Governors
United States Postal Service

We have audited the accompanying balance sheets of the United States Postal Service as of September 30, 2007 and 2006, and the related statements of operations, changes in net capital and cash flows for each of the three years in the period ended September 30, 2007. These financial statements are the responsibility of the United States Postal Service's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the United States Postal Service's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the United States Postal Service's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the United States Postal Service as of September 30, 2007 and 2006, and the results of its operations and its cash flows for each of the three years in the period ended September 30, 2007 in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 14, 2007, on our consideration of the United States Postal Service's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Ernst + Young LLP

McLean, VA
November 14, 2007

Statements of Operations

(Dollars in millions)		Years Ended September 30,	
	2007	**2006**	**2005**
Operating revenue	$ 74,778	$ 72,650	$ 69,907
Operating expenses:			
Compensation and benefits	54,186	54,665	52,449
Retiree health benefits	10,084	1,637	1,495
Transportation	6,502	6,045	5,437
Other	9,333	9,334	8,900
Total operating expenses	80,105	71,681	68,281
Income from operations	**(5,327)**	**969**	**1,626**
Interest and investment income	195	167	86
Interest expense on deferred retirement obligations	-	(231)	(263)
Other interest expense	(10)	(5)	(4)
Net (Loss) Income	**$ (5,142)**	**$ 900**	**$ 1,445**

See accompanying notes to the financial statements

Balance Sheets - Assets

(Dollars in millions)	September 30, 2007	2006
Assets		
Current Assets:		
Cash and cash equivalents	$ 899	$ 997
Receivables:		
Foreign countries	425	527
U.S. government	155	150
Other	223	210
Receivables before allowances	803	887
Less allowances	44	48
Total receivables, net	759	839
Supplies, advances and prepayments	201	205
Total Current Assets	**1,859**	**2,041**
Cash - Restricted	**-**	**2,958**
Appropriations Receivable - Revenue Forgone	**392**	**394**
Property and Equipment, at Cost:		
Buildings	21,591	21,083
Equipment	21,060	19,729
Land	2,914	2,887
Leasehold improvements	842	1,232
	46,407	44,931
Less allowances for depreciation and amortization	24,688	23,951
	21,719	20,980
Construction in progress	1,877	2,115
Total Property and Equipment, Net	**23,596**	**23,095**
Total Assets	**$ 25,847**	**$ 28,488**

See accompanying notes to the financial statements

Balance Sheets – Liabilities and Net Capital

(Dollars in millions)	September 30, 2007	2006
Liabilities and Net Capital		
Current Liabilities:		
Compensation and benefits	$ 3,571	$ 3,224
Payables and accrued expenses:		
Trade payables and accrued expenses	1,523	1,481
Foreign countries	452	567
U.S. government	111	111
Total payables and accrued expenses	2,086	2,159
Customer deposit accounts	1,499	1,647
Deferred revenue-prepaid postage	1,142	1,187
Outstanding postal money orders	847	885
Prepaid box rent and other deferred revenue	434	411
Debt	4,200	2,100
Total Current Liabilities	**13,779**	**11,613**
Noncurrent Liabilities:		
Workers' compensation costs	6,800	6,869
Employees' accumulated leave	2,129	2,116
Deferred appropriation and other revenue	591	674
Long-term portion capital lease obligations	618	637
Deferred gains on sales of property	341	123
Contingent liabilities and other	455	180
Total Noncurrent Liabilities	**10,934**	**10,599**
Total Liabilities	**24,713**	**22,212**
Net Capital		
Capital contributions of the U.S. government	3,034	3,034
Retained (deficit) earnings since reorganization	(1,900)	3,242
Total Net Capital	**1,134**	**6,276**
Total Liabilities and Net Capital	**$ 25,847**	**$ 28,488**

See accompanying notes to the financial statements

Statements of Changes in Net Capital

Years ended September 30, 2007, 2006 and 2005

(Dollars in millions)		Capital Contributions of U.S. Government		Retained Earnings (Deficit) Since Reorganization		Total Net Capital
Balance, September 30, 2004	$	3,034	$	897	$	3,931
Net Income		-		1,445		1,445
Balance, September 30, 2005		3,034		2,342		5,376
Net Income		-		900		900
Balance, September 30, 2006		3,034		3,242		6,276
Net (Loss)		-		(5,142)		(5,142)
Balance, September 30, 2007	**$**	**3,034**	**$**	**(1,900)**	**$**	**1,134**

See accompanying notes to the financial statements

Statements of Cash Flows

(Dollars in millions)	2007	2006	2005
Cash flows from operating activities:			
Net (Loss) Income	$ (5,142)	$ 900	$ 1,445
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
Depreciation and amortization	2,152	2,149	2,089
Loss (gain) on disposals of property and equipment, net	23	(40)	5
Decrease (increase) in appropriations receivable revenue forgone	2	(18)	(15)
(Decrease) increase in workers' compensation liability	(69)	342	(58)
Increase in employees' accumulated leave	13	100	10
(Increase) decrease in noncurrent deferred appropriations and other rever	(7)	21	(56)
Increase (decrease) in other noncurrent liabilities	275	(66)	(12)
Changes in current assets and liabilities:			
Receivables, net	80	169	16
Supplies, advances and prepayments	4	(5)	20
Compensation and benefits	347	204	314
Deferred revenue-prepaid postage	(45)	(13)	(56)
Payables and accrued expenses	(73)	63	(203)
Customer deposit accounts	(148)	(73)	114
Outstanding postal money orders	(38)	55	63
Prepaid box rent and other deferred revenue	23	(20)	54
Net cash (used in) provided by operating activities	(2,603)	3,768	3,730
Cash flows from investing activities:			
Decrease (increase) in restricted cash	2,958	(2,958)	-
Purchase of property and equipment	(2,715)	(2,630)	(2,317)
Proceeds from building sale	218	-	-
Proceeds from sales of property and equipment	39	114	31
Net cash provided by (used in) investing activities	500	(5,474)	(2,286)
Cash flows from financing activities:			
Issuance of debt	4,200	2,100	-
Payments on debt	(2,100)	-	(1,800)
Payments for Issuance of capital lease obligations, net	(19)	(37)	16
U.S. government appropriations - received	-	-	503
U.S. government appropriations - expensed	(76)	(85)	(45)
Net cash provided by (used in) financing activities	2,005	1,978	(1,326)
Net (decrease) increase in cash and cash equivalents	(98)	272	118
Cash and cash equivalents at beginning of year	997	725	607
Cash and cash equivalents at end of year	$ 899	$ 997	$ 725

