

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

FORM 10-Q

**QUARTERLY REPORT PURSUANT TO 39 U.S.C. § 3654 AND SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended June 30, 2020



UNITED STATES POSTAL SERVICE
(Exact name of registrant as specified in its charter)

| | |
|--|--|
| Washington, D.C. (State or other jurisdiction of incorporation or organization) | 41-0760000 (I.R.S. Employer Identification No.) |
|--|--|

| | |
|--|---------------------|
| 475 L'Enfant Plaza, S.W. Washington, D.C. (Address of principal executive offices) | 20260 (ZIP Code) |
|--|---------------------|

(202) 268-2000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the *Securities Exchange Act of 1934* during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☐ No ☐ Not Applicable ☒

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

| | | |
|--|--|--|
| Large accelerated filer <input type="checkbox"/> | Accelerated filer <input type="checkbox"/> | Non-accelerated filer <input type="checkbox"/> |
| Smaller reporting company <input type="checkbox"/> | Emerging growth company <input type="checkbox"/> | Not applicable <input checked="" type="checkbox"/> |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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

Securities registered pursuant to Section 12(b) of the Act:

| | | |
|----------------------------|--------------------------|--|
| <u>Title of each class</u> | <u>Trading Symbol(s)</u> | <u>Name of each exchange on which registered</u> |
| Not applicable | Not applicable | Not applicable |

The number of shares of common stock outstanding as of August 6, 2020: N/A

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

UNITED STATES POSTAL SERVICE STATEMENTS OF OPERATIONS (UNAUDITED)

| <i>(in millions)</i> | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|---------------------------------|--------------------------------|-------------------|-------------------------------|-------------------|
| | 2020 | 2019 | 2020 | 2019 |
| Revenue: | | | | |
| Operating revenue | \$ 17,639 | \$ 17,086 | \$ 54,831 | \$ 54,289 |
| Other revenue | 1 | 7 | 6 | 16 |
| Total revenue | 17,640 | 17,093 | 54,837 | 54,305 |
| Operating expenses: | | | | |
| Compensation and benefits | 12,158 | 11,526 | 36,470 | 35,909 |
| Retirement benefits | 1,710 | 1,477 | 5,143 | 4,433 |
| Retiree health benefits | 1,045 | 873 | 3,495 | 3,423 |
| Workers' compensation | 153 | 1,038 | 2,948 | 2,696 |
| Transportation | 2,182 | 1,968 | 6,587 | 6,310 |
| Other operating expenses | 2,562 | 2,451 | 7,578 | 7,345 |
| Total operating expenses | 19,810 | 19,333 | 62,221 | 60,116 |
| Loss from operations | (2,170) | (2,240) | (7,384) | (5,811) |
| Interest and investment income | 9 | 36 | 83 | 109 |
| Interest expense | (49) | (52) | (172) | (173) |
| Net loss | \$ (2,210) | \$ (2,256) | \$ (7,473) | \$ (5,875) |

See accompanying notes to the unaudited financial statements.

**UNITED STATES POSTAL SERVICE
BALANCE SHEETS**

(in millions)

| | June 30, 2020 | September 30, 2019 |
|--|----------------------|---------------------------|
| | (Unaudited) | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 12,925 | \$ 8,795 |
| Restricted cash | 404 | 366 |
| Receivables, net | 1,469 | 1,461 |
| Supplies, advances and prepayments | 193 | 178 |
| Total current assets | 14,991 | 10,800 |
| Property and equipment, net | 14,344 | 14,352 |
| Operating lease right-of-use assets | 4,417 | — |
| Other assets | 545 | 481 |
| Total assets | \$ 34,297 | \$ 25,633 |
| Current Liabilities: | | |
| Compensation and benefits | \$ 2,299 | \$ 2,571 |
| Retirement benefits | 10,667 | 8,385 |
| Retiree health benefits | 50,700 | 47,205 |
| Workers' compensation | 1,324 | 1,359 |
| Payables and accrued expenses | 2,207 | 2,228 |
| Deferred revenue-prepaid postage | 2,230 | 2,225 |
| Operating lease liabilities | 1,205 | — |
| Customer deposit accounts | 1,215 | 1,119 |
| Other current liabilities | 1,327 | 1,190 |
| Current portion of debt | 3,400 | — |
| Total current liabilities | 76,574 | 66,282 |
| Workers' compensation, noncurrent | 18,795 | 17,170 |
| Operating lease liabilities, noncurrent | 3,357 | — |
| Employees' accumulated leave, noncurrent | 2,122 | 2,064 |
| Other noncurrent liabilities | 1,454 | 649 |
| Long-term debt | 11,000 | 11,000 |
| Total liabilities | 113,302 | 97,165 |
| Net Deficiency: | | |
| Capital contributions of the U.S. government | 3,132 | 3,132 |
| Deficit since 1971 reorganization | (82,137) | (74,664) |
| Total net deficiency | (79,005) | (71,532) |
| Total liabilities and net deficiency | \$ 34,297 | \$ 25,633 |

See accompanying notes to the unaudited financial statements.

**UNITED STATES POSTAL SERVICE
STATEMENTS OF CHANGES IN NET DEFICIENCY
(UNAUDITED)**

For the three and nine months ended June 30, 2019

| <i>(in millions)</i> | Capital Contributions of U.S. Government | Accumulated Deficit Since Reorganization | Total Net Deficiency |
|---|---|---|-----------------------------|
| Balance, September 30, 2018 | \$ 3,132 | \$ (65,769) | \$ (62,637) |
| Cumulative effect adjustments for adoption of new accounting pronouncements | — | (82) | (82) |
| Net loss | — | (1,537) | (1,537) |
| Balance, December 31, 2018 | \$ 3,132 | \$ (67,388) | \$ (64,256) |
| Net loss | — | (2,082) | (2,082) |
| Balance, March 31, 2019 | \$ 3,132 | \$ (69,470) | \$ (66,338) |
| Net loss | — | (2,256) | (2,256) |
| Balance, June 30, 2019 | \$ 3,132 | \$ (71,726) | \$ (68,594) |

See accompanying notes to the unaudited financial statements.

For the three and nine months ended June 30, 2020

| <i>(in millions)</i> | Capital Contributions of U.S. Government | Accumulated Deficit Since Reorganization | Total Net Deficiency |
|------------------------------------|---|---|-----------------------------|
| Balance, September 30, 2019 | \$ 3,132 | \$ (74,664) | \$ (71,532) |
| Net loss | — | (748) | (748) |
| Balance, December 31, 2019 | \$ 3,132 | \$ (75,412) | \$ (72,280) |
| Net loss | — | (4,515) | (4,515) |
| Balance, March 31, 2020 | \$ 3,132 | \$ (79,927) | \$ (76,795) |
| Net loss | — | (2,210) | (2,210) |
| Balance, June 30, 2020 | \$ 3,132 | \$ (82,137) | \$ (79,005) |

See accompanying notes to the unaudited financial statements.

**UNITED STATES POSTAL SERVICE
STATEMENTS OF CASH FLOWS
(UNAUDITED)**

| | Nine Months Ended June 30, | |
|---|----------------------------|-----------------|
| | 2020 | 2019 |
| <i>(in millions)</i> | | |
| Cash flows from operating activities: | | |
| Net loss | \$ (7,473) | \$ (5,875) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | |
| Depreciation and amortization | 1,283 | 1,271 |
| Loss (gain) on disposals of property and equipment, net | 12 | (7) |
| Lease expense | (53) | — |
| Increase in other assets | (64) | (11) |
| Increase in noncurrent workers' compensation | 1,625 | 1,330 |
| (Decrease) increase in noncurrent deferred appropriations and other revenue | (4) | 12 |
| Net lease liabilities | 178 | — |
| Increase in other noncurrent liabilities | 793 | 110 |
| Changes in current assets and liabilities: | | |
| Receivables, net | (8) | (413) |
| Other current assets | (15) | (27) |
| Retirement benefits | 2,282 | 1,643 |
| Retiree health benefits | 3,495 | 3,423 |
| Payables, accrued expenses and other | (96) | (194) |
| Deferred revenue-prepaid postage and other deferred revenue | 6 | (13) |
| Net cash provided by operating activities | 1,961 | 1,249 |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | (1,187) | (953) |
| Proceeds from sales of property and equipment | 25 | 23 |
| Net cash used in investing activities | (1,162) | (930) |
| Cash flows from financing activities: | | |
| Issuance of notes payable | 3,400 | 26,800 |
| Payments on notes payable | — | (29,000) |
| Payments on finance lease obligations and other | (31) | (37) |
| Net cash provided by (used in) financing activities | 3,369 | (2,237) |
| Net increase (decrease) in cash, cash equivalents & restricted cash | 4,168 | (1,918) |
| Cash, cash equivalents & restricted cash - beginning of period | 9,161 | 10,336 |
| Cash, cash equivalents & restricted cash - end of period | \$ 13,329 | \$ 8,418 |
| Supplemental cash flow disclosures: | | |
| Cash paid for interest | \$ 165 | \$ 169 |

See accompanying notes to the unaudited financial statements.

NOTES TO UNAUDITED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

Interim Financial Statements

The accompanying unaudited interim financial statements of the United States Postal Service (the "Postal Service") have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of the U.S. Securities and Exchange Commission Regulation S-X. These financial statements should be read in conjunction with the Postal Service's financial statements for the year ended September 30, 2019, included in its Annual Report on Form 10-K ("Annual Report") filed with the Postal Regulatory Commission ("PRC") on November 14, 2019, and do not include all information and footnotes which are normally included in the Annual Report. Except as otherwise specified, all references to years are to fiscal years beginning October 1 and ending September 30, and quarters are quarters within fiscal years 2020 and 2019.

In the opinion of management, the accompanying unaudited interim financial statements reflect all material adjustments, including recurring adjustments, necessary to fairly present the financial position as of June 30, 2020, the results of operations for the three and nine months ended June 30, 2020, and 2019, the changes in net deficiency for the nine months ended June 30, 2020, and 2019, and cash flows for the nine months ended June 30, 2020, and 2019. Operating results for the three and nine months ended June 30, 2020, are not necessarily indicative of the results that may be expected for all of 2020. Mail volume and revenue are historically greatest in the first quarter of the year, which includes the holiday mailing season.

Reclassifications

Certain reclassifications have been made to the financial statements for the three and nine months ended June 30, 2019, as well as subsequent footnotes, to conform to the current period presentation. Specifically, expenses associated with employer contributions to Social Security and the Thrift Savings Plan ("TSP") have been reclassified from *Retirement benefits* and are included as *Compensation and benefits* within *Operating expenses* in the accompanying unaudited *Statements of Operations*.

The liabilities associated with these benefits have also been reclassified from *Retirement benefits* and are included as *Compensation and benefits* within *Current liabilities* in the balance sheets. Corresponding reclassifications have been made within *Changes in current assets and liabilities* in the accompanying unaudited *Statements of Cash Flows*.

These reclassifications had no effect on previously reported total operating expenses, loss from operations or net loss. See *Note 9 - Retirement Plans* for further disclosure pertaining to retirement benefits.

NOTE 2 - RECENT ACCOUNTING PRONOUNCEMENTS

Recently Adopted Accounting Pronouncement

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update 2016-02 *Leases*, which has since been codified in Accounting Standards Codification ("ASC") 842, *Leases* ("ASC 842"). The new standard requires an entity to record most leases in its balance sheets but continue to recognize expenses in its statements of operations in a manner similar to current accounting practices. The new standard requires a lessee to recognize a lease liability for the obligation to make lease payments and a right-of-use ("ROU") asset for the right to use the underlying asset for the lease term. Expenses associated with operating leases are recognized on a straight-line basis and include embedded interest and amortization components. The Postal Service recognizes expenses associated with operating leases as rent expense or transportation expense within *Other operating expenses* or *Transportation*, respectively, in the statements of operations. The Postal Service recognizes expenses associated with finance leases (formerly capital leases under previous guidance) with both interest and amortization expenses and presents these separately in the statements of operations. As such, finance leases generally have higher expenses in the earlier periods of the lease term.

The Postal Service adopted ASC 842 for its 2020 fiscal year (beginning October 1, 2019). In connection with the adoption of ASC 842, the Postal Service has made necessary changes to relevant policies, processes, information

systems and internal controls. For transition purposes, the Postal Service has elected the option not to restate comparative financial statements under the modified retrospective transition model. This option allows the application of the standard to all leases in effect as of the effective date (October 1, 2019) or commencing thereafter, without any restatement impact on the comparative financial statement balances. Accordingly, all comparative financial statements enclosed herein are presented in accordance with the previous ASC 840, *Leases* ("ASC 840"), with related ASC 840 disclosures provided in *Note 12 - Leases*.

In implementing ASC 842, the Postal Service has elected the package of practical expedients which permits carrying forward historical accounting positions around lease identification, lease classification and initial direct costs for all leases commencing prior to October 1, 2019. The Postal Service has also made a policy election to not separate the lease and non-lease components for all types of underlying assets and to exclude its short-term leases from the ROU asset and lease liability balances.

The Postal Service adopted ASC 842 on October 1, 2019. The implementation of ASC 842 resulted in an opening balance sheet adjustment, as of October 1, 2019, to recognize \$4.4 billion in right-of-use assets and lease liabilities relating to operating leases as follows:

| <i>(in millions)</i> | As reported on September 30, 2019 | | Adjustments | | Balance on October 1, 2019 | |
|---|--------------------------------------|---------------|-------------|--------------|-------------------------------|---------------|
| CONDENSED BALANCE SHEETS: | | | | | | |
| Operating lease right-of-use assets | \$ | — | \$ | 4,364 | \$ | 4,364 |
| Total assets | \$ | 25,633 | \$ | 4,364 | \$ | 29,997 |
| Operating lease liabilities | \$ | — | \$ | 1,129 | \$ | 1,129 |
| Other current liabilities | | 1,190 | | (20) | | 1,170 |
| Operating lease liabilities, noncurrent | | — | | 3,255 | | 3,255 |
| Total liabilities and net deficiency | \$ | 25,633 | \$ | 4,364 | \$ | 29,997 |

The implementation of ASC 842 did not have a material impact on the Postal Service's *Statement of Operations* or *Statement of Cash Flows* and did not have any impact on the Postal Service's *Statement of Changes in Net Deficiency*. See *Note 12 - Leases* for additional disclosures pertaining to ASC 842.