Years Ended September 30,

See accompanying notes to the financial statements

Notes to the Financial Statements

Note 1 – Description of business

Nature of Operations

The United States Postal Service (we) provides a variety of classes of mail service to the public, without undue discrimination among our many customers. This means that within each class of mail our price does not unreasonably vary by customer for the levels of service we provide. This fulfills our legal mandate to offer universal service at a fair price. We conduct our operations primarily in the domestic market, with international operations representing less than 3% of our total revenue.

Our primary lines of service are First-Class Mail and Standard Mail, which account for about 94% of our volume. Priority Mail, International Mail, Express Mail, Periodicals and Package Services are other significant services we provide. The principal markets for these services are the communications, distribution, delivery, advertising, and retail markets. Our services are sold and distributed through almost 37,000 Post Offices, stations, branches, contract postal units, and a large network of consignees.

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

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

Postal Reorganization

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

The equity that the U.S. government held in the former Post Office Department became our initial capital. We valued the assets of the former Post Office Department at original cost less accumulated depreciation. The initial transfer of assets, including property, equipment and cash, totaled $1.7 billion. Subsequent cash contributions and transfers of assets between 1972 and 1982 totaled approximately $1.3 billion, resulting in total government contributions of $3.034 billion. The U.S. government remains responsible for all of the liabilities attributable to operations of the former Post Office Department. However, under the Balanced Budget Act of 1997, the liability for Post Office Department workers' compensation costs was transferred to us.

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

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

Note 2 – Summary of significant accounting policies

Basis of Accounting and Use of Estimates

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

Segment Information

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

Reclassifications

Certain comparative prior year amounts that we have determined are immaterial to the Financial Statements and accompanying Notes have been reclassified to conform to the current year presentation. These reclassifications had no effect on previously reported operating income and net income.

Notes to the Financial Statements

Cash and Cash Equivalents

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

Cash - Restricted

In 2006 we established a restricted cash account in conformity with provisions set forth in P.L.108-18 to set aside "savings". See Note 10, *Retirement programs,* in the Notes to the Financial Statements for additional information. Restricted cash was reported as a noncurrent asset. With the passage of P.L. 109-435, the balance we held in restricted cash was to be paid into the new Postal Service Retiree Health Benefit Fund (PSRHBF). The $2,958 million balance reported as of September 30, 2006 was transferred to the PSRHBF on April 6, 2007.

Allowance for Doubtful Accounts

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

Supplies and Repair Parts

Our supplies and repair parts consist of repair parts for mail processing equipment. We value these at average cost. Total supplies and repair parts amounted to $119 million at the end of 2007 and $125 million at the end of 2006. A majority of our motor vehicle spare parts are supplied on consignment through agreements with our vendors.

Property and Equipment

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

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

Impaired Assets

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

Asset Retirement Obligations

We account for our asset retirement obligations in accordance with Financial Accounting Standards Board Interpretation 47, *Accounting for Conditional Asset Removal* (FIN 47). Under the provisions of FIN 47, we have accrued $40 million as of September 30, 2007, and $25 million as of September 30, 2006, in asset retirement obligations under "Noncurrent Liabilities, Contingent liabilities and other" on our balance sheet.

Amortization of Leasehold Improvements

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

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

Foreign Currency Translation

We have foreign currency risk related to settlements with foreign postal administrations for international mail. The majority of our international accounts are denominated in special drawing rights (SDRs). The SDR exchange rate fluctuates daily based on a basket of currencies comprised of the euro, Japanese yen, pound sterling, and the U.S. dollar. Changes in the relative value of these currencies will increase or decrease the value of our settlement accounts and result in a gain or loss from revaluation reported in the results from operations. The actual currency used to settle accounts varies by country. The impacts on our financial statements from foreign currency fluctuations were insignificant for 2007, 2006 and 2005.

Outstanding Postal Money Orders

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

Revenue Recognition/Deferred Revenue-Prepaid Postage

We recognize revenue when service is rendered. Deferred revenue-prepaid postage is our estimate of the amount of cash we have collected by the end of the year for services that we will perform in a future year.

Notes to the Financial Statements

Advertising Expenses

Advertising costs are expensed as incurred and are classified in other operating expenses. Advertising expenses were $121 million in 2007, $138 million in 2006 and $143 million in 2005.

Compensation and Benefits Payable

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

Workers' Compensation

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

Retiree Benefits

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

Revenue Forgone Appropriation

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

Emergency Preparedness Appropriation

Emergency preparedness appropriations are funds we received from the federal government to help pay the costs of keeping the mail, postal employees and postal customers safe and are restricted for such use. These funds were accounted for as deferred revenue upon receipt and were largely utilized to procure capital equipment. We recognize revenue for emergency preparedness appropriations at the same time we recognize depreciation expense for capital equipment purchased with these appropriations. The emergency preparedness appropriations revenue recognized during the years ended September 30 were $76 million in 2007, $85 million in 2006, and $45 million in 2005.

Appropriations that have not been recognized as revenue during the years ended September 30 were $611 million in 2007, $687 million in 2006 and $772 million in 2005. The current portion is included in prepaid box rent and other deferred revenue, and the long-term portion is in deferred appropriations and other revenue on our balance sheets.

Note 3 – Recent pronouncements

In September 2006, the FASB issued SFAS 157, which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The provisions of SFAS 157 are effective as of the beginning of our 2009 fiscal year. We are currently evaluating the impact of adopting SFAS 157 on our financial statements.