Accounting Pronouncements Issued but not Adopted

Accounting Standards Update 2016-13 Financial Instruments - Credit Losses

In June 2016, the FASB issued Accounting Standards Update 2016-13 *Financial Instruments - Credit Losses*, which has since been codified in ASC 326, *Financial Instruments - Credit Losses* ("ASC 326"). The new standard requires entities to measure expected credit losses on financial instruments and other commitments by replacing the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates.

The Postal Service intends to adopt ASC 326 for its 2021 fiscal year (beginning October 1, 2020) and the quarters therein. The standard is applicable to the Postal Service's valuation of its receivables. The Postal Service has substantially completed evaluating all of the necessary information to properly measure its expected credit losses. The Postal Service is also finalizing changes to its receivable accounting policies and procedures and to related processes. The adoption will result in enhanced disclosures, however the Postal Service does not currently expect the adoption to have a material impact on its financial statements.

Accounting Standards Update 2018-13 Fair Value Measurement

In August 2018, the FASB issued Accounting Standards Update 2018-13 *Fair Value Measurement: Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement*, which has since been codified

in ASC 820, *Fair Value Measurement* ("ASC 820"). The new standard modifies the disclosure requirements for fair value measurements by adding, modifying or removing certain disclosures.

The Postal Service intends to adopt ASC 820 for its 2021 fiscal year (beginning October 1, 2020) and the quarters therein. The standard is applicable to the Postal Service's fair value measurements of its revenue forgone installment receivable and its long-term debt, as described further in *Note 13 - Fair Value Measurement*. Under ASC 820, certain disclosures are required to be applied on a retrospective basis and others on a prospective basis. The Postal Service has completed its evaluation of the standard and determined that the adoption will result in changes to its recurring disclosures with no impact on its financial statements.

Accounting Standards Update 2018-15 Intangibles - Goodwill and Other - Internal-Use Software

In August 2018, the FASB issued Accounting Standards Update 2018-15 *Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40) - Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement*, which has since been codified in ASC Subtopic 350-40, *Intangibles - Goodwill and Other - Internal-Use Software* ("ASC 350-40"). This is an update to a standard the FASB issued in April 2015 for entities evaluating the accounting for fees paid by a customer in a cloud computing (hosting) arrangement by providing guidance for determining when such arrangement includes a software license.

If a cloud computing arrangement includes a license for internal-use software, then the software license is accounted for by the customer in accordance with ASC 350-40. This generally means that an intangible asset is recognized for the software license and, to the extent that the payments attributable to the software license are made over time, a liability also is recognized. If a cloud computing arrangement does not include a software license, the entity should account for the arrangement as a service contract. This generally means that the fees associated with the hosting element (service) of the arrangement are expensed as incurred.

The Postal Service intends to adopt ASC 350-40 for its 2021 fiscal year (beginning October 1, 2020) and the quarters therein. The Postal Service is updating its accounting policies and procedures and changes will be applied prospectively.

NOTE 3 - LIQUIDITY

The Postal Service's liquidity consists of unrestricted cash and cash equivalents plus authorized borrowing capacity.

Cash

The Postal Service generates its cash almost entirely through the sale of postal products and services. End-of-period cash balances may fluctuate significantly from period to period due to the timing of biweekly payroll-related payments, or as a result of financing activities, as discussed below. As of June 30, 2020, and September 30, 2019, the Postal Service held unrestricted cash and cash equivalents of \$12.9 billion and \$8.8 billion, respectively. See *Note 6 - Cash, Cash Equivalents and Restricted Cash* for further disclosures pertaining to cash.

Debt

The *Postal Reorganization Act*, as amended by Public Laws 101-227 and 109-435 (the "PRA"), authorizes the Postal Service to raise cash through the issuance of debt obligations. The PRA requires the Postal Service to notify the Secretary of the Treasury of its intent to issue debt, allowing the U.S. Treasury the first option to purchase such obligations. However, if the Secretary of the Treasury elects not to purchase such obligations, the PRA authorizes the Postal Service to issue and sell such obligations to a party or parties other than the U.S. Treasury, which may include a transaction in the public or private debt markets.

In 1974, the Postal Service began issuing debt through individual debt agreements to the Federal Financing Bank ("FFB"), a government-owned corporation under the general supervision of the Secretary of the Treasury. Under the PRA, the Postal Service is limited by statute to annual net increases in debt of \$3.0 billion calculated as of the end of each fiscal year, and total debt of \$15.0 billion. The availability of additional debt is discussed below, under *COVID-19 Considerations*.

In 1999, the Postal Service entered into a Note Purchase Agreement ("NPA") with the FFB to establish standardized procedures for issuing debt. Under the NPA, the Postal Service was able to issue a series of notes and revolving credit line facilities with established terms and conditions by providing two days prior notice. These note

arrangements and credit line facilities provided the flexibility to borrow short or long-term, using floating or fixed-rate instruments.

The NPA was extended each year through September 30, 2018, and in shorter increments between that date and August 31, 2019, at which time the NPA expired. This expiration did not affect the terms of any of the Postal Service's outstanding debt as of June 30, 2020, all of which was issued under the NPA. As a contractual matter, the FFB continued to lend to the Postal Service under each commitment and line of credit until it expired.

On April 3, 2020, the Postal Service drew \$3.4 billion on a revolving credit facility with the FFB that survived the expiration of the NPA, increasing the aggregate principal balance of all debt outstanding to \$14.4 billion. While the Postal Service is currently \$600 million below the \$15.0 billion maximum borrowing amount allowed under the Postal Service's statutory debt ceiling, \$400 million of the revolving credit facility will require repayment by September 30, 2020, to comply with the annual debt net increase limit. Given that the credit facility has a maximum term of up to one year, the Postal Service must repay any outstanding balance of the credit facility by April 2, 2021.

As of June 30, 2020, the Postal Service held \$3.4 billion in short-term debt relating to the revolving credit facility and \$11.0 billion in long-term debt consisting of a combination of fixed-rate and floating-rate notes.

As of September 30, 2019, the aggregate principal balance of all debt outstanding was \$11.0 billion consisting of a combination of fixed-rate and floating-rate notes, all of which was considered long-term debt.

Liquidity Concerns

The Postal Service reported operating expenses of approximately \$80 billion in 2019 and has incurred cumulative net losses of \$85.3 billion from 2007 through June 30, 2020. Absent legislative and regulatory change, the Postal Service projects continuing annual net losses in the future. As a result of these losses and its liquidity concerns, the Postal Service may not have sufficient liquidity to meet all of its existing legal obligations when due while also reducing its debt and making the critical infrastructure investments that have been deferred in recent years.

Furthermore, while the expiration of the NPA did not remove the Postal Service's statutory ability to issue debt under the PRA, if the Postal Service is unable to renew or replace the NPA with the FFB, it has no assurance it would be able to raise additional cash through debt financing with the FFB, or that such financing would be provided on terms comparable to those under the NPA. Alternatively, if the Postal Service were to use its authority under the PRA to issue and sell obligations to a party or parties other than the FFB, it has no assurance it would be successful in raising additional cash, or that such financing would be provided on terms comparable to those under the NPA.

COVID-19 Considerations

In March 2020, the World Health Organization declared a novel strain of coronavirus ("COVID-19") a global pandemic, and the virus has since spread throughout the U.S. Given its mandate to provide universal postal services to the nation, the Postal Service provides an essential service as part of the nation's critical infrastructure and has continued to process and deliver mail and packages during the pandemic. The Postal Service serves a critical role in the U.S. economy as its employees accept, process, transport, and deliver vital mail and packages like medicine, essential consumer staples, benefits checks, and important information.

The COVID-19 pandemic has had a material effect on certain of the Postal Service's results of operations. Quarantines, shelter-in-place orders, and travel and logistics restrictions in connection with the outbreak have affected retail and commercial customers, as well as suppliers and mail service providers. The Postal Service relies on the sale of postal products and services to fund its operations and is significantly impacted by factors including, but not limited to, overall customer demand, the mix of postal services and contribution associated with those services, and the volume of mail and packages processed through its network.

As a result of the pandemic, and to a lesser extent, secular mail declines, the Postal Service's sales from mail services, its most profitable revenue stream, continued to decline during the third quarter. Meanwhile, the Postal Service's sales from Shipping and Packages, its most labor-intensive revenue stream, experienced substantial growth as a result of the surge in e-commerce driven by the COVID-19 pandemic. While the shift led to overall

higher revenue results for the quarter, Shipping and Packages produces a lower contribution margin per piece due to the higher associated labor and transportation expenses.

In addition to increased labor costs to support this volume increase, transportation expenses were impacted as logistics restrictions and limitations associated with the pandemic led to fewer modes of available transportation. Furthermore, the pandemic significantly increased the Postal Service's expenses on supplies and services, such as personal protective equipment ("PPE"), and on paid sick leave, including new leave authorized by the *Families First Coronavirus Response Act*, enacted as Public Law 116-127 ("FFCRA"). The FFCRA provides the means for companies and other government entities to receive federal reimbursement for payment of this FFCRA leave; however, the Postal Service is not eligible for such reimbursement.

The duration of the COVID-19 disruption remains uncertain, and the Postal Service expects that its liquidity may worsen if the nation experiences a prolonged period of disruption. Given these COVID-19 considerations, the Postal Service may require an additional injection of liquidity, provided by either the U.S. government or other sources.

On March 27, 2020, the President signed the *Coronavirus Aid, Relief, and Economic Security Act*, enacted as Public Law 116-136 (the "CARES Act"). Notwithstanding the \$15.0 billion statutory debt limit and the \$3.0 billion limit on annual borrowing, the *CARES Act* allows the Postal Service to borrow up to an additional \$10.0 billion in financing from the U.S. Treasury to fund operating expenses. The U.S. Treasury may lend up to this amount at the request of the Postal Service, upon terms and conditions mutually agreed upon. On July 29, 2020, the Postal Service announced that it had reached an agreement in principle with the U.S. Treasury on the terms and conditions associated with the *CARES Act* financing. The agreed-upon terms and conditions must be memorialized in loan documents and satisfied before the Postal Service will have access to the *CARES Act* borrowing, as limited by such terms and conditions.

The *CARES Act* also offers certain employers the ability to defer payment of the employer's share of the Social Security payroll tax on wages incurred from March 27, 2020, through December 31, 2020. In accordance with this provision, the Postal Service began deferring these payments in April 2020, and intends to continue the deferral for the remainder of calendar year 2020. One half of these deferred payments would be due by December 31, 2021, and the other half by December 31, 2022. As of June 30, 2020, the Postal Service had deferred approximately \$658 million. This amount is recorded within *Other noncurrent liabilities* in the accompanying *Balance Sheets*.

Business Model Challenges and Constraints

The Postal Service is constrained by laws and regulations, including the *Postal Accountability and Enhancement Act* ("PAEA"), which restrict revenue sources and mandate certain expenses.

Market-Dominant services, which include, but are not limited to, *First-Class Mail*, *Marketing Mail*, *Periodicals* and certain parcel services, accounted for approximately 66% of the Postal Service's annual operating revenues in 2019, and are currently subject to a price cap as measured by the Consumer Price Index for All Urban Consumers ("CPI-U"). Due to the significant declines in the Market-Dominant services and the surge in Shipping and Packages services during the third quarter resulting from the COVID-19 pandemic, revenue from Market-Dominant services has declined to 59% of the Postal Service's total operating revenues for the nine months ended June 30, 2020.

The ongoing decline in the volume of Market-Dominant products and services, which has been exacerbated by the COVID-19 pandemic, is a significant factor contributing to Postal Service losses. Specifically, declines in *First-Class Mail* are largely the result of changes in consumers' and businesses' use of mail resulting from the continuing migration to electronic communication and transactional alternatives, which have taken place over the last decade and are expected to continue. *Marketing Mail* volume has generally been challenged by commercial mailers' increasing use of digital and mobile advertising, and more recently by the COVID-19 pandemic, although this class has benefited from strong political and election mail volumes, particularly in the second half of 2018 and the first quarter of 2019.

Unlike the Postal Service's Market-Dominant prices, the Postal Service's costs are not similarly constrained. Under current law, the Postal Service is generally unable to increase prices sufficiently to offset increased costs, and is likewise constrained by law from reducing many of its costs or from pursuing many alternate sources of revenue.

A large portion of its cost structure cannot be altered expeditiously due to the Postal Service's universal service obligation and many employee and retiree benefit costs are mandated by law and cannot be altered without legislative change.

The Postal Service's Shipping and Packages category has historically provided revenue and volume growth as a result of its successful efforts to compete in shipping services, including last-mile e-commerce fulfillment services and Sunday delivery as well as end-to-end services. This service category is subject to intense competition which significantly impacts both revenue and volume. Certain major customers of the Postal Service had begun diverting volume from the Postal Service's network by in-sourcing last-mile delivery. However, as a result of the surge in e-commerce growth driven by the COVID-19 pandemic, some of these customers increased their volume to the Postal Service's network beginning in March 2020 due to their delivery capacity constraints and these increased volumes have continued through the third quarter of 2020.

The Postal Service is required to participate in U.S. government benefit programs administered by the Office of Personnel Management ("OPM") for both active and retired employees. These programs include the Civil Service Retirement System ("CSRS") and the Federal Employees Retirement System ("FERS"), retirement programs that are required by law, and the Federal Employees Health Benefit ("FEHB") Program, a health benefit program required by union contract. Statutorily mandated expenses include amortization payments to provide full funding of retirement benefits under CSRS and FERS, as well as FERS normal costs, described in greater detail below and in *Note 9 - Retirement Plans*. Additionally, the PAEA established the Postal Service Retiree Health Benefits Fund ("PSRHBF") and mandated certain obligations for paying normal costs, the present value of the estimated retiree health benefits attributable to active employees' current year of service, and amortization payments for full prefunding of retiree health benefits. These prefunding obligations, described in greater detail below and in *Note 10 - Health Benefits Plans*, are unlike expenses imposed on most other federal entities or private-sector businesses that offer such benefits.

Because the Postal Service provides its services primarily through its employees, its costs are heavily concentrated in wages and benefits for both current employees and retirees. These costs are significantly impacted by contractual wage increases, employee health benefit premium increases, and statutorily mandated retirement and workers' compensation programs. Some of these costs have historically increased at a higher rate than inflation.

Further, the number of delivery points continues to grow by approximately one million per year, which drives up delivery costs. When combined with the impact of lower mail volume, the average number of pieces delivered per delivery point per day has decreased from approximately 5.5 pieces in 2007 to 3.4 pieces in 2019, a decline of approximately 39%, and has continued to decline in 2020.

Past Due Obligations

The following table presents the total expenses accrued but unpaid by the Postal Service as of September 30, 2019, related to retiree health benefits, CSRS and FERS and the fiscal years in which the accruals were recorded:

| <i>(in millions)</i> | 2019 | 2018 | 2017 | 2012 to 2016 | Total |
|---|-----------------|-----------------|-----------------|---------------------|------------------|
| PSRHBF prefunding fixed amount ¹ | \$ — | \$ — | \$ — | \$ 33,900 | \$ 33,900 |
| PSRHBF unfunded benefits amortization | 789 | 815 | 955 | — | 2,559 |
| Normal cost of retiree health benefits | 3,775 | 3,666 | 3,305 | — | 10,746 |
| CSRS unfunded retirement benefits amortization | 1,617 | 1,440 | 1,741 | — | 4,798 |
| FERS unfunded retirement benefits amortization ² | 1,060 | 958 | 917 | 495 | 3,430 |
| Total expenses accrued but unpaid | \$ 7,241 | \$ 6,879 | \$ 6,918 | \$ 34,395 | \$ 55,433 |

¹ The 2012 to 2016 period amount includes \$5.8 billion for 2016, \$5.7 billion for 2015, \$5.7 billion for 2014, \$5.6 billion for 2013 and \$11.1 billion for 2012.

² The 2012 to 2016 period amount includes \$247.6 million for 2016, \$240.9 million for 2015 and \$6.7 million for 2014.

Mitigating Circumstances

The Postal Service continues to pursue strategies within its control to increase operational efficiency and improve liquidity. The Postal Service has managed capital in recent years by spending what it believed was essential to maintain its existing facilities and service levels, to ensure employee safety and to increase efficiencies. However, some increases in capital investment are necessary to upgrade its facilities, fleet of vehicles and processing equipment in order to remain operationally viable. Aggressive management of the business operations, as well as an additional injection of liquidity, provided by either the U.S. government or other sources, and legislative and regulatory reforms that will enable it to increase revenue and reduce costs, will all be necessary to restore the Postal Service to financial health.

The Postal Service's status as an independent establishment of the executive branch that does not receive tax dollars for its operations presents unique requirements and restrictions, but also potentially mitigates some of the financial risk that would otherwise be associated with a cash shortfall. With annual total revenue in 2019 of approximately \$71 billion, a financially sound Postal Service continues to be vital to U.S. commerce.

The U.S. economy benefits greatly from the Postal Service and the many businesses that provide the printing and mailing services that it supports. Disruption of the mail would cause undue hardship to businesses and consumers as it would significantly inhibit the remittance of payments through the mail, as well as vital mail and packages like medicine, essential consumer staples, benefits checks, and important information. In the event of a cash shortfall, the U.S. government would likely prevent the Postal Service from significantly curtailing or ceasing operations. The Postal Service continues to inform the executive branch, Congress, the PRC and other stakeholders of the immediate and long-term financial challenges it faces and the legislative and regulatory changes that are required to restore its financial stability.

In the event that circumstances leave the Postal Service with insufficient liquidity, it would likely be required to implement additional contingency plans to ensure that its primary mission is fulfilled and that mail deliveries continue. These measures may require the Postal Service to prioritize payments to the FFB, employees and suppliers ahead of some payments to fund retirement and retiree health benefits, as has been done in the past. By exercising these contingency plans, the Postal Service expects that it will have sufficient liquidity to continue operating through at least August 2021.

NOTE 4 - REVENUE RECOGNITION

The Postal Service generates the majority of its revenue from contracts associated with the processing and delivery of different types of mail and packages, both domestically and internationally, which generally occur over a relatively short period of time (e.g., several days).

Disaggregation of Revenue

The following table summarizes the Postal Service's disaggregated operating revenue for the three and nine months ended June 30, 2020, and 2019, by each service category:

| (in millions) | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|--|--------------------------------|------------------|-------------------------------|------------------|
| | 2020 | 2019* | 2020 | 2019* |
| Operating revenue: | | | | |
| First-Class Mail | \$ 5,481 | \$ 5,854 | \$ 18,328 | \$ 18,780 |
| Marketing Mail | 2,427 | 3,862 | 10,577 | 12,360 |
| Shipping and Packages | 8,311 | 5,412 | 20,738 | 17,307 |
| International | 490 | 604 | 1,802 | 1,913 |
| Periodicals | 244 | 302 | 797 | 910 |
| Other | 686 | 1,052 | 2,589 | 3,019 |
| Total operating revenue | \$ 17,639 | \$ 17,086 | \$ 54,831 | \$ 54,289 |
| * Prior period amounts for certain service categories include reclassifications of amounts amongst service categories to conform to current period presentation. These reclassifications are immaterial for each affected category, and had no effect on total operating revenue for the period. | | | | |

Satisfaction of Performance Obligations

A performance obligation is a promise in a contract to transfer a distinct good or service to the customer. A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied.

First-Class Mail, *Marketing Mail*, *Shipping and Packages*, *International Mail* and *Periodicals* are categorized as Mailing and Shipping services for purposes of satisfying performance obligations. The Postal Service recognizes revenue for Mailing and Shipping services as it fulfills its obligation to process and deliver each mailpiece and the customer mail sender/recipient receives and consumes the benefits of these services.

Other revenue includes *PO Box* services, Return Receipts, Insurance, Other Ancillary Services, Shipping and Mailing Supplies, Collect on Delivery, *Registered Mail*, Stamped Envelopes and Cards, Money Orders and other goods and services. The Postal Service recognizes revenue for the majority of these services over time as the customer receives and consumes the benefits of the service. The revenue for a small portion of certain goods or services in this service category is recognized at a point in time when the goods or services are provided to the customer.

The vast majority of the Postal Service's contracts include only one performance obligation. However, if a contract is separated into more than one performance obligation, the total transaction price for each performance obligation is allocated in an amount based on the estimated relative stand-alone selling prices of the promised goods or services underlying each performance obligation. The majority of the goods or services sold by the Postal Service have observable stand-alone sales prices. Further, payment for the majority of the goods and services is received up front.

If the Postal Service were unable to complete delivery to the destination point, another entity would not need to re-perform the entire portion of delivery already performed by the Postal Service. Accordingly, control from the Postal Service to the customer transfers over time for the vast majority of services the Postal Service offers, and revenue is recognized based on the progress of the completion of the performance obligations.

Variable Consideration

The Postal Service offers certain contracts to its customers that contain various types of customer incentives or other provisions that can either increase or decrease the transaction price. Customer incentives include discounts, money back guarantees, rebates, refunds or incentive payments. The other provisions include performance

penalties. The Postal Service uses the expected value approach to estimate variable consideration to which it expects to be entitled.

Contract Modifications

The Postal Service considers contract modifications to exist when the modification either creates new enforceable rights and obligations or alters the existing arrangement. Contract modifications do not add distinct services; they are typically used to change the prices that the Postal Service charges its customer for existing services. These contract modifications are accounted for prospectively as the remaining performance obligations are executed.

Principal vs. Agent Consideration

The Postal Service utilizes third parties to assist with the transportation of mailpieces between different points as part of the delivery process. Based on its evaluation of the transfer of control model, the Postal Service has determined that it acts as the principal rather than the agent within these arrangements.

Contract Liabilities

The vast majority of the Postal Service's contract liabilities consist of *Deferred revenue-prepaid postage* and prepaid *PO Box* and Caller Service fees. *Deferred revenue-prepaid postage* is an estimate of postage that has been sold, but not yet used by customers. The Postal Service recognizes revenue over time as the Postal Service delivers mailpieces. Because payments for postage are typically collected in advance of the satisfaction of related performance obligations, the Postal Service defers and reports this unearned revenue as *Deferred revenue-prepaid postage* in its balance sheet. Stamp sales and metered postage account for the majority of *Deferred revenue-prepaid postage*. The liability also includes an estimate for mail that is in-transit within the Postal Service network.

The prepaid *PO Box* and Caller Service fees consist of the payments received from customers for *PO Box* fees at the beginning of their contracts. The Postal Service defers and reflects this unearned revenue as prepaid *PO Box* and Caller Service fees within *Other current liabilities* in the accompanying *Balance Sheets*. Revenue is recognized over time as customers use the *PO Box* and Caller Services over the terms of their contracts.

The following table presents the balances of the Postal Service's contract liabilities, including *Deferred revenue-prepaid postage* and prepaid *PO Box* and Caller Service fees, as of June 30, 2020, and September 30, 2019, respectively:

| <i>(in millions)</i> | June 30, 2020 | September 30, 2019 |
|---|----------------------|---------------------------|
| Deferred revenue-prepaid postage: | | |
| Forever stamps | \$ 1,332 | \$ 1,238 |
| Mail-in-transit | 518 | 555 |
| Metered postage | 260 | 313 |
| Other prepaid postage | 120 | 119 |
| Total deferred revenue-prepaid postage | 2,230 | 2,225 |
| Prepaid PO Box and Caller Service fees | 488 | 461 |
| Total deferred revenue | \$ 2,718 | \$ 2,686 |

The following table provides details of revenue recognized for the nine months ended June 30, 2020, that was reported in the Postal Service's contract liabilities for deferred revenue as of September 30, 2019:

| <i>(in millions)</i> | Nine Months Ended June 30, 2020 |
|--|--|
| Revenue recognized in the period from deferred revenue: | |
| Forever stamps | \$ 858 |
| Mail-in-transit | 555 |
| Metered postage | 313 |
| Other prepaid postage | 88 |
| PO Box and Caller Service fees | 441 |

NOTE 5 - RELATED PARTIES

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

The following table presents related-party assets and liabilities as of June 30, 2020, and September 30, 2019:

| <i>(in millions)</i> | June 30, 2020 | September 30, 2019 |
|--|----------------------|---------------------------|
| Related-party assets: | | |
| Receivables and advances ¹ | \$ 27 | \$ 25 |
| Operating lease right-of-use assets ² | 135 | — |
| Carrying amount of revenue forgone installment receivable ³ | 481 | 466 |
| Related-party liabilities: | | |
| Current portion of debt | \$ 3,400 | \$ — |
| Operating lease liabilities ⁴ | 135 | — |
| Other current liabilities ⁵ | 63,083 | 57,518 |
| Long-term debt | 11,000 | 11,000 |
| Other noncurrent liabilities ⁶ | 18,810 | 17,187 |

¹ Current portion within *Receivables, net* and noncurrent portion within *Other assets* in the accompanying *Balance Sheets*.
² Amount includes right-of-use assets for operating leases with the General Services Administration ("GSA").
³ Included within *Other assets* in the accompanying *Balance Sheets*. See further discussion in *Note 13 - Fair Value Measurement*.
⁴ Amount includes liabilities for operating leases with the GSA.
⁵ Amounts include CSRS, FERS, PSRHB and current workers' compensation obligations, as well as payables to other agencies.
⁶ Amounts include noncurrent workers' compensation obligations.

The following table presents related-party revenue and expenses for the three and nine months ended June 30, 2020, and 2019:

| (in millions) | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|---|--------------------------------|----------|-------------------------------|-----------|
| | 2020 | 2019 | 2020 | 2019 |
| Related-party operating revenue ¹ | \$ 290 | \$ 238 | \$ 1,098 | \$ 724 |
| Related-party operating expenses ² | \$ 4,214 | \$ 3,815 | \$ 13,085 | \$ 12,293 |
| Related-party interest income ³ | \$ 9 | \$ 36 | \$ 83 | \$ 109 |
| Related-party interest expense ⁴ | \$ 47 | \$ 50 | \$ 163 | \$ 163 |

¹ Included within *Operating revenue* in the accompanying unaudited *Statements of Operations*.
² Included within *Operating expenses* in the accompanying unaudited *Statements of Operations*.
³ Represents interest imputed on the revenue forgone installment receivable, as well as interest generated on U.S. Treasury instruments and other cash equivalents held with the Federal Reserve Bank of New York. Included within *Interest and investment income* in the accompanying unaudited *Statements of Operations*.
⁴ Incurred on debt issued to the FFB, and included within *Interest expense* in the accompanying unaudited *Statements of Operations*.

NOTE 6 - CASH, CASH EQUIVALENTS AND RESTRICTED CASH

The following table provides a reconciliation of *Cash and cash equivalents* and *Restricted cash* reported in the balance sheets as of June 30, 2020, and 2019, respectively, and as of September 30, 2019, and 2018, respectively (to disclose the opening balances), that sum to the totals of the same such amounts presented in the accompanying unaudited *Statements of Cash Flows* for the nine months ended June 30, 2020, and 2019:

| (in millions) | June 30, | | September 30, | |
|---|------------------|-----------------|-----------------|------------------|
| | 2020 | 2019 | 2019 | 2018 |
| Cash and cash equivalents | \$ 12,925 | \$ 7,953 | \$ 8,795 | \$ 10,061 |
| Restricted cash | 404 | 465 | 366 | 275 |
| Total cash, cash equivalents and restricted cash | \$ 13,329 | \$ 8,418 | \$ 9,161 | \$ 10,336 |

Restricted cash represents Postal Service cash that is not available for general use. This includes cash originated from forfeitures or seizures related to consumer fraud or other criminal activity related to the mail and either held for third-party beneficiaries or awaiting disposition. *Restricted cash* also includes funds for use in restricted activities such as congressional appropriation for Postal Service obligations to the PRC and the United States Postal Service Office of Inspector General, or that is otherwise restricted.

The Postal Service holds its *Cash and cash equivalents* and *Restricted cash* with the Federal Reserve Bank of New York and invests its excess cash, when available, in highly-liquid, short-term investments issued by the U.S. Department of the Treasury.