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

P.L.109-435, enacted December 20, 2006, made significant reforms in the governance of the Postal Service and significantly altered some of our financial responsibilities, particularly in respect to the funding of CSRS benefits and retiree health benefits. The legislation does not change our parent-subsidiary type relationship as an "independent establishment of the executive branch of the Government of the United States." Our employees and retirees continue to participate in all federally-sponsored retirement and health benefit plans. Therefore we continue to account for our participation in U.S. government sponsored health benefit and retirement plans using multiemployer plan accounting rules in accordance with FAS 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions* and FAS 87, *Employers' Accounting for Pensions*.

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

P.L.109-435 returned to the U.S. Treasury the obligation to fund the portion of the CSRS retirement benefit earned while serving in the military by participants who retire as postal employees. This funding obligation, originally estimated by the OPM in 2003 at $27 billion, was transferred from the U.S. Treasury to us in 2003 with the enactment of Public Law 108-18 (P.L.108-18). With the return of this funding requirement to the U.S. Treasury, it has been estimated by OPM that we have fully funded our CSRS pension obligation as of September 30, 2006. Recognizing this, the law suspends our employer contribution to CSRS that would otherwise be required under Title 5, Section 8334(a) (1), of the United States Code until 2017. At that time, OPM will determine whether additional funding is required to pay the benefits of postal retirees. This provision was effective October 14, 2006. See Note 10, *Retirement programs,* in the Notes to the Financial Statements for more information on our retirement obligations.

Under P.L. 109-435, OPM was required by June 15, 2007 to determine the CSRS surplus or "supplemental liability" attributable to Postal employees as of September 30, 2006. OPM determined that this CSRS surplus was $17.1 billion as of September 30, 2006. The surplus amount was transferred to the newly created PSRHBF, which is held by the U.S. Treasury and controlled by OPM, on June 29, 2007.

The PSRHBF will be used, commencing in 2017, to pay our share of the health insurance premiums for our current and future Postal Service retirees. Beginning in 2007, P.L.109-435 requires us to make annual payments into the PSRHBF. The payment schedule in the law requires us to pay, on average, $5.6 billion per year into the fund for ten years, which began in 2007. This is in addition to our regularly allocated cost of premiums for current retirees, which will continue to be payable through 2016. After these annual payments are complete, OPM will make an actuarial valuation and determine whether any further payments into the PSRHBF are required. In 2007 we paid into the PSRHBF and expensed $5.4 billion.

P.L.109-435 repealed the escrow provisions of P.L.108-18, which required us to place into an escrow account by September 2006, any "savings" from the change in the retirement provisions created by P.L.108-18. OPM calculated the savings at $2,958 million as of September 30, 2006. These escrowed funds were shown as restricted cash on our September 30, 2006 balance sheet. P.L.109-435 required that we pay the 2006 escrowed "savings" to the PSRHBF. In 2007 we expensed the entire amount payable to the PSRHBF. On April 6, 2007, these "savings" were transferred to the PSRHBF.

The following table summarizes the impacts of the new legislation on our statement of operations for 2007.

P.L. 109-435 Comparison	Prior to Public Law 109-435	P.L. 109-435 Impact	After Public Law 109-435
(Dollars in millions)			
Line on Statement of Operations:			
Compensation and benefits	$ 55,537	$ (1,351)	$ 54,186
Retiree health benefits	1,726	8,358	10,084
Total	57,263	7,007	64,270
Deferred Int. on CSRS Supplemental Liability	231	(231)	-
Net Income (Loss)	**$ 1,634**	**$ (6,776)**	**$ (5,142)**
Impact on Compensation and Benefits and Retiree Health Benefits Expense			
Discontinuance of CSRS employer contributions		$ (1,325)	
Repeal of 2007 "Supplemental Liability" principal		(26)	
Subtotal		$ (1,351)	
PSRHBF annual expense		$ 5,400	
PSRHBF expense (escrow transfer)		2,958	
Subtotal		$ 8,358	

Note 5 – Debt and related interest

Borrowing Limits and Debt

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

Debt Consists of the Following:			
Interest Rate %	Terms *	2007	2006
(Dollars in millions)			
NOTES PAYABLE TO THE FEDERAL FINANCING BANK (FFB):			
3.366%**	Short-term revolving credit facility; Payable October 1, 2007	$ 2,900	$ 1,900
3.528%***	Overnight revolving credit note; Payable October 1, 2007	300	200
3.101%	Payable November 15, 2007	500	0
3.866%	Payable December 20, 2007	500	0
		$ 4,200	$ 2,100

** All debt is repurchasable at any time at a price determined by the Secretary of the Treasury, based on rates prevailing in the Treasury Security market at the time of repricing.*
*** Prior year rate was 4.714%*
**** Prior year rate was 4.701%*

The current value of our debt is what it would cost to pay off the debt if we used the current yield on equivalent U.S. Treasury notes. At year-end, the current estimated value of our debt is $4.2 billion.

Note Purchase Agreements
Our note purchase agreements with the Federal Financing Bank provide for revolving credit lines of $4 billion. These credit lines enable us to draw up to $3.4 billion with two days' notice, and up to $600 million on the same business day the funds are needed. Under these agreements we can also use a series of other notes with varying provisions to draw upon with two days' notice. The notes provide us the flexibility to borrow short-term or long-term, using fixed or floating rate debt, and can be either callable or non-callable.

Interest Payments on Retirement
There were no cash outlays for interest on the retirement "supplemental liability" in 2007 because of the enactment of P.L. 109-435. In 2006, the cash outlay was $231 million and $263 million in 2005. See Note 10, *Retirement programs,* in the Notes to the Financial Statements for additional information.

Other Interest Payments
Cash outlays for other interest were $9 million in 2007, $4 million in 2006 and $3 million in 2005.