NOTE 7 - PROPERTY AND EQUIPMENT, NET

Assets within *Property and equipment, net* in the accompanying *Balance Sheets* are recorded at cost, which includes the interest on borrowings used to finance construction of major capital additions, less allowances for depreciation and amortization. Interest capitalized during both the three and nine months ended June 30, 2020, and 2019, was not significant. Fixed assets are depreciated over estimated useful lives ranging from 3 to 40 years using the straight-line method.

For the three months ended June 30, 2020, and 2019, depreciation and amortization expense was \$429 million and \$430 million, respectively. For both the nine-month periods ended June 30, 2020, and 2019, depreciation and amortization expense was approximately \$1.3 billion. These items are included within *Other operating expenses* in the accompanying unaudited *Statements of Operations*.

NOTE 8 - COMMITMENTS AND CONTINGENCIES

Collective Bargaining Agreements

In May 2019, the Postal Service reached a tentative agreement with the National Rural Letter Carriers' Association (NRLCA) on a three-year collective bargaining agreement, which the union membership ratified in August 2019. The new contract will expire on May 20, 2021.

In March 2020, a three-member arbitration panel reached a decision in the Postal Service's legally mandated binding interest arbitration process with the American Postal Workers Union, AFL-CIO (APWU), establishing the terms of a new collective bargaining agreement. The new contract will expire on September 20, 2021.

In January 2020, the Postal Service reached a tentative agreement with the National Postal Mail Handlers Union, AFL-CIO (NPMHU) on a new three-year collective bargaining agreement, which the union membership ratified on April 7, 2020. The new contract will expire on September 20, 2022.

In September 2019, the Postal Service agreed to extend contract negotiations relating to a new collective bargaining agreement with the National Association of Letter Carriers, AFL-CIO ("NALC"). The previous contract with the NALC expired on September 20, 2019, and negotiations with the NALC are at an impasse. The Postal Service and the NALC will continue to follow the current agreement until a new contract is reached through the dispute resolution process.

Contingent Liabilities

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

The Postal Service is from time to time involved in other litigation incidental to the conduct of its business, none of which is expected to be material to its financial condition or operations.

Provision for Losses

The Postal Service has made adequate provision for probable losses arising from all claims. The following table presents contingent liabilities by current and noncurrent portions and by category, as of June 30, 2020, and September 30, 2019:

| <i>(in millions)</i> | June 30, 2020 | September 30, 2019 |
|---|----------------------|---------------------------|
| Current / noncurrent portions of contingent liabilities: | | |
| Current portion ¹ | \$ 101 | \$ 195 |
| Noncurrent portion ² | 185 | 141 |
| Total contingent liabilities | \$ 286 | \$ 336 |
| Contingent liabilities by category: | | |
| Labor and employment matters | \$ 138 | \$ 204 |
| Asset retirement obligations | 70 | 57 |
| Tort matters | 78 | 75 |
| Total contingent liabilities | \$ 286 | \$ 336 |

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

Reasonably Possible Contingencies

The Postal Service does not accrue for contingencies which it deems reasonably possible of an unfavorable outcome. These ranged in amount from approximately \$175 million to \$1.0 billion at June 30, 2020, and from approximately \$150 million to \$1.0 billion at September 30, 2019.

Class Action Litigation

As previously reported, on January 14, 2010, the Equal Employment Opportunity Commission's ("EEOC") Office of Federal Operations ("OFO") certified the case *McConnell v. Brennan* (first instituted in 2006 as *McConnell v. Potter*) as a class action against the Postal Service, with the class consisting of permanent-rehabilitation and limited-duty Postal Service employees who the Postal Service assessed under the National Reassessment Process ("NRP") between the dates of May 5, 2006, and July 1, 2011. The Postal Service utilized the NRP to ensure employees receiving workers' compensation benefits were placed in jobs consistent with their abilities, and that records regarding employees injured on the job were correct.

The *McConnell* case alleges violations of the Rehabilitation Act of 1973 resulting from the NRP's failure to provide a reasonable accommodation, the NRP's wrongful disclosure of medical information, the NRP's creation of a hostile work environment, and the NRP's adverse impact on disabled employees. The class is seeking injunctive relief and damages of an uncertain amount.

In 2015, the Administrative Judge assigned to handle the *McConnell* case granted in-part both the Class Agent's and the Postal Service's motions for summary judgment. In her decision, the Administrative Judge found that the NRP violated the Rehabilitation Act. The Postal Service appealed this decision to the OFO, and the OFO denied this appeal in 2018. The Postal Service implemented the OFO's order, and notified all class members of their right to file an individual claim for relief. Class members were allowed thirty days to submit claims to the Postal Service's National Equal Employment Opportunity Investigative Services Office. The claims submission deadline has now passed and the dispute process for individual claims is currently underway before a newly assigned EEOC Administrative Judge.

The class members have the right to pursue individual claims. Should they be successful in establishing liability and damages, the ultimate outcome in this case could have a material impact on the Postal Service's financial results.

NOTE 9 - RETIREMENT PLANS

The majority of career employees participate in one of two U.S. government defined benefit pension programs, CSRS and FERS, which OPM administers. These plans provide retirement, death and disability benefits for eligible employees based on specific eligibility and participation requirements, vesting periods and benefit formulas. Each employee's participation in either plan is based on the starting date of employment with the Postal Service or another U.S. government entity.

As government-sponsored benefit plans, CSRS and FERS are not subject to the provisions of the *Employee Retirement Income Security Act of 1974*, as amended. Likewise, because the Postal Service cannot direct the costs, benefits or funding requirements of these plans, it accounts for program expenses under multiemployer plan accounting rules. As such, the Postal Service records required contributions to the plans as an expense in the period in which each contribution is due. For FERS, the Postal Service contributes to the plan an amount established by OPM as the employer portion of retirement benefits for participating employees and their qualifying survivors, upon retirement, for each employee's current year of service, which is considered the FERS normal cost. As further discussed below, the Postal Service is not required to pay the normal cost for those employees who participate in CSRS.

Career employees may also participate in the TSP, a defined contribution retirement savings and investment plan administered by the Federal Retirement Thrift Investment Board. The Postal Service's TSP expenses relate only to its contributions for FERS employees who participate in the TSP.

CSRS provides a basic annuity plan benefit to employees hired before January 1, 1984. CSRS Offset provides Social Security benefits in addition to its basic annuity plan for employees hired between January 1, 1984, and

January 1, 1987. CSRS and CSRS Offset employees may also participate in the TSP, although the Postal Service does not match contributions for these participants.

The PAEA suspended the Postal Service's employer contributions to CSRS that would otherwise have been required under *Title 5, Section 8334(a)(1)* of the U.S. Code, although CSRS employees continue to contribute to the plan.

Effective January 1, 1987, FERS covers employees hired since December 31, 1983, and FERS employees are covered by an annuity, Social Security and TSP benefits. For FERS employees who participate in TSP, the Postal Service contributes 1% of basic pay and matches voluntary employee contributions up to an additional 4% of basic pay. The Postal Service recognizes Social Security and TSP expenses as they are incurred and records them within *Compensation and benefits* in the accompanying unaudited *Statements of Operations*. A liability is established for any contribution due and unpaid at the end of each reporting period. Amounts are generally expected to be paid within one year and are included within *Compensation and benefits* in the accompanying *Balance Sheets*. However, as of June 30, 2020, the Postal Service had deferred payment of approximately \$658 million relating to the employer portion of Social Security as authorized by the *CARES Act*. As this amount is not due until December 31, 2021, at the earliest, this amount has been included within *Other noncurrent liabilities* in the accompanying *Balance Sheets*.

FERS employees are further categorized as either FERS, FERS - Revised Annuity Employees ("FERS-RAE"), or FERS - Further Revised Annuity Employees ("FERS-FRAE") depending on whether their date of hire was before, during, or after calendar year 2013, respectively.

The following table presents the employee and employer contributions, as a percentage of employee basic pay, during the three and nine months ended June 30, 2020, and 2019:

| | June 30, 2020 | | June 30, 2019 | |
|-----------|------------------------|------------------------------|------------------------|------------------------------|
| | Employee Contributions | Postal Service Contributions | Employee Contributions | Postal Service Contributions |
| CSRS | 7.0% | —% | 7.0% | —% |
| FERS | 0.8% | 14.7% | 0.8% | 13.7% |
| FERS-RAE | 3.1% | 12.8% | 3.1% | 11.9% |
| FERS-FRAE | 4.4% | 11.7% | 4.4% | 10.7% |

Aside from these different contribution rates, the Postal Service uses the term "FERS employees" to apply to employees within all of the FERS employee categories.

The following table presents the retirement benefits expenses for the three and nine months ended June 30, 2020, and 2019:

| (in millions) | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|---|-----------------------------|-----------------|----------------------------|-----------------|
| | 2020 | 2019 | 2020 | 2019 |
| FERS normal costs | \$ 939 | \$ 878 | \$ 2,830 | \$ 2,635 |
| CSRS unfunded retirement benefits amortization ¹ | 450 | 360 | 1,349 | 1,080 |
| FERS unfunded retirement benefits amortization ² | 321 | 239 | 964 | 718 |
| Total retirement benefits | \$ 1,710 | \$ 1,477 | \$ 5,143 | \$ 4,433 |

¹ Expense for the accrual for the annual payment due to OPM by September 30 of the respective fiscal year, to amortize the unfunded CSRS retirement obligation. The 2020 amounts are based on updated Postal Service estimates resulting from revised actuarial assumptions. Payments are to be made through 2043 based on OPM invoices.

² Expense for the accrual for the annual payment due to OPM by September 30 of the respective fiscal year, to amortize the unfunded FERS retirement obligation. The 2020 amounts are based on updated Postal Service estimates resulting from revised actuarial assumptions. Payments are to be made over a 30-year rolling period based on OPM invoices.

FERS Normal Costs

The Postal Service records expenses for FERS normal costs within *Retirement benefits* in the accompanying unaudited *Statements of Operations*.

The Postal Service makes payments for FERS normal costs in accordance with its bi-weekly payroll cycle. The employer contributions and employee withholdings not yet remitted to OPM were \$126 million and \$157 million at June 30, 2020, and September 30, 2019, respectively, and were recorded as a current liability within *Retirement benefits* in the accompanying *Balance Sheets*.

CSRS and FERS Unfunded Retirement Benefits

OPM periodically notifies the Postal Service regarding its revaluation of unfunded CSRS and FERS liabilities. OPM calculates these obligations using Postal Service-specific demographics data and government-wide economic assumptions. The Postal Service records these expenses as *Retirement benefits* in the accompanying unaudited *Statements of Operations*. These amounts may be significantly impacted by changes in actuarial assumptions used to revalue the unfunded liabilities.

In October 2019, OPM provided the Postal Service with an actuarial report indicating the projected annual amortization payments due September 30, 2020, would be \$1.6 billion for the CSRS obligation and \$1.1 billion for the FERS obligation.

On April 2, 2020, the Board of Actuaries of the CSRS, which establishes the key actuarial assumptions used in OPM's calculation of the actuarial liabilities for CSRS and FERS, recommended changes to the assumptions, including lowering the discount rate from 4.25% to 4.00%, as well as decreasing the inflation rate, the cost-of-living adjustment ("COLA") rate and the general wage increase rate. The Postal Service has estimated that the impact of these changes in actuarial assumptions on the annual CSRS and FERS amortization expense will result in revised projected amortization payments due September 30, 2020, of approximately \$1.8 billion for the CSRS obligation and approximately \$1.3 billion for the FERS obligation, increases of \$181 million and \$226 million, respectively.

The Postal Service expects to receive invoices from OPM for the actual amounts due September 30, 2020, during the fourth quarter of 2020, and these invoices may differ from the estimated projections and calculations due to further changes in experience and/or actuarial assumptions as of the calculation date.

Given that OPM considers these amounts to be due and payable, the Postal Service reflects the cumulative unpaid amounts as a current liability within *Retirement benefits* in the accompanying *Balance Sheets*. Those accrued but unpaid amounts were approximately \$10.5 billion and \$8.2 billion at June 30, 2020, and September 30, 2019, respectively.

NOTE 10 - HEALTH BENEFITS PLANS

The FEHB Program covers nearly all career employees and also covers non-career employees and retirees who meet certain eligibility requirements. OPM administers FEHB and allocates the cost of funding the program to participating U.S. government employers. Separate from FEHB, the Postal Service offers its own healthcare plan to certain non-career employees who are ineligible for FEHB.

Active Employees

The Postal Service paid 71.9% and 71.8% of healthcare premium costs during the three months ended June 30, 2020, and 2019, respectively. The Postal Service paid 71.9% and 72.1% of healthcare premium costs during the nine months ended June 30, 2020, and 2019, respectively. Although OPM determines the actual FEHB premium costs, the allocation of these costs between the Postal Service and most of its employees is determined through agreements with Postal Service labor unions.

Postal Service employee health benefits expense (which includes the employer portion of Medicare taxes) is most significantly impacted by the number of employees electing coverage and the premium costs of the selected plans. Postal Service employee health benefits expense was approximately \$1.3 billion for each of the three-month periods ended June 30, 2020, and 2019, and \$3.9 billion and \$3.8 billion for the nine-month periods ended June 30,

2020, and 2019, respectively. These expenses are included within *Compensation and benefits* in the accompanying unaudited *Statements of Operations*.

Retirees

Postal Service retirees who participated in FEHB for the five years immediately preceding their retirement may continue to participate in the plan during retirement. Qualifying survivors of retirees are also eligible to receive benefits. The Postal Service is required to contribute to the PSRHBFB an amount estimated to be equal to the employer portion of FEHB insurance premiums for participating employees and their qualifying survivors, upon retirement, for each employee's current year of service (normal cost). The Postal Service is also required to contribute an amount sufficient to fully amortize the unfunded liability of the PSRHBFB by 2056. These amounts are based, in part, on each current and prospective retiree's length of federal civilian service occurring on or after July 1, 1971. Each participant's share of premium costs is set by law and is not subject to negotiation with Postal Service labor unions. The Postal Service cannot direct the costs, benefits or funding requirements of the plans. Therefore, it accounts for program expenses using multiemployer plan accounting rules by recording contributions to the plans that will be required by OPM as an expense in the period in which the contributions are due.

The PAEA required the Postal Service to prefund retiree health benefits during years 2007 through 2016 by paying statutorily specified annual amounts ranging from \$1.4 billion to \$5.8 billion, totaling \$54.8 billion, into the PSRHBFB, which began paying the Postal Service's share of retiree health benefit premiums in 2017. The Postal Service remains obligated to fund the \$33.9 billion in statutorily required PSRHBFB prefunding payments that it defaulted on for the years 2012 through 2016, as well as the normal cost and amortization payments of \$10.7 billion and \$2.6 billion, respectively, that it did not pay for the years 2017 through 2019. As of the date of this report, the Postal Service has not been assessed any penalties associated with these non-payments. The cumulative amount of statutorily specified, normal cost and amortization PSRHBFB obligations the Postal Service has accrued is \$50.7 billion as of June 30, 2020, inclusive of the \$47.2 billion that was unpaid as of September 30, 2019. Given that OPM considers these amounts to be due and payable, the Postal Service reflects the cumulative unpaid amount as a current liability within *Retiree health benefits* in the accompanying *Balance Sheets*.

As required by PAEA, OPM annually performs an actuarial valuation for the purpose of developing a payment schedule for the Postal Service to fund the remaining unfunded PSRHBFB obligation in annual payments through the year 2056. On July 22, 2020, the Postal Service received OPM's invoice for 2020, which indicated the year-end amortization payment amount due is \$810 million. This amount was lower than the Postal Service's original estimate of \$900 million largely due to a lower-than-estimated number of career postal employees enrolled in FEHB. Due to the lower-than-estimated invoiced amount, the Postal Service has adjusted its accrual for the amortization payment, resulting in expenses of \$158 million and \$608 million for the three and nine months ended June 30, 2020, respectively. These amounts are included within *Retiree health benefits* in the accompanying unaudited *Statements of Operations*.

Furthermore, the Postal Service is obligated to pay the estimated normal cost of retiree health benefits attributable to the service of its employees during the most recent year. OPM's July 22, 2020, invoice indicated the normal cost payment amount due is approximately \$3.8 billion. This amount was lower than the Postal Service's original estimate of \$4.0 billion largely due to a lower-than-estimated number of career postal employees enrolled in FEHB. Due to the lower-than-estimated invoiced amount, the Postal Service has adjusted its accrual for the normal cost payment, resulting in expenses of \$887 million and \$2.9 billion for the three and nine months ended June 30, 2020, respectively. These amounts are included within *Retiree health benefits* in the accompanying unaudited *Statements of Operations*.

The following table details retiree health benefits expenses for the three and nine months ended June 30, 2020, and 2019:

| (in millions) | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|---|--------------------------------|---------------|-------------------------------|-----------------|
| | 2020 | 2019 | 2020 | 2019 |
| PSRHBF unfunded liability amortization ¹ | \$ 158 | \$ 42 | \$ 608 | \$ 592 |
| Normal cost of retiree health benefits ² | 887 | 831 | 2,887 | 2,831 |
| Total retiree health benefits expense | \$ 1,045 | \$ 873 | \$ 3,495 | \$ 3,423 |

¹ Expense for the annual payment due to OPM by September 30 of the respective year, as calculated by OPM, to amortize the unfunded PSRHBF retirement health benefit obligation. 2020 and 2019 amounts are based on OPM's invoices for the respective years, each reflecting updated discount rate assumptions. Payments are to be made through 2056 based on OPM invoices.

² Expense for the annual payment due to the PSRHBF by September 30 of the respective year, based on information provided by OPM, for actuarially determined normal cost of retiree health benefits for current employees. 2020 and 2019 amounts are based on OPM's invoices for the respective years, each reflecting updated discount rate assumptions.

NOTE 11 - WORKERS' COMPENSATION

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

Workers' Compensation Liability

The Postal Service records a liability for its workers' compensation obligations for employees who have been injured on the job and are eligible for benefits, or for their qualified survivors. Both the current and noncurrent portions of the workers' compensation liability are recorded in the accompanying *Balance Sheets*. The Postal Service uses an estimation model that utilizes four generally accepted actuarial valuation techniques based upon past claim-payment experience and exposure to claims as measured by total employee hours worked.

Changes in the liability are primarily attributable to the combined impacts of routine changes in actuarial assumptions, new compensation and medical cases, the progression of existing cases and changes in discount (interest) and inflation rates, including long-term COLA rates for compensation claims, and medical rates for medical claims. These rates are updated as of the balance sheet date and factored into the model.

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

This liability calculation is highly sensitive to changes in discount rates. For example, a 1% increase in the discount rate would decrease the June 30, 2020, liability and related expense by approximately \$2.4 billion. Likewise, a 1% decrease in the discount rate would increase the June 30, 2020, liability and related expense by approximately \$3.0 billion.

The following table details the applicable inflation and discount rates for compensation and medical claims used to estimate the workers' compensation liability as of June 30, 2020, and September 30, 2019:

| | June 30, 2020 | September 30, 2019 |
|---------------------------------------|---------------|--------------------|
| Compensation claims liability: | | |
| Discount rate | 1.06% | 1.90% |
| Long-term wage inflation rate | 2.60% | 2.60% |
| Medical claims liability: | | |
| Discount rate | 1.08% | 1.91% |
| Medical inflation rate | 3.50% | 2.50% |

As of June 30, 2020, and September 30, 2019, the Postal Service's total liability for workers' compensation was approximately \$20.1 billion and \$18.5 billion, respectively. As of June 30, 2020, and September 30, 2019, the current portion of the liability was approximately \$1.3 billion and \$1.4 billion, respectively, and the noncurrent portion of the liability was approximately \$18.8 billion and \$17.1 billion, respectively, as reflected in the accompanying *Balance Sheets*.

Workers' Compensation Expense

The impacts of changes in discount rates and inflation rates, as well as the actuarial valuation of new cases and revaluation of existing cases, are components of total workers' compensation expense as recorded in the accompanying unaudited *Statements of Operations*. In addition, the Postal Service pays an administrative fee to DOL, which is considered a component of workers' compensation expense.

The following table presents the components of workers' compensation expense for the three and nine months ended June 30, 2020, and 2019:

| (in millions) | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|--|-----------------------------|-----------------|----------------------------|-----------------|
| | 2020 | 2019 | 2020 | 2019 |
| Impact of discount rate changes | \$ (55) | \$ 697 | \$ 2,030 | \$ 1,656 |
| Actuarial revaluation of existing cases | (124) | 28 | (128) | 80 |
| Cost of new cases | 311 | 291 | 983 | 893 |
| Administrative fee | 21 | 22 | 63 | 67 |
| Total workers' compensation expense | \$ 153 | \$ 1,038 | \$ 2,948 | \$ 2,696 |

NOTE 12 - LEASES

Postal Service Leases

The Postal Service holds lessee positions in real property leases as well as lessee positions embedded in service contracts involving rights to use transportation equipment and facilities.

Real property leases support retail, delivery, mail processing, maintenance, administrative and support activities. The non-cancellable base terms of these leases typically range from one to five years, with one or more options to renew for additional five-year terms. The lease terms for these arrangements generally range from one to thirty years including any renewal options that are reasonably certain to be exercised. Additionally, certain real property leases contain purchase and termination options. At the commencement of most real property lease arrangements, the Postal Service is not reasonably certain if it will exercise such options. Real property leases include certain variable lease payments associated with non-lease components, such as common area maintenance costs, and non-lease components such as real estate taxes, which are generally charged as a pass-through based on actual amounts incurred by the lessor. The Postal Service records costs associated with real property leases within *Other operating expenses* in the accompanying unaudited *Statements of Operations*.

Transportation equipment leases apply primarily to vehicles, trailers, and aircraft. The non-cancellable base terms of these leases typically range from two to five years, and may include one or more options to renew for an additional one or two years. The lease terms for these arrangements generally range from two to five years including any renewal options the Postal Service is reasonably certain to exercise. Transportation equipment leases do not contain purchase options, however certain of these leases contain termination options. At the commencement of most transportation lease arrangements, the Postal Service is not reasonably certain if it will exercise such termination options. Certain transportation leases contain variable lease payments based on the volume of activity under the contract. The Postal Service records costs associated with transportation leases within *Transportation* in the accompanying unaudited *Statements of Operations*.

Postal Service leases do not contain any material residual value guarantees or restrictive covenants.

Sublease income was not material to the financial statements for the three and nine months ended June 30, 2020.

Balances disclosed herein include those pertaining to certain related-party transactions. See *Note 5 - Related Parties* for additional information on related party transactions.

The table below reconciles the undiscounted cash flows for the first five years and the total remaining finance lease liabilities and operating lease liabilities recorded in the accompanying unaudited *Balance Sheet* as of June 30, 2020:

| (in millions) | June 30, 2020 | | |
|--|----------------|------------------|-----------------|
| | Finance Leases | Operating Leases | Total Leases |
| 2020 | \$ 15 | \$ 324 | \$ 339 |
| 2021 | 53 | 1,218 | 1,271 |
| 2022 | 60 | 1,030 | 1,090 |
| 2023 | 23 | 750 | 773 |
| 2024 | 27 | 534 | 561 |
| Thereafter | 132 | 928 | 1,060 |
| Total undiscounted lease payments | \$ 310 | \$ 4,784 | \$ 5,094 |
| Present value adjustment | (60) | (222) | (282) |
| Net lease liabilities | \$ 250 | \$ 4,562 | \$ 4,812 |

Leases that were entered into but not yet commenced as of June 30, 2020, are not significant to the Postal Service's financial statements.

Lease costs for finance and operating leases for all non-cancellable leases are set forth below for the three and nine months ended June 30, 2020:

| <i>(in millions)</i> | Three Months Ended June 30, 2020 | Nine Months Ended June 30, 2020 |
|-------------------------------------|---|--|
| Finance lease cost: | | |
| Amortization of right-of-use assets | \$ 6 | \$ 21 |
| Interest on lease liabilities | 3 | 9 |
| Total finance lease cost | \$ 9 | \$ 30 |
| Operating lease cost | 316 | 1,075 |
| Variable lease cost | 176 | 545 |
| Short-term lease cost | 25 | 128 |
| Total lease cost | \$ 526 | \$ 1,778 |

The following information represents supplemental cash and non-cash information as well as lease term and discount rate information separately for finance leases and operating leases, for the nine months ended June 30, 2020:

| <i>(\$ in millions)</i> | Nine Months Ended June 30, 2020 |
|--|--|
| Finance Leases: | |
| Cash paid for amounts included in measurement of lease liabilities: | |
| Operating cash flows - interest on lease liability | \$ 9 |
| Financing cash flows - principal repayments | \$ 31 |
| Right-of-use assets obtained in exchange for lease payments | \$ 15 |
| Weighted-average remaining lease term - finance leases | 8.93 years |
| Weighted-average discount rate - finance leases | 5.25% |
| Operating Leases: | |
| Operating cash flows from operating leases | \$ 942 |
| Right-of-use assets obtained in exchange for operating lease liabilities | \$ 312 |
| Weighted-average remaining lease term - operating leases | 5.29 years |
| Weighted-average discount rate - operating leases | 1.71% |

Disclosures Related to Period Prior to ASC 842 Adoption

Rent expense was \$298 million and \$912 million for three and nine months ended June 30, 2019, respectively. Amortization expense for capital leases was approximately \$8 million and \$25 million for the three and nine months ended June 30, 2019, respectively. Sublease income was immaterial for both the three and nine months ended June 30, 2019.

The amounts below represent future minimum payments for all non-cancellable leases with original lease terms greater than one year, including leases containing renewal options that have been exercised, as of September 30, 2019:

| <i>(in millions)</i> | Operating | Capital |
|--|------------------|----------------|
| 2020 | \$ 1,214 | \$ 48 |
| 2021 | 1,061 | 35 |
| 2022 | 829 | 21 |
| 2023 | 540 | 15 |
| 2024 | 352 | 13 |
| Thereafter | 563 | 59 |
| Total lease obligations | \$ 4,559 | \$ 191 |
| Less: Interest | | 46 |
| Total capital lease obligations | | \$ 145 |
| Less: Current portion of capital lease obligations | | 66 |
| Noncurrent portion of capital lease obligations | | \$ 79 |

Capital leases, recorded at historical cost within *Property and equipment, net* in the accompanying *Balance Sheets*, were \$496 million as of September 30, 2019. Total accumulated amortization related to capital leases was \$377 million at September 30, 2019.

Lease Accounting Policies

Lease Accounting Policy for Comparative Periods

As the lessee, the Postal Service classifies leases which have original lease terms greater than one year and that transfer substantially all the risks and rewards of ownership to the Postal Service, as capital leases. These leases are capitalized on the lease commencement date at the lower of the fair value of the leased assets or the present value of the minimum lease payments. The discount rate used to determine the present value is based on average U.S. Treasury rates. Property acquired under a capital lease is amortized over the lease term. Capital leases are included within *Property and equipment, net* in the accompanying *Balance Sheets*.

The Postal Service classifies all other lease arrangements in which substantially all risks and rewards of ownership are retained by the lessor as operating leases. Rent expense for operating leases is included in *Other operating expenses* in the accompanying unaudited *Statements of Operations* on a straight-line basis over the term of the lease.

Lease Accounting Policy for the Nine Months Ended June 30, 2020

The Postal Service determines at the inception of the contract if an arrangement represents a lease or contains lease components. A contract is deemed to represent or include a lease if it conveys the right to control the use of an identified asset for a period of time in exchange for consideration. The Postal Service is assumed to have the right to control the use of the underlying asset if the contract conveys the rights to obtain substantially all of the economic benefits of the underlying asset and the rights to direct how and for what purpose such asset is used during the contract term.

As the lessee, the Postal Service classifies all leases with original lease terms less than one year as short-term leases. The Postal Service classifies all other leases which transfer substantially all the risks and rewards of ownership to the Postal Service as finance leases. Finance lease right-of-use assets are included within *Property and equipment, net* in the accompanying *Balance Sheets*. The current and noncurrent portions of finance lease liabilities are included within *Payables and accrued expenses* and *Other noncurrent liabilities*, respectively, within the accompanying *Balance Sheets*. The Postal Service classifies the remaining leases, not classified as short-term leases or finance leases, as operating leases. The Postal Service considers a lease term to include all non-

cancelable periods and renewal periods when the Postal Service is reasonably certain that it will exercise the related renewal option.