Note 6 – Property and equipment

Sale of Major Facility
On March 30, 2007, we sold the James A. Farley building in New York City to the Empire State Development Corporation (ESDC) for $190 million and additional proceeds of up to $55 million, contingent upon the achievement of certain development and leasing criteria by the developer of the property. This building formerly housed retail, carrier and mail processing operations. Mail processing operations formerly housed in this facility had been transferred to other facilities in 2004. The Postal Service continues to conduct retail and carrier operations at this facility under the terms of an interim lease with annual rentals of $5.6 million per year. Once the carrier operations are relocated to other facilities, we will continue to conduct retail and some administrative functions in a smaller portion of the building under a 99-year lease, with a rental fee of $1. The Postal Service has an option to require the building owner to change the legal structure of the building ownership into condominium units, with the Postal Service being given the right to purchase the space subject to the 99-year lease.

We have accounted for the transaction under the deposit method under the provisions of FAS 66, *Accounting for Sales of Real Estate.* The gain will not be recognized and the asset will not be removed from our accounting records until the lease and other continuing involvement in the building have expired. If the condominiumization of the building is legally completed prior to that time, and the contingent payments are satisfied, or we completely move out of the facility, then the gain could be recognized earlier.

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

Interest Capitalization
No interest was capitalized in 2007, 2006 or 2005.

Repairs and Maintenance
Repairs and maintenance are charged to expense as incurred. This expense amounted to $956 million in 2007, $933 million in 2006, and $809 million in 2005.

Notes to the Financial Statements

Note 7 – Leases and other commitments

Capital

At September 30, 2007 our future minimum lease payments for all noncancelable leases are as follows.

Lease Obligations (Dollars in millions)	Operating	Capital
2008	$ 760	$ 102
2009	746	100
2010	704	97
2011	643	95
2012	576	97
After 2012	4,987	587
Total Lease Obligations	$ 8,416	$ 1,078
Less: Interest		416
Total Capital Lease Obligations		$ 662
Less: Short-term portion of capital lease obligations		44
Long-term Portion of Capital Lease Obligations		$ 618

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

Capital leases included in buildings were $931 million in 2007 and $891 million in 2006. Total accumulated amortization is $404 million in 2007 and $350 million in 2006. Amortization expense for assets recorded under capital leases is recorded as depreciation expense, which is included in other operating expenses in the statements of operations.

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

Rental Expense (Dollars in millions)	2007	2006	2005
Non-cancelable real estate leases including related taxes	$ 927	$ 953	$ 892
Facilities leased from GSA subject to 120-day cancellation	46	49	42
Equipment and other short-term rentals	261	192	209
Total Rental Expense	$ 1,234	$ 1,194	$ 1,143

At September 30, 2007, we estimate our financial commitment for approved capital projects in progress (resources on order) to be $2,694 million, detailed in the following table.

Capital Resources on Order (Dollars in millons)	2007
Mail Processing Equipment	$ 1,565
Building Improvements	513
Postal Support Equipment	338
Construction and Building Purchase	200
Vehicles	40
Retail Equipment	38
Total Capital Resources on Order	$ 2,694

Expense Commitments

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

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

Expense Resources on Order (Dollars in millons)	2007
Miscellaneous Contracts	$ 5,231
Inventory Contracts	76
Research and Development Contracts	48
Total Expense Resources on Order	$ 5,355

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

Retiree Health Benefits Commitments		P.L. 109-435 Requirement
(Dollars in millions)		
2008	$	5,600
2009		5,400
2010		5,500
2011		5,500
2012		5,600
After 2012		22,800
Total Retiree Health Benefits Commitments	$	50,400

Note 8 – Contingent liabilities

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

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

Contingent Liabilities		2007		2006
(Dollars in millions)				
Labor Cases	$	526	$	254
Equal Employment Opportunity Cases		57		66
Tort Cases		39		57
Environmental		40		25
Contractual Cases		14		16
Total Contingent Liabilities	$	676	$	418

We believe that adequate provision has been made for the probable liabilities from claims and suits. The current portion of this liability at September 30, 2007 of $248 million is included on the balance sheet under the heading "Trade payables and accrued expenses". On September 30, 2006 this amount was $267 million. The long-term portion at September 30, 2007 of $428 million is accrued under the heading, "Noncurrent Liabilities, Contingent liabilities and other" in our balance sheet. On September 30, 2006 the long-term liability was $151 million.

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

Note 9 – Health benefit programs

Current Employees

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

Our portion of the cost is based upon the weighted average premium cost of the various employee coverage choices and the specific coverage choices made by our employees. Our employees paid approximately 17% of the premium costs in 2007, 2006 and 2005. We paid the remainder of employee health care expense, which was $5,401 million in 2007, $5,345 million in 2006 and $5,100 million in 2005.

Retirees

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

As discussed in Note 4, *Postal Accountability and Enhancement Act, Public Law 109-435 (P.L. 109-435)*, resulted in our retiree health benefit expenses increasing dramatically, to $10,084 million in 2007, compared to $1,637 million in 2006 and $1,495 million in 2005. These costs are reflected as Retiree health benefits in our Statements of Operations.

Note 10 – Retirement programs

Pension Programs

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

CSRS

Under the Postal Reorganization Act, officers and career employees hired prior to January 1, 1984 are covered by the Civil Service Retirement System, which provides a basic annuity toward which we and the employee contribute at rates prescribed by law. Effective October 14, 2006, P.L.109-435 suspends the obligation of making employer contributions for CSRS employees' retirement. We do not match TSP contributions for employees who participate in CSRS. In addition, employees hired before January 1, 1984, could choose during certain periods in 1987, 1988 and 1998 to switch their participation to FERS.

DUAL CSRS

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

FERS

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

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

Employee / Employer Contributions

Employer and employee base contributions, as a percentage of employee basic pay, are as follows for each of the three plans for 2007, 2006, and 2005.

Retirement Contribution	2007	2006	2005
(Percentage)			
CSRS Employer	-	17.4	17.4
CSRS Employee	7.0	7.0	7.0
Dual CSRS Employer	-	18.0	18.0
Dual CSRS Employee	0.8	0.8	0.8
FERS Employer	11.2	11.2	11.2
FERS Employee	0.8	0.8	0.8

The number of employees enrolled in each of the retirement plans at the end of 2007, 2006, and 2005 is as follows.