For short-term leases, the Postal Service records lease expenses in the statement of operations on a straight-line basis over the lease term.

Leases that do not qualify as short-term are recorded in the balance sheet on the lease commencement date, each as a right-of-use asset and a lease liability.

Lease liabilities are initially measured at the net present value of the lease payments due after the commencement date. For this purpose, lease payments include fixed and in-substance fixed rental payments, variable lease payments that depend on an index or rate, and the price of options that the Postal Service is, at the commencement of the lease, reasonably certain to exercise. Lease liabilities are subsequently increased to reflect the interest accrued and reduced when lease payments are made by the Postal Service.

Right-of-use assets are initially measured at the net present value of the lease payments (including amounts due prior to or on the commencement date), adjusted for the impact of initial direct costs and lease incentives. For finance leases, right-of-use assets are subsequently amortized on a straight-line basis over the shorter of the useful life of the underlying asset or the lease term. For operating leases, right-of-use assets are amortized in such a way that the combination of the interest expense accrued on the lease liability and the asset amortization results in a straight-line expense over the lease term.

Right-of-use assets for operating and finance leases are periodically reviewed for impairment losses, following the same process as for other long-lived assets. Impairment losses on long-lived assets are recorded when events or circumstances indicate that an asset's fair value is less than its carrying value. When such a determination is made, the carrying values of the assets are written down to fair value. The Postal Service uses the long-lived assets impairment guidance in ASC Subtopic 360-10, *Property, Plant, and Equipment - Overall*, to determine whether a right-of-use asset is impaired, and if so, the amount of the impairment loss to recognize. No impairment losses have been recognized to date.

The discount rates used in net present value calculations are determined based on the Postal Service's incremental borrowing rates on debt outstanding with the FFB at the beginning of each year, which is approximated as the daily U.S. Treasury Yield Curve Rates for the five-year, 10-year, 20-year and 30-year periods, plus a 12.5 basis point spread.

Variable lease payments, except for those based on an index or rate, are recognized as variable lease expenses in the period in which the obligation for those payments are incurred.

NOTE 13 - FAIR VALUE MEASUREMENT

The Postal Service defines fair value as the price that would be received upon sale of an asset or the price that would be paid to transfer a liability between unrelated parties.

The carrying amounts of certain current assets and liabilities, including cash, accounts receivable, accounts payable and accrued expenses, approximate fair value due to their short-term nature. Assets within *Property and equipment, net* are recorded at cost and measured at fair value on a nonrecurring basis if they are determined to be impaired or classified as assets held for sale.

Noncurrent receivables and long-term debt are measured using a fair value hierarchy model. This model prioritizes observable and unobservable inputs used to measure fair value, and consists of three broad levels, as defined in authoritative literature.

For the three and nine months ended June 30, 2020, no significant transfers between *Level 1* and *Level 2* assets or liabilities transpired. The carrying amount and fair value of the revenue forgone installment receivable and long-term debt are presented for disclosure purposes only in the following table:

| (in millions) | June 30, 2020 | | September 30, 2019 | |
|---|-----------------|------------|--------------------|------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Revenue forgone installment receivable ¹ | \$ 481 | \$ 582 | \$ 466 | \$ 516 |
| Long-term debt ² | \$ 11,000 | \$ 11,917 | \$ 11,000 | \$ 11,437 |

¹ The carrying amount is included within *Other assets* (which includes items in addition to the revenue forgone installment receivable) in the accompanying *Balance Sheets*.

² The fair value amount reflects the premium or discount associated with prepayment of all debt based on prevailing interest rates plus any prepayment penalties, as applicable.

The revenue forgone installment receivable qualifies as a financial instrument in accordance with authoritative literature. To calculate its fair value, the Postal Service recognizes the imputed interest it is owed as interest income and estimates the value of this receivable using the interest method, which converts future cash flows to a single discounted amount using interest rates for similar assets, which are considered *Level 2* inputs. The Postal Service then calculates the net present value of anticipated annual installment payments to be received, discounted by the 20-year U.S. Treasury Constant Maturity Rate, which was 1.18% and 1.94% as of June 30, 2020, and September 30, 2019, respectively.

The long-term debt also qualifies as a financial instrument. Because no active market exists for its debt with the FFB, the Postal Service estimates the fair value of the long-term debt by imputing future payments at discount rates provided by the FFB, considered *Level 3* inputs. The weighted averages of the FFB discount rates, based on U.S. Treasury Yield Curve Rates, were 0.35% and 1.79% as of June 30, 2020, and September 30, 2019, respectively.

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

CAUTIONARY STATEMENTS

The following *Management's Discussion and Analysis of Financial Condition and Results of Operations* and other parts of this report describe the principal factors affecting the financial results, liquidity, capital resources and critical accounting estimates of the United States Postal Service ("Postal Service," "USPS," "we," "our" and "us"). Our results of operations may be impacted by risks and uncertainties discussed here and in our Annual Report on Form 10-K for the year ended September 30, 2019, ("Annual Report") filed with the Postal Regulatory Commission ("PRC") on November 14, 2019. Such factors, many of which we cannot control or influence, may cause actual results to differ materially from those currently contemplated.

Our operating results for the three and nine months ended June 30, 2020, are presented in accordance with accounting principles generally accepted in the United States ("GAAP"). These results are not necessarily indicative of the results to be expected for the year ended September 30, 2020, and should be read in conjunction with our Annual Report. All references to years in this report, unless otherwise stated, refer to fiscal years beginning October 1 and ending September 30. All references to quarters, unless otherwise stated, refer to quarters within fiscal years 2020 and 2019.

Forward-looking statements contained in this report represent our best estimates of known and anticipated trends believed relevant to future operations. However, actual results may differ significantly from current estimates. Certain forward-looking statements included in this report use such words as "may," "will," "could," "expect," "believe," "plan," "estimate," "project" or other similar terminology. These forward-looking statements, which involve a number of risks and uncertainties, reflect current expectations regarding future events and operating performance as of the date of this report. These risks include, but are not limited to, the effects of the novel strain of coronavirus

("COVID-19") on our business, financial condition and results of operations. We have no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

OVERVIEW

With our mandate to provide universal postal services to the nation, we serve retail and commercial customers in the U.S. as well as internationally. Our operations include an extensive and integrated retail, processing, distribution, transportation and delivery network, and we operate throughout the U.S., its possessions and territories. We do not operate in segments and report our performance as a single business.

The *Postal Accountability and Enhancement Act* ("PAEA") classifies our products into two broad categories: Market-Dominant and Competitive "products," however, we use the term "services" in this document for consistency with other descriptions of services offered. The statutes under which we operate also establish certain requirements that affect our financial results, including obligations for retirement benefits within the Civil Service Retirement System ("CSRS") and the Federal Employee Retirement System ("FERS"), and obligations for retiree health benefits including funding of the Postal Service Retiree Health Benefits Fund ("PSRHBF"). We must coordinate with the U.S. Office of Personnel Management ("OPM") to address these obligations.

We have successfully implemented initiatives that have reduced the growth in certain costs by billions of dollars while offering new features for customers such as *Informed Delivery*. However, legal restrictions on pricing, service diversification and operations restrict our ability to cover our costs to provide prompt, reliable and efficient postal services to the nation.

As an independent establishment of the U.S. government, we have a unique mission to:

- Serve the American people and, through the universal service obligation, bind our nation together by maintaining and operating our unique, vital and resilient infrastructure;
- Provide trusted, safe and secure communications and services between the U.S. government and the American people, businesses and their customers, and the American people with each other; and
- Serve all areas of our nation, making full use of evolving technologies.

We will carry out this mission by remaining an integral part of the U.S. government and providing all Americans with universal and open access to our unrivaled delivery and retail network; using technology, innovation and, where appropriate, private-sector partnerships to meet our customers' changing needs; operating in a modern, efficient and effective manner; and remaining an employer of choice, including attracting and retaining high-quality employees.

RESULTS OF OPERATIONS

SUMMARY

The major factors that impact our operating results include overall customer demand, the mix of postal services and contribution associated with those services, volume of mail and packages processed through our network and our ability to manage our cost structure in line with declining levels of mail volume, increased competition in the more labor-intensive Shipping and Packages business and an increasing number of delivery points.

Effects of COVID-19

In March 2020, the World Health Organization ("WHO") declared COVID-19 a global pandemic, which has since spread throughout the U.S. Changing federal, state and local government actions to address the pandemic have been occurring on a daily basis, and government-imposed shelter-in-place and other movement restrictions designed to slow the pace of the outbreak have severely impacted the U.S. economy. While many state and local governments began to relax their COVID-19-related restrictions in June 2020, the recent increase in new COVID-19 cases has caused some governments to pause or reverse their easing of such restrictions. The severity and duration of the pandemic remains uncertain.

Our employees provide an essential public service and bind the nation together as a part of the country's critical infrastructure. At least six days per week, and in some instances seven, our employees accept, process, transport, and deliver vital mail and packages like medicine, essential consumer staples, benefits checks, and important

information, in every community, to every home and business, and we will continue to do so. The importance of the mail continues to grow during the pandemic as our customers, including those in rural areas and senior citizens, need access to vital communications, essential packages and other necessities. As a testament to this, we recently received the highest ranking in the *Harris Poll Essential 100* reflecting the public's perception of our COVID-19 response, demonstrating our commitment to serving the nation during this challenging time.

All of our employees are considered essential, and their safety is our highest priority. Following strategies recommended by the Centers for Disease Control and Prevention, we have continued to implement enhanced safety measures to protect the health of our employees. These measures include restrictions on business travel, the implementation of remote work arrangements for certain of our office-based employees, and liberal leave policies for employees who may be affected by illness, quarantines or childcare obligations. We have also invested in various safety measures in response to the pandemic. These arrangements have not materially affected our ability to maintain our business operations, including the operation of financial reporting systems, internal control over financial reporting, and disclosure controls and procedures.

While we have maintained operations during the pandemic, travel and logistics restrictions have continued to negatively affect our retail and commercial customers, as well as our suppliers and mail service providers. Many of our commercial customers, especially those with consumer-facing businesses, have been required to curtail their operations, operate at a lower capacity and/or suspend their marketing and advertising expenditures. As a result, our mail volumes began to decline significantly in late March 2020, and this decline continued during the third quarter of 2020. The sudden drop in mail volumes, our most profitable revenue stream, is steep and may never fully recover to levels prior to the pandemic.

Although the COVID-19 pandemic has caused a surge in the nation's use of e-commerce resulting in higher Shipping and Packages volumes, we do not know if the current increases in our Shipping and Packages revenues will be sustainable or will continue to offset losses in mail service revenue caused by the COVID-19 pandemic in the long term. While the future is uncertain, we believe that the nation's increased use of e-commerce may plateau in the short term as the effects of the pandemic begin to subside, followed by a longer-term regression of e-commerce and a shift by consumers to staples from discretionary spending caused by a weakened U.S. economy.

On March 27, 2020, the President signed the *Coronavirus Aid, Relief, and Economic Security Act*, enacted as Public Law 116-136 (the "CARES Act"). Notwithstanding our \$15.0 billion statutory debt limit, and \$3.0 billion annual limit on new borrowing, the CARES Act allows us to borrow up to an additional \$10.0 billion in financing from the U.S. Treasury to fund operating expenses. The U.S. Treasury may lend up to this amount at our request, upon terms and conditions mutually agreed upon. On July 29, 2020, we announced that we had reached an agreement in principle with the U.S. Treasury on the terms and conditions associated with the CARES Act financing. The agreed-upon terms and conditions must be memorialized in loan documents and satisfied before we will have access to the CARES Act borrowing, as limited by such terms and conditions.

We estimate that the COVID-19 pandemic may increase our net operating loss by more than \$10.0 billion through 2021. If we prioritize payments to the Federal Financing Bank ("FFB"), employees and suppliers ahead of some payments to fund retirement and retiree health benefits, if necessary to ensure the fulfillment of our primary mission as has been done in the past, we expect that we will have sufficient liquidity to continue to operate through August 2021.

Three Months Ended June 30, 2020

As more fully described below in *Operating Revenue and Volume*, our operating revenue for the three months ended June 30, 2020, increased \$553 million, or 3.2%, compared to the same period last year. The increase in operating revenue was due to a significant increase in Shipping and Packages revenue of \$2.9 billion, or 53.6%, compared to the same period last year, with a volume growth of 708 million pieces, or 49.9%, compared to the same period last year, driven by the surge in e-commerce resulting from the COVID-19 pandemic. Revenue increased at a greater rate than volume due to the January 2020 price increases applicable to certain Competitive services.

The above increase in operating revenue was partially offset by the following:

- *Marketing Mail* revenue decrease of \$1.4 billion, or 37.2%, compared to the same period last year, with a volume decline of 6.4 billion pieces, or 36.4%, compared to the same period last year, largely the result of the COVID-19 pandemic, as many of our commercial customers, especially those with consumer-facing businesses, had curtailed their operations, operated at a lower capacity and/or suspended their marketing and advertising expenditures during the period; and
- *First-Class Mail* revenue decrease of \$373 million, or 6.4%, compared to the same period last year, with a volume decline of approximately 1.1 billion pieces, or 8.4%, compared to the same period last year, reflecting the continuing migration from mail to electronic communication and transaction alternatives and lower business transactions, which have been exacerbated by the COVID-19 pandemic.