Retirement Enrollment by Program	2007	2006	2005
(Actual numbers)			
CSRS	144,034	157,945	171,958
Dual CSRS	7,716	8,150	8,640
FERS	533,012	530,043	524,118

Notes to the Financial Statements

Expense Components

The following table lists the components of our total retirement expenses that are included in compensation and benefits expense and related interest expense in the Statements of Operations for 2007, 2006 and 2005.

Retirement Expense	2007	2006	2005
(Dollars in millions)			
CSRS	$ 52	$ 1,450	$ 1,533
FERS	2,771	2,652	2,510
FERS Thrift Savings Plan	1,007	960	912
Dual CSRS	3	75	78
Social Security	1,904	1,843	1,750
CSRS "Supplemental Liability"	0	26	27
Total Retirement Expense	$ 5,737	$ 7,006	$ 6,810

Employer cash contributions to retirement plans were $3,889 million in 2007, $5,122 million in 2006, and $5,014 million in 2005. These amounts do not include Social Security contributions and interest expense on deferred retirement liabilities.

P.L.109-435 relieved the Postal Service of the obligation to pay for the portion of the CSRS pension costs attributable to the military service of its retirees that was previously imposed by P.L.108-18. The cost of these benefits was estimated by OPM to be $27 billion in 2003. The elimination of the military service funding requirement dramatically impacted the funded status of the portion of the CSRS allocated to the Postal Service. P.L. 109-435 directed OPM to determine the funded status of the CSRS, without the military benefits, on September 30, 2006 by June 15, 2007. OPM determined that, as a result of the changes imposed by P.L. 109-435, the Postal Service portion of the CSRS had a surplus of $17.1 billion. Accordingly, the “supplemental liability” payment required by P.L. 108-18 was suspended and no amount was incurred or paid in 2007.

Beginning in 2004, we had been required by P.L.108-18 to pay an additional annual amount into the CSRS retirement plan, if necessary, each September, as determined by OPM. The “supplemental liability” represented the excess of the actuarial present value of plan assets, future contributions, earnings, and other actuarial factors related to Postal Service participants in the CSRS plan.

The following table presents OPM’s estimate of the present value of our CSRS “supplemental liability” as of September 30, 2006 and 2005. This calculation assumed general salary increases of 2.8%, COLAs of 3.25%, and interest of 6.25% and was intended to provide for the liquidation of the “supplemental liability” over a 38-year period ending in September 30, 2043.

Present Value Analysis of CSRS "Supplemental Liability"	2006	2005
(Dollars in billions as of September 30)		
Present Value of Benefits	$ 193.7	$ 196.9
Present Value of Contributions *	3.2	12.3
Current Fund Balance **	207.6	180.9
Surplus (Deficit)	$ 17.1	$ (3.7)
Transferred to PSRHBF in 2007	(17.1)	
Surplus (Deficit) After Transfer	$ -	

* Expected employer and employee contributions

** Excess of contribution benefits paid as estimated by OPM

As explained above, the “supplemental liability” payments were suspended until 2017 by P.L. 109-435. At that time, OPM will perform an actuarial valuation and determine whether additional “supplemental liability” payments are necessary. Accordingly, no “supplemental liability” payment was made in 2007. The “supplemental liability” payment in 2006 was $257 million.

Note 11 – Workers’ compensation

We pay for workers’ compensation costs under a program administered by DOL. These costs, recorded as an operating expense, include employees’ medical expenses, payments for continuation of wages, and DOL administrative fees.

Our liability at September 30, 2007, represents the estimated present value of the total amount we expect to pay in the future for postal workers injured through the end of 2007. The estimated total cost of a claim is based upon the severity of the injury, the age of the injured employee, the estimated duration of payments to the employee, the trend of our experience with such an injury, and other factors.

We estimated our total liability for future workers’ compensation costs to be to be $7,771 million at the end of 2007 and $7,863 million at the end of 2006. The payout period for this liability will, for some claimants currently on the rolls, be for the rest of their lives.

The liability is sensitive to changes in inflation and discount rates. An increase of 1% in the assumptions would decrease our estimate of the liability by approximately $603 million. A decrease of 1% would increase our estimate of the liability by approximately $904 million.

In 2007, we engaged an independent actuarial consulting firm to perform an actuarial valuation of our workers' compensation liability at September 30, 2007. They are also assisting us in developing our own model, which we plan to implement in 2008. The methodology employed in the actuary's model is similar to that which will be employed in our new model.

The standard actuarial valuation techniques used in estimating the workers compensation liability at September 30, 2007 included the paid loss development and the incremental frequency / severity methods. The paid loss development method estimates the liability based on the historical pattern of payments observed over many years. The frequency / severity method estimates liability by considering not only the cost, but the number of claims payments over many years. The frequency / severity method requires that we make explicit assumptions about future changes in the average payment amounts due to inflation or other cost increases. Both methods used in calculating the 2007 workers' compensation liability are generally accepted actuarial techniques and are equally valid for estimating a liability such as ours. Accordingly, we used an average of the results of the two methods in determining our liability as of September 30, 2007.

During 2007, we also conducted a review of the inflation and discount rates used to determine the present value of estimated future workers' compensation payments. Separate analyses of the appropriate inflation rates for medical and compensation portions of the liability were performed, utilizing forecasts of medical inflation and inflation in the general economy. Due to the differences between medical and compensation claims in the average length of time that claimants stay on the rolls, we validated our assumptions and methodology with an independent actuarial firm. Appropriate discount rates were determined using forecasted rates of return on baskets of Treasury securities of varying durations.

The workers' compensation liability estimation technique used in 2006 and prior years utilized a net discount rate, which was the estimated difference between the expected return on investments in a basket of Treasury securities offset by the estimated inflation rate for medical costs and wages. The net discount rate in 2006 was 3.3% for compensation claims and -0.8% for medical claims. The new model uses separate calculations for returns on investments and inflation factors rather than a net discount rate. The rates used in the new model are returns on investments for compensation claims of 5.6% and wage inflation of 3.0%. For medical claims the new model uses 5.4% for returns on investments and 5.0% for medical future inflation.

The total change to our liability as a result of the changes in actuarial valuation techniques, including various individually insignificant underlying assumptions, and inflation and discount rates was $685 million. This is shown is the table below.

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

In 2007, we recorded $880 million in workers' compensation expense, compared to the $1,279 million in 2006 and $838 million recorded in 2005. The effect of the changes discussed above is accounted for as a change in accounting estimate, as defined by GAAP.

In addition to the cost of workers' compensation claims, OWCP charges us an administrative fee for processing claims. In 2007, the administrative fee, which is included in the expense above, was $49 million, compared to $45 million in 2006 and $56 million in 2005.

Note 12 – Revenue forgone

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

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

In 2007 we included $63 million of revenue forgone as operating revenue, $99 million in 2006, and $109 million in 2005. We record requested amounts as government receivables until the appropriations are received.

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

The future payments authorized by the Revenue Forgone Reform Act of 1993 total $1,218 million for which we calculated the present value, at 7% interest, to be approximately $390 million and recognized the $390 million as revenue during fiscal years 1991 through 1998. The discounted present value of the remaining future payments as of the years ended September 30 was $353 million in 2007 and $357 million in 2006.

The total receivable for revenue forgone as of the years ended September 30 was $476 million in 2007 and $490 million in 2006.

Operating Statistics

Category of Service	2007	2006	2005	2004	2003
(In millions of units indicated, unaudited)					
First-Class Mail					
Revenue	$ 37,563.8	$ 37,038.8	$ 36,061.8	$ 36,376.8	$ 37,048.3
Pieces, Number	95,898.1	97,617.5	98,071.0	97,926.4	99,058.7
Weight, Pounds	4,332.9	4,376.0	4,369.9	4,389.9	4,236.3
Standard Mail					
Revenue	$ 20,779.2	$ 19,876.8	$ 18,953.5	$ 18,122.5	$ 17,231.3
Pieces, Number	103,516.1	102,459.6	100,942.1	95,563.5	90,492.2
Weight, Pounds	11,815.2	11,771.2	11,656.5	11,148.3	10,827.6
Priority Mail					
Revenue	$ 5,233.3	$ 5,042.5	$ 4,633.6	$ 4,421.4	$ 4,494.3
Pieces, Number	896.9	924.2	887.5	848.6	859.6
Weight, Pounds	1,796.0	1,809.5	1,690.7	1,623.3	1,622.9
Package Services					
Revenue	$ 2,306.1	$ 2,259.0	$ 2,201.1	$ 2,206.9	$ 2,215.7
Pieces, Number	1,162.8	1,174.6	1,165.5	1,131.9	1,128.5
Weight, Pounds	3,308.5	3,459.9	3,660.2	3,632.6	3,793.8
Periodicals					
Revenue	$ 2,187.9	$ 2,215.1	$ 2,160.8	$ 2,191.8	$ 2,234.8
Pieces, Number	8,795.8	9,022.6	9,070.0	9,135.3	9,319.9
Weight, Pounds	3,895.6	4,040.7	4,025.6	4,067.5	3,995.0
Express Mail					
Revenue	$ 950.6	$ 918.1	$ 872.3	$ 852.8	$ 888.1
Pieces, Number	54.8	55.9	55.5	54.1	55.8
Weight, Pounds	52.5	53.8	51.7	50.6	53.2
International Mail *					
Revenue	$ 2,035.8	$ 1,793.7	$ 1,764.8	$ 1,695.8	$ 1,586.9
Pieces, Number	832.6	792.9	851.5	843.8	805.2
Weight, Pounds	268.6	257.2	241.8	228.7	213.1
Mailgrams **					
Revenue	$ -	$ -	$ 0.8	$ 0.7	$ 1.2
Pieces, Number	-	-	1.9	1.6	2.8
U.S. Postal Service					
Pieces, Number	1,008.4	1,015.9	621.3	529.3	391.6
Weight, Pounds	140.6	128.1	110.7	105.4	80.1
Free Matter for the Blind					
Pieces, Number	68.5	74.5	76.4	71.1	70.4
Weight, Pounds	33.3	35.4	34.4	34.6	29.8
Totals					
Revenue	$ 71,056.7	$ 69,144.0	$ 66,648.7	$ 65,868.7	$ 65,700.6
Pieces, Number	212,234.0	213,137.7	211,742.7	206,105.6	202,184.7
Weight, Pounds	25,643.2	25,931.8	25,841.5	25,280.9	24,851.9

Operating Statistics

Category of Service	2007	2006	2005	2004	2003
(In millions of units indicated, unaudited)					
Registered Mail ***					
Revenue	$ 68.4	$ 72.8	$ 77.2	$ 75.0	$ 82.1
Number of articles	6.1	7.1	7.7	7.4	8.2
Certified Mail ***					
Revenue	$ 698.2	$ 631.6	$ 600.6	$ 629.5	$ 624.2
Number of articles	280.2	265.7	261.1	273.7	271.4
Insurance ***					
Revenue	$ 163.5	$ 136.7	$ 132.2	$ 127.8	$ 138.3
Number of articles	58.6	52.8	53.6	53.2	59.1
Delivery Receipt Services ****					
Revenue	$ 662.2	$ 610.1	$ 569.2	$ 538.0	$ 503.1
Number of articles	1,112.9	1,018.8	953.8	840.6	748.8
Collect on Delivery					
Revenue	$ 9.6	$ 9.8	$ 9.3	$ 11.4	$ 11.1
Number of articles	1.4	1.5	1.5	1.9	1.9
Money Orders					
Revenue	$ 212.2	$ 193.3	$ 208.2	$ 230.7	$ 230.7
Face value of issues (non-add)	$ 27,194.0	$ 28,277.4	$ 28,723.0	$ 28,782.2	$ 29,151.7
Number of articles	163.3	176.2	181.0	188.0	202.5
Other					
Box rent revenue	$ 836.9	$ 813.7	$ 791.5	$ 779.9	$ 788.1
Stamped envelope and card revenue	$ 16.9	$ 25.2	$ 21.0	$ 21.9	$ 24.4
Other revenue, net	$ 990.4	$ 914.2	$ 740.3	$ 676.8	$ 395.8
Totals					
Special Services revenue	$ 3,658.3	$ 3,407.4	$ 3,149.5	$ 3,091.0	$ 2,797.8
Mail revenue	$ 71,056.7	$ 69,144.0	$ 66,648.7	$ 65,868.7	$ 65,700.7
Revenue forgone	$ 63.1	$ 99.0	$ 109.2	$ 36.3	$ 30.7
Total Operating Revenue	$ 74,778.1	$ 72,650.4	$ 69,907.4	$ 68,996.0	$ 68,529.2

* With the simplification of International Mail services we are reporting one International Mail category.