As more fully described below in *Operating Expenses*, our operating expenses for the three months ended June 30, 2020, increased approximately \$477 million, or 2.5%, compared to the same period last year. The increase in operating expenses was due to the following:

- Compensation and benefits expense increase of \$632 million, or 5.5%, compared to the same period last year, primarily due to contractual wage increases and an increase in paid sick leave as a result of the COVID-19 pandemic;
- Retirement benefits expense increase of \$233 million, or 15.8%, compared to the same period last year, due to revised actuarial assumptions for CSRS and FERS unfunded retirement benefits amortization, which are outside of management's control, and to increased contribution rates for FERS normal costs;
- Transportation expense increase of \$214 million, or 10.9%, compared to the same period last year, driven by an increase in air transportation costs resulting from the surge in Shipping and Packages volumes and a shift from commercial carriers to chartered air carriers due to the reduction in commercial flights associated with the COVID-19 pandemic;
- Retiree health benefits expense increase of \$172 million, or 19.7%, compared to the same period last year, driven by differences in actuarial assumptions, which are outside of management's control; and
- Other operating expenses increase of \$111 million, or 4.5%, compared to the same period last year, due to spending increases on supplies and services, including personal protective equipment ("PPE"), associated with the COVID-19 pandemic.

These increases were slightly offset by a decrease in workers' compensation expense of \$885 million, primarily due to increases in discount rates, outside of management's control.

Overall, we reported a net loss of approximately \$2.2 billion for the three months ended June 30, 2020, compared to a net loss of approximately \$2.3 billion for the same period last year.

Nine Months Ended June 30, 2020

As more fully described below in *Operating Revenue and Volume*, our operating revenue for the nine months ended June 30, 2020, increased \$542 million, or 1.0%, compared to the same period last year. The increase in operating revenue was due to a significant increase in Shipping and Packages revenue of \$3.4 billion, or 19.8%, compared to the same period last year, with a volume growth of 635 million pieces, or 13.5%, compared to the same period last year, largely driven by the surge in e-commerce resulting from the COVID-19 pandemic and the January 2020 price increases applicable to certain Competitive services.

The above increase in operating revenue was partially offset by the following:

- *Marketing Mail* revenue decrease of \$1.8 billion, or 14.4%, compared to the same period last year, with a volume decline of approximately 8.8 billion pieces, or 15.3%, compared to the same period last year, largely the result of the COVID-19 pandemic, as many of our commercial customers, especially those with consumer-facing businesses, began operating at a lower capacity in late March 2020; and
- *First-Class Mail* revenue decrease of \$452 million, or 2.4%, compared to the same period last year, with a volume decline of 1.7 billion pieces, or 4.0%, compared to the same period last year, reflecting the continuing migration from mail to electronic communication and transaction alternatives, which has been exacerbated by the COVID-19 pandemic.

As more fully described below in *Operating Expenses*, our operating expenses for the nine months ended June 30, 2020, increased approximately \$2.1 billion, or 3.5%, compared to the same period last year. The increase in operating expenses was primarily due to the following:

- Retirement benefits expense increase of \$710 million, or 16.0%, compared to the same period last year, due to revised actuarial assumptions for CSRS and FERS unfunded retirement benefits amortization, which are outside of management's control, and to increased contribution rates for FERS normal costs;
- Compensation and benefits expense increase of \$561 million, or 1.6%, compared to the same period last year, primarily due to contractual wage increases and an increase in paid sick leave as a result of the COVID-19 pandemic;
- Transportation expenses increase of \$277 million, or 4.4%, compared to the same period last year, primarily resulting from higher air transportation costs and higher highway transportation costs. The increase in air transportation costs was driven by the surge in Shipping and Packages volumes and a shift from commercial carriers to chartered air carriers due to travel restrictions associated with the COVID-19 pandemic. The increase in highway transportation costs was driven by a one-time adjustment associated with embedded leases and an increase in the number of miles driven;
- Workers' compensation expense increase of \$252 million, or 9.3%, compared to the same period last year, primarily due to declines in discount rates, outside of management's control; and
- Other operating expenses increase of \$233 million, or 3.2%, compared to the same period last year, due to spending increases on supplies and services, including PPE, associated with the COVID-19 pandemic.

Overall, we reported a net loss of approximately \$7.5 billion for the nine months ended June 30, 2020, compared to a net loss of approximately \$5.9 billion for the same period last year.

Non-GAAP Controllable Loss

In the day-to-day operation of our business, we focus on costs that can be managed in the course of normal business operations, such as salaries and transportation. We calculate controllable loss, a non-GAAP measure, by excluding items over which we have no control, such as PSRHBf actuarial revaluation and amortization expenses, workers' compensation expenses caused by actuarial revaluation and discount rate changes, and retirement expenses caused by actuarial revaluation. Controllable loss should not be considered a substitute for net loss and other GAAP reporting measures.

The following table reconciles our GAAP net loss to controllable loss for the three and nine months ended June 30, 2020, and 2019:

| (in millions) | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|---|--------------------------------|-------------------|-------------------------------|-------------------|
| | 2020 | 2019 | 2020 | 2019 |
| Net loss | \$ (2,210) | \$ (2,256) | \$ (7,473) | \$ (5,875) |
| PSRHBF unfunded liability amortization expense ¹ | 158 | 42 | 608 | 592 |
| Change in workers' compensation liability resulting from fluctuations in discount rates | (55) | 697 | 2,030 | 1,656 |
| Other change in workers' compensation liability ² | (95) | 9 | (88) | 11 |
| CSRS unfunded liability amortization expense ³ | 450 | 360 | 1,349 | 1,080 |
| FERS unfunded liability amortization expense ⁴ | 321 | 239 | 964 | 718 |
| Change in normal cost of retiree health benefits due to revised actuarial assumptions ⁵ | (113) | (168) | (113) | (168) |
| Controllable loss | \$ (1,544) | \$ (1,077) | \$ (2,723) | \$ (1,986) |
| ¹ Expense for the annual payment due to OPM by September 30 of the respective year, as calculated by OPM, to amortize the unfunded PSRHBF retirement health benefit obligation. 2020 and 2019 amounts are based on OPM's invoices for the respective years, each reflecting updated discount rate assumptions. Payments are to be made through 2056 based on OPM invoices. ² Net amounts include changes in assumptions, valuation of new claims and revaluation of existing claims, less current year claim payments. ³ Expense for the annual payment due to OPM by September 30 of the respective fiscal year, to amortize the unfunded CSRS retirement obligation. The 2020 amounts are based on updated Postal Service estimates resulting from revised actuarial assumptions. Payments are to be made through 2043 based on OPM invoices. ⁴ Expense for the annual payment due to OPM by September 30 of the respective fiscal year, to amortize the unfunded FERS retirement obligation. The 2020 amounts are based on updated Postal Service estimates resulting from revised actuarial assumptions. Payments are to be made over a 30-year rolling period based on OPM invoices. ⁵ Represents the accrual for the portion of the increase in the annual normal cost payments due September 30, 2020, and 2019, attributable to revised actuarial assumptions and discount rate changes, based on OPM's invoices for the respective year. This amount represents the noncontrollable portion of the expense recorded for normal cost of retiree health benefits. | | | | |

Our controllable loss increased \$467 million for the three months ended June 30, 2020, compared to the same period last year. This increase was largely driven by the higher compensation and benefits expenses of \$632 million, higher transportation expenses of \$214 million, higher other operating expenses of \$111 million and higher FERS normal costs of \$61 million, partially offset by the \$553 million increase in operating revenue.

Our controllable loss increased \$737 million for the nine months ended June 30, 2020, compared to the same period last year. This increase was largely driven by higher compensation and benefits expenses of \$561 million, higher transportation expenses of \$277 million, higher other operating expenses of \$233 million and higher FERS normal costs of \$195 million, partially offset by the \$542 million increase in operating revenue.

As discussed in greater detail below, the higher operating expenses for both the three and nine months ended June 30, 2020, reflect the impacts of the COVID-19 pandemic. Specifically, we have incurred greater expenses for PPE, higher air transportation costs due to lower availability of commercial air flights, and greater compensation costs representing both increased sick leave and labor costs associated with the higher volumes in our labor-intensive Shipping and Packages category.

These items are discussed in greater detail in *Operating Revenue and Volume* and *Operating Expenses* below.

OPERATING REVENUE AND VOLUME

The combined categories of *First-Class Mail* and *Marketing Mail* have historically provided the majority of our revenue, despite long-term trends away from traditional paper communication and correspondence to electronic media. This migration to electronic media has resulted in significant volume declines in *First-Class Mail* over the last decade, and significant volume declines in *Marketing Mail* over the last three years, aside from a *Marketing Mail* volume rebound between the second half of 2018 through the first quarter of 2019 driven by increases in political and election mail associated with the calendar year 2018 mid-term elections. The COVID-19 pandemic has further exacerbated these systemic declines, and when combined with the increased Shipping and Packages

volume from the surge in e-commerce, resulted in significant shifts in results among our service categories during the third quarter.

The following table summarizes our operating revenue and volume for the three and nine months ended June 30, 2020, and 2019, by each service category:

| (in millions) | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|------------------------------------|--------------------------------|------------------|-------------------------------|------------------|
| | 2020 | 2019 | 2020 | 2019 |
| Operating Revenue: | | | | |
| First-Class Mail ¹ | \$ 5,481 | \$ 5,854 | \$ 18,328 | \$ 18,780 |
| Marketing Mail ² | 2,427 | 3,862 | 10,577 | 12,360 |
| Shipping and Packages ³ | 8,311 | 5,412 | 20,738 | 17,307 |
| International | 490 | 604 | 1,802 | 1,913 |
| Periodicals | 244 | 302 | 797 | 910 |
| Other ⁴ | 686 | 1,052 | 2,589 | 3,019 |
| Total operating revenue | \$ 17,639 | \$ 17,086 | \$ 54,831 | \$ 54,289 |
| Volume: | | | | |
| First-Class Mail ¹ | 12,007 | 13,101 | 40,532 | 42,225 |
| Marketing Mail ² | 11,240 | 17,673 | 48,581 | 57,360 |
| Shipping and Packages ³ | 2,128 | 1,420 | 5,349 | 4,714 |
| International | 140 | 202 | 569 | 675 |
| Periodicals | 980 | 1,183 | 3,111 | 3,544 |
| Other ⁵ | 75 | 85 | 242 | 246 |
| Total volume | 26,570 | 33,664 | 98,384 | 108,764 |

¹ Excludes *First-Class Package Service - Retail* and *First-Class Package Service - Commercial*.

² Excludes *Marketing Mail Parcels*.

³ Includes *Priority Mail*, *USPS Retail Ground*, *Parcel Select Mail*, *Parcel Return Service Mail*, *Marketing Mail Parcels*, *Package Service Mail*, *First-Class Package Service - Retail*, *First-Class Package Service - Commercial* and *Priority Mail Express*.

⁴ Revenue includes *PO Box* services, *Certified Mail*, *Return Receipts*, *Insurance*, *Other Ancillary Services*, *Shipping and Mailing Supplies*, *Collect on Delivery*, *Registered Mail*, *Stamped Envelopes and Cards*, *Money Orders* and *Other services*.

⁵ Volume includes Postal Service internal mail and free mail provided to certain congressionally mandated groups.

For the three months ended June 30, 2020, *First-Class Mail* generated approximately 31% of operating revenue, a 3% decrease in percentage points compared to the same period last year, and approximately 45% of our volume, a 6% increase in percentage points compared to the same period last year. *Marketing Mail* generated approximately 14% of operating revenue, a 9% decrease in percentage points compared to the same period last year, and approximately 42% of our volume, a 10% decrease in percentage points from the same period last year.

For the nine months ended June 30, 2020, *First-Class Mail* generated approximately 33% of operating revenue, a 2% decrease in percentage points compared to the same period last year, and approximately 41% of our volume, a 2% increase in percentage points compared to the same period last year. *Marketing Mail* generated approximately 19% of operating revenue and 49% of our volume, both 4% decreases in percentage points from the same period last year.

We experienced higher revenue results in our Shipping and Packages category, and it represented approximately 47% of our revenue for the three months ended June 30, 2020, a 15% increase in percentage points from the same period last year, and approximately 38% of our revenue for the nine months ended June 30, 2020, a 6% increase in percentage points from the same period last year. Shipping and Packages generated approximately 8% of our volume for the three months ended June 30, 2020, a 4% increase in percentage points compared to the same period last year, and 5% of our volume for the nine months ended June 30, 2020, a 1% increase in percentage points compared to the same period last year.

Although revenue and volume are closely linked to the strength of the U.S. economy and changes in how our customers use the mail, we have proactively targeted opportunities to grow our business. We continue to focus on our customers' needs and have increased our investment in mail and package innovation. However, we also recognize that revenue growth is constrained by laws and regulations restricting the types of products, services and pricing we may offer to our customers and the speed with which we can bring new products to market.

We anticipate that *First-Class Mail* will continue to lose volume in future years with the migration to electronic communication and transactional alternatives resulting from technological changes. To address the long-term trend that such changes have had on our *First-Class Mail* revenue and volume, we have been working with the mailing industry to slow the decline through mailing promotions and leveraging the high open-and-read rates of, for example, bills and statements for additional customer engagement and education.

However, due to the COVID-19 pandemic our mail volumes began an accelerated decline in late March 2020, and this decline continued through the third quarter. It is possible that the COVID-19-driven sudden drop in mail volumes, our most profitable revenue stream, may never fully recover to levels prior to the pandemic, similar to how mail volumes dropped significantly and never recovered following the Great Recession of 2007-2009.

We have also focused on providing new services and innovating with *Marketing Mail*. We have expanded service offerings such as *Informed Delivery*, which enables customers to preview mail and manage packages scheduled to arrive as a means of merging digital and physical mail, as well as allowing mailers to launch interactive digital campaigns. Additionally, we are focusing on opportunities to pilot new products and innovate with customers and the mail industry to enhance the value of hard-copy communication. We believe these service offerings will further improve the value of both *First-Class Mail* and *Marketing Mail*.

Our Shipping and Packages category has historically experienced revenue and volume growth as a result of our successful efforts to compete in shipping services, including last-mile e-commerce fulfillment markets and Sunday delivery as well as end-to-end markets. We continue to focus on responding to customers' needs by implementing solutions and maintaining strategic business partnerships that help us capitalize on the growing e-commerce business.

The COVID-19 pandemic has caused a recent surge in the nation's use of e-commerce, resulting in higher Shipping and Packages volumes, but also higher associated costs. However, we do not expect the resulting increases in Shipping and Packages revenues to be sustainable or to fully offset losses in mail service revenue caused by the COVID-19 pandemic in the long term. Although the future is uncertain, we believe that the nation's increased use of e-commerce is likely to plateau in the short term assuming the effects of the pandemic begin to subside, followed by a longer-term regression of e-commerce caused by a weakened U.S. economy.