** Mailgram service has been discontinued.

*** Return receipts have been broken out from Registered Mail, Certified Mail and Insurance special service categories and reported in Delivery Receipt Services.

**** Delivery Receipt Services contains Return Receipts for special services, Merchandise Return and Delivery Confirmation.

Operating Statistics

	2007	2006	2005	2004	2003
(Actual numbers, unaudited)					
Career Employees					
Headquarters and HQ Related Employees					
Headquarters **	2,856	2,761	2,654	2,708	1,867
Headquarters - Field Support					
Units * / **	4,527	4,402	4,333	3,396	4,104
Inspection Service - Field	2,991	3,130	3,443	3,648	3,770
Inspector General	1,147	1,071	843	782	723
Total HQ and HQ Related Employees	11,521	11,364	11,273	10,534	10,464
Field Employees					
Area Offices *	1,281	1,395	1,420	2,196	2,205
Postmasters / Installation Heads	25,285	25,429	25,322	25,519	25,509
Supervisors / Managers	32,635	33,201	33,234	33,635	35,360
Professional Administration					
and Technical Personnel	8,058	8,539	8,945	9,168	9,436
Clerks	204,145	213,920	221,644	226,183	242,276
Nurses	160	166	167	167	171
Mail Handlers	57,882	57,158	56,028	54,769	56,776
City Delivery Carriers	222,132	224,400	228,278	228,140	229,404
Motor Vehicle Operators	8,726	8,715	8,689	8,628	8,778
Rural Delivery Carriers - Full Time	67,584	66,344	64,335	62,762	61,611
Building and Equipment					
Maintenance Personnel	39,948	39,986	39,893	40,263	41,469
Vehicle Maintenance Employees	5,405	5,521	5,488	5,521	5,576
Total Field Employees	673,241	684,774	693,443	696,951	718,571
Total Career Employees	684,762	696,138	704,716	707,485	729,035
Noncareer Employees					
Casuals	22,078	22,518	19,182	20,529	17,373
Nonbargaining Temporary	1,244	1,135	1,185	1,138	910
Rural Part Time:					
Subs / RCA / RCR / AUX	60,444	59,087	57,411	56,403	56,451
Postmaster Relief and					
Leave Replacements	12,169	12,188	12,046	12,157	12,161
Transitional Employees	5,232	5,133	8,460	9,884	11,025
Total Noncareer Employees	101,167	100,061	98,284	100,111	97,920
Total Employees	785,929	796,199	803,000	807,596	826,955

* Beginning 2005, employees in the Sales organization were reported as Headquarters Related instead of in the Area Offices.

** Beginning 2004, field employees performing headquarters functions were reclassified as Headquarters Related.

Operating Statistics

	2007	2006	2005	2004	2003
(In actual units indicated, unaudited)					
Post Offices, Stations and Branches					
Post Offices	27,276	27,318	27,385	27,505	27,556
Classified Stations, Branches and Carrier Annexes	5,419	5,557	5,622	5,623	5,796
Contract Postal Units	3,131	3,014	3,116	2,889	2,777
Community Post Offices	895	937	1,019	1,142	1,450
Total Offices, Stations and Branches	36,721	36,826	37,142	37,159	37,579
Residential Delivery *					
City Delivery Carriers	79,470,894	78,949,153	78,524,242	77,967,046	77,490,203
Rural	37,022,488	36,068,838	34,958,986	33,817,615	33,324,799
PO Box	15,635,480	15,615,744	15,614,801	15,634,610	15,730,694
Highway Contract	2,473,323	2,345,255	2,243,520	2,162,772	2,153,056
Total Residential Delivery	134,602,185	132,978,990	131,341,549	129,582,043	128,698,752
Business Delivery *					
City Delivery Carriers	7,411,582	7,343,020	7,280,384	7,185,300	7,208,608
Rural	1,360,478	1,297,022	1,230,645	1,172,499	1,192,144
PO Box	4,548,973	4,490,102	4,412,559	4,321,862	4,203,433
Highway Contract	69,304	65,062	61,228	58,084	58,339
Total Business Delivery	13,390,337	13,195,206	12,984,816	12,737,745	12,662,524
Total Delivery Points	147,992,522	146,174,196	144,326,365	142,319,788	141,361,276
Change in Delivery Points	1,818,326	1,847,831	2,006,577	958,512	1,908,797

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

Financial History Summary

(Dollars in millions)	2007	2006	2005	2004	2003
Statements of Operations					
Total revenue	$ 74,973	$ 72,817	$ 69,993	$ 69,029	$ 68,764
Total expense ***	80,115	71,917	68,548	65,964	64,896
Net (Loss) Income	**$ (5,142)**	**$ 900**	**$ 1,445**	**$ 3,065**	**$ 3,868**
Operating revenue	$ 74,715	$ 72,551	$ 69,798	$ 68,960	$ 68,498
Revenue foregone	63	99	109	36	31
Total operating revenue	74,778	72,650	69,907	68,996	68,529
Compensation and benefits***	54,186	54,665	52,449	50,821	49,295
Retiree health benefits ***	10,084	1,637	1,495	1,313	1,133
Other expenses	15,835	15,379	14,337	13,717	13,474
Total operating expenses ***	80,105	71,681	68,281	65,851	63,902
Income from operations	(5,327)	969	1,626	3,145	4,627
Interest and investment income	195	167	86	33	58
Interest expense deferred retirement	-	(231)	(263)	(103)	(116)
Other interest expense **	(10)	(5)	(4)	(10)	(694)
Emergency preparedness, net	-	-	-	-	(7)
Net (Loss) Income	**$ (5,142)**	**$ 900**	**$ 1,445**	**$ 3,065**	**$ 3,868**
Balance Sheets					
Current assets *	$ 1,859	$ 2,041	$ 1,933	$ 1,851	$ 3,607
Property, equipment, and other assets	23,988	26,447	23,065	22,858	23,419
Total assets	**$ 25,847**	**$ 28,488**	**$ 24,998**	**$ 24,709**	**$ 27,026**
Current liabilities *	$ 13,778	$ 11,613	$ 9,160	$ 10,800	$ 16,753
Other Liabilities *	10,935	10,599	10,462	9,978	9,407
Equity	1,134	6,276	5,376	3,931	866
Total liabilities and net capital	**$ 25,847**	**$ 28,488**	**$ 24,998**	**$ 24,709**	**$ 27,026**
Changes in Net Capital					
Capital contributions of the U.S. government	$ 3,034	$ 3,034	$ 3,034	$ 3,034	$ 3,034
Equity (deficit) since reorganization	3,242	2,342	897	(2,168)	(6,036)
Total beginning balance	6,276	5,376	3,931	866	(3,002)
Net (loss) income	(5,142)	900	1,445	3,065	3,868
Ending balance	**$ 1,134**	**$ 6,276**	**$ 5,376**	**$ 3,931**	**$ 866**

* Certain reclassifications have been made to previously reported amounts.

** 2003 Includes $360 million in debt repurchase expense.

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

Selected Quarterly Financial Data

2007	Quarter 1	Quarter 2	Quarter 3	Quarter 4
(Dollars in millions, unaudited)				
Operating revenue	$ 19,663	$ 18,292	$ 18,361	$ 18,462
Total operating expenses	22,443	19,431	19,057	19,174
(Loss) from operations	(2,780)	(1,139)	(696)	(712)
Other revenue (expense)	48	61	37	39
Net (Loss)	**$ (2,732)**	**$ (1,078)**	**$ (659)**	**$ (673)**

2006	Quarter 1	Quarter 2	Quarter 3	Quarter 4
(Dollars in millions, unaudited)				
Operating revenue	$ 18,498	$ 18,615	$ 17,835	$ 17,702
Total operating expenses	17,730	17,741	17,778	18,432
Income (loss) from operations	768	874	57	(730)
Other revenue (expense)	(40)	(28)	24	(25)
Net (Loss) Income	**$ 728**	**$ 846**	**$ 81**	**$ (755)**

2005	Quarter 1	Quarter 2	Quarter 3	Quarter 4
(Dollars in millions, unaudited)				
Operating revenue	$ 18,786	$ 17,296	$ 16,847	$ 16,978
Total operating expenses	17,059	16,986	17,022	17,214
Income (loss) from operations	1,727	310	(175)	(236)
Other revenue (expense)	(45)	(35)	(65)	(36)
Net (Loss) Income	**$ 1,682**	**$ 275**	**$ (240)**	**$ (272)**

Glossary

Accruals. Revenue and expenses that are recorded as they occur, even though they may not have actually been paid.

Amortize. To reduce the value of an asset through regular charges to income over time; or to write off expenses by prorating them over a period of time.

Appropriation. Public funds set aside by Congress for a specific purpose.

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

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

Capitalize. To treat an expenditure as an asset; or to compute the present value of a future payment that will be paid over a period of time.

Contribution. The difference between the revenue from a class of mail and that class's volume-variable costs. For example, if a class of mail has revenue of $1.5 billion and volume-variable costs of $1 billion, its contribution is $500 million, which means that this class of mail covers its costs and contributes $500 million to the common costs of all mail services.

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

Delivery Confirmation. A special service that provides the date of delivery or attempted delivery for Priority Mail and Standard Mail parcels, Bound Printed Matter and Library Mail.

Depreciate. To periodically reduce the estimated value of an asset over the course of its useful life.

Direct Mail. A form of advertising often employed by businesses to reach targeted groups of potential customers by mail.

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

Equity. The difference between the value of all assets less all liabilities.

Express Mail. The Postal Service's premium delivery service, providing guaranteed overnight delivery for documents and packages weighing up to 70 pounds. Both domestic and international services are offered.

First-Class Mail. A class of mail including letters, postcards and all matter sealed or otherwise closed against inspection. This service is required for personal correspondence, handwritten or typewritten letters and bills or statements of account.

Fiscal Year. As used in the financial section of this report, the Postal Service fiscal year, which is the 12-month period during which the Postal Service keeps accounts, beginning Oct. 1 and closing Sept. 30.

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

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

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

Inspector General. The Inspector General is appointed by and reports directly to the Governors of the Postal Service and is independent of postal management. The Office of Inspector General (OIG) primarily investigates and evaluates programs and operations of the Postal Service to ensure the efficiency and integrity of the postal system.

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

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

Glossary

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

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

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

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

Payable. Money that is owed by the Postal Service.

Periodicals. A class of mail formerly called second-class mail that consists of magazines, newspapers and other publications.

Postal Inspection Service. The investigative arm of the Postal Service responsible for investigating criminal acts involving the mails and misuse of the postal system.

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

Prepaid. Payments made in advance of service being provided.

Present Value. The value today of a future payment that is discounted at a stated rate of compound interest. For example, the present value of $100 that will be paid to the Postal Service 10 years from now is about $38.55, if we discount that $100 at a rate equal to 10% interest compounded annually.

Priority Mail. Priority mail is a 1-3-day non-guaranteed delivery service.

Receivable. Money that is owed to the Postal Service.

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

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

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

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

Universal Service. The Postal Service's mandate and commitment to the nation to provide mail delivery service at uniform and reasonable rates to everyone, everywhere.

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