Our Shipping and Packages category is subject to intense competition which significantly impacts both revenue and volume. Certain major customers continue to divert volume from our network by in-sourcing last-mile delivery into their own networks. These customers are also aggressively pricing their products and services in order to fill their networks and grow package density. However, as a result of the surge in e-commerce growth driven by the COVID-19 pandemic, some of these customers have increased their volume to our network during the pandemic due to their delivery capacity constraints.

We implemented price increases for certain Market-Dominant and Competitive services in January 2019 and 2020. Additionally, we implemented dimensional weighting provisions that amount to price increases for certain Shipping and Packages subcategories in June 2019.

First-Class Mail

First-Class Mail, presented in this report as a mail class and a Market-Dominant service category, includes cards, letters and flats. Prices of *First-Class Mail*, our most profitable service category, are the same regardless the geographic distance between the origination and delivery points. Because *First-Class Mail* is classified by law as Market-Dominant, price increases are currently generally subject to a price cap based on the Consumer Price Index for All Urban Consumers ("CPI-U").

For the three months ended June 30, 2020, *First-Class Mail* revenue decreased \$373 million, or 6.4%, on a volume decline of 1.1 billion pieces, or 8.4%, compared to the same period last year. For the nine months ended June 30, 2020, *First-Class Mail* revenue decreased \$452 million, or 2.4%, and volume declined 1.7 billion pieces, or 4.0%, compared to the same period last year. Revenue declined at a slower rate than volume due to the January 2020 price increase applicable to certain Market-Dominant services. The most significant factor contributing to the declining trend in *First-Class Mail* volume has been the continuing migration from mail to electronic communication and transaction alternatives, which has been exacerbated by the COVID-19 pandemic and may never fully recover to levels prior to the pandemic. A protracted loss in customer demand for our services will continue to have a material effect on *First-Class Mail* revenue and volume.

Marketing Mail

USPS Marketing Mail (more commonly, *Marketing Mail*), presented as a mail class and a Market-Dominant service category, generally consists of advertising, newsletters, catalogs, small marketing parcels and other printed matter not required to be processed and delivered as *First-Class Mail* or *Periodicals*.

Marketing Mail volume has generally been challenged by commercial mailers' increasing use of digital and mobile advertising, which had grown to an estimated 39% of total U.S. advertising expenditures as of calendar year 2019. This trend has been exacerbated by the COVID-19 pandemic, although this class has benefited from strong political and election mail volumes every two years during general election cycles, and we expect these volumes will be greater during the calendar year 2020 election cycle than in previous cycles as many more citizens will vote by mail during the pandemic.

For the three months ended June 30, 2020, *Marketing Mail* revenue decreased \$1.4 billion, or 37.2%, and volume declined 6.4 billion pieces, or 36.4%, compared to the same period last year. For the nine months ended June 30, 2020, *Marketing Mail* revenue decreased \$1.8 billion, or 14.4%, and volume declined approximately 8.8 billion pieces, or 15.3%, compared to the same period last year. For the three months ended June 30, 2020, our revenue and volume from political and election mail increased by approximately \$40 million and 175 million pieces, respectively, compared to the same period last year, as we began to benefit from the impact of the 2020 elections during the third quarter of 2020. For the nine months ended June 30, 2020, our revenue and volume from political and election mail decreased by approximately \$110 million and 700 million pieces, respectively, compared to the same period last year, which benefited from the impact of the calendar year 2018 mid-term elections during the first quarter of 2019.

Due to the COVID-19 pandemic, many of our commercial customers, especially those with consumer-facing businesses, have been required to curtail their operations, operate at a lower capacity and/or suspend their marketing and advertising expenditures. As a result, our *Marketing Mail* volume began to decline significantly in late March 2020, and it may never fully recover to levels prior to the pandemic. A protracted loss in customer demand for our services will continue to have a material effect on our *Marketing Mail* revenue and volume.

Marketing Mail is subject to intense competition, and price increases are currently generally capped at the rate of inflation. *Marketing Mail* volume is somewhat reflective of the cyclical nature of the U.S. economy, although targeted advertising campaigns can stimulate demand for this service, and our customers have used *Marketing Mail* to mail to more targeted prospects.

Shipping and Packages

The following table summarizes our operating revenue and volume for Shipping and Packages for the three and nine months ended June 30, 2020, and 2019, by each service subcategory:

| (in millions) | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|--|--------------------------------|-----------------|-------------------------------|------------------|
| | 2020 | 2019 | 2020 | 2019 |
| Shipping and Packages Revenue: | | | | |
| Priority Mail Services ¹ | \$ 3,493 | \$ 2,506 | \$ 9,167 | \$ 7,994 |
| Parcel Services ² | 2,560 | 1,613 | 6,519 | 5,337 |
| First-Class Package Services ³ | 2,044 | 1,108 | 4,431 | 3,361 |
| Package Services | 214 | 185 | 621 | 615 |
| Total Shipping and Packages revenue | \$ 8,311 | \$ 5,412 | \$ 20,738 | \$ 17,307 |
| Shipping and Packages Volume: | | | | |
| Priority Mail Services ¹ | 367 | 270 | 950 | 865 |
| Parcel Services ² | 1,019 | 675 | 2,649 | 2,318 |
| First-Class Package Services ³ | 601 | 339 | 1,313 | 1,063 |
| Package Services | 141 | 136 | 437 | 468 |
| Total Shipping and Packages volume | 2,128 | 1,420 | 5,349 | 4,714 |

¹ Includes *Priority Mail*, a 1-3 business day delivery service; *Priority Mail Express*, an overnight delivery service available 365 days per year; and *USPS Retail Ground*, a retail-only Competitive service priced identically and functionally equivalent to *Priority Mail* for Zones 1-4.

² Includes *Parcel Select*, *Parcel Return*, and *Marketing Mail Parcels*.

³ Includes *First-Class Package Services - Retail* and *First-Class Package Services - Commercial*.

Our Shipping and Packages category has historically experienced revenue and volume growth as a result of our successful efforts to compete in shipping services, including last-mile e-commerce fulfillment markets and Sunday delivery as well as end-to-end markets. However, this service category is subject to intense competition which significantly impacts both our revenue and volume. While Shipping and Packages revenue and volume are historically greatest in the first quarter of the year due to the holiday shipping season, we have experienced a significant increase in Shipping and Packages revenue and volume during the third quarter of 2020 as a result of the surge in e-commerce driven by the COVID-19 pandemic.

For the three months ended June 30, 2020, Shipping and Packages revenue increased 53.6%, with a volume growth of 49.9%, compared to the same period last year. The volume increased due to the surge in e-commerce resulting from the COVID-19 pandemic, and revenue outpaced volume increases due to the January 2020 price increases associated with certain Competitive services.

For the nine months ended June 30, 2020, Shipping and Packages revenue increased 19.8%, with a volume growth of 13.5%, compared to the same period last year. The volume increased due to the surge in e-commerce beginning in late March 2020 as a result of the COVID-19 pandemic, and revenue outpaced volume increases due to the January 2020 price increases associated with certain Competitive services.

Priority Mail Services

Priority Mail Services is our Shipping and Packages subcategory that includes *Priority Mail*, *Priority Mail Express* and *USPS Retail Ground*. *Priority Mail* and *Priority Mail Express* services allow customers the ability to send documents and packages requiring expedited transportation and handling. While Priority Mail Services revenue has historically grown year-over-year, its service offerings are price sensitive and its growth rate has been lower than other Shipping and Packages subcategories due to intense competition.

Priority Mail Services accounted for our largest portion of Shipping and Packages revenue, representing approximately 42% and 44% of the total for the three and nine months ended June 30, 2020, respectively, compared to approximately 46% for the same periods last year. However, Priority Mail Services accounted for approximately

17% and 18% of the total Shipping and Packages volume for three and nine months ended June 30, 2020, respectively, compared to approximately 19% and 18% for the same periods last year.

For the three months ended June 30, 2020, Priority Mail Services revenue grew 39.4%, on volume growth of 35.9%, compared to the same period last year. For the nine months ended June 30, 2020, Priority Mail Services revenue grew 14.7%, with volume growth of 9.8%, compared to the same period last year. Revenue and volume increased due to the surge in e-commerce from the COVID-19 pandemic, while revenue grew at a greater rate than volume for both periods, largely due to the January 2020 price increases applicable to Competitive services.

Parcel Services

Our Parcel Services subcategory includes Competitive services *Parcel Select* and *Parcel Return*, as well as Market-Dominant *USPS Marketing Mail Parcels* (more commonly, *Marketing Mail Parcels*). *Parcel Select* and *Parcel Return* services largely consist of last-mile deliveries, offered to large bulk shippers that perform their own sorting before dropping parcels deeper into our network.

For the three months ended June 30, 2020, revenue from Parcel Services increased 58.7%, on volume growth of 51.0%, compared to the same period last year. For the nine months ended June 30, 2020, revenue from Parcel Services increased 22.1%, on volume growth of 14.3%, compared to the same period last year. This subcategory is primarily a last-mile service that bypasses much of our infrastructure and therefore is one of our lowest-priced package services. Revenue and volume increased due to the surge in e-commerce from the COVID-19 pandemic. Revenue grew at a greater rate than volume largely due to the January 2020 price increases applicable to Competitive services.

First-Class Package Services

Our First-Class Package Services subcategory includes the competitively priced *First-Class Package Service - Retail*, a Competitive service targeted to retail customers for packages weighing up to 13 ounces, and *First-Class Package Service - Commercial*, a Competitive service targeted to commercial customers for packages weighing up to 16 ounces. This subcategory offers commercial customers that ship primarily lightweight fulfillment parcels the lowest-priced expedited end-to-end tracked package option in the marketplace. First-Class Package Services revenue and volume performance has historically experienced strong increases for the past several years, particularly from our commercial customers. These increases are primarily attributable to growth in e-commerce.

For the three months ended June 30, 2020, First-Class Package Services revenue increased 84.5%, with a volume growth of 77.3%, compared to the same period last year. For the nine months ended June 30, 2020, First-Class Package Services revenue increased 31.8%, with volume growth of 23.5%, compared to the same period last year. Revenue and volume increased due to the surge in e-commerce from the COVID-19 pandemic. Revenue grew at a greater rate than volume largely due to the January 2020 price increases applicable to Competitive services.

Package Services

Our Package Services subcategory is a Market-Dominant service that includes both Bound Printed Matter for materials up to 15 pounds and Library and Media Mail for materials up to 70 pounds. For the three months ended June 30, 2020, Package Services revenue increased 15.7% on a volume growth of 3.7%, compared to the same period last year. For the nine months ended June 30, 2020, Package Services revenue increased 1.0% despite a volume decline of 6.6%, compared to the same period last year. Revenue grew at a faster rate than volume for the three-month period, and despite the volume decline for the nine-month period, due to the January 2020 price increase applicable to Market-Dominant services.

International Mail

Our *International Mail* category includes several services that enable customers, both domestic and abroad, to send international mail, including postcards, envelopes, flats and packages with either standard or express delivery options. “Outbound” services, which allow customers in the U.S. to send mail and packages to other countries, generate approximately two thirds of *International Mail* revenue, but “inbound” services are the opposite, generating two thirds of volume but only a third of the revenue. This is primarily due to the smaller size and lower rates for inbound international e-commerce packages.

For the three months ended June 30, 2020, *International Mail* revenue decreased 18.9%, with a volume decline of 30.7%, compared to the same period last year. For the nine months ended June 30, 2020, *International Mail* revenue decreased 5.8%, with a volume decline of 15.7%, compared to the same period last year. Revenue decreased at a slower rate than volume due to the January 2020 price increases applicable to Competitive services. The declines in both inbound and outbound volume were due to various competitive pricing, political and economic factors, including the impact of the COVID-19 pandemic on transportation logistics and the global economy in general.

The U.S. is a member of the Universal Postal Union (“UPU”), a specialized agency of the United Nations that facilitates the exchange of international mail. We are the designated postal operator for the U.S. under the UPU, and payments to the designated postal operator for the delivery of foreign origin letter-post mails are known as “terminal dues”.

In September 2019, the UPU members had a special meeting -- known as the Extraordinary Congress -- to discuss the terminal dues system. During that meeting, UPU members agreed to establish a new remuneration system that allowed us to self-declare rates beginning in July 2020. Other foreign postal operators may also reciprocally apply rates at full-self-declared rates at that time.

In February 2020, we officially invoked the provision of the new remuneration system to self-declare rates, and our self-declared rates went into effect in July 2020.

Periodicals

Periodicals, also presented as a mail class and a Market-Dominant service category, includes services designed for publishers of newspapers, magazines and other periodical publications whose primary purpose is providing publications to subscribers or other users. For the three months ended June 30, 2020, *Periodicals* revenue decreased 19.2% and volume declined 17.2%, compared to the same period last year. For the nine months ended June 30, 2020, *Periodicals* revenue decreased 12.4% and volume declined 12.2%, compared to the same period last year.

Periodicals revenue and volume have been in decline for more than a decade as trends in hard-copy reading behavior and shifts of advertising away from print have eroded this business. The *Periodicals* category is not expected to rebound as electronic content continues to grow in popularity with the public.

Other

Other services include ancillary services such as *Certified Mail*, *PO Box* services, and *Return Receipt* services. Also included in this category are money orders and passport services. Other services revenue decreased 34.8%, and 14.2% for the three and nine months ended June 30, 2020, respectively, compared to the same periods last year.

OPERATING EXPENSES

In an effort to align our resources with anticipated future mail and package volume, we continue to aggressively manage operating expenditures under management’s control.

We originally designed our mail processing and distribution network to provide overnight delivery service of *First-Class Mail* within specified delivery areas for a much higher volume of mail than we are required to process and deliver today, and the network’s legacy capabilities are not completely aligned to today’s mail mix and volumes. Consequently, certain of our processing and distribution facilities continue to operate at less than full capacity. Our challenge to contain costs is also compounded by the increasing number of delivery points, which, when combined with lower mail volume, has resulted in a drop in the average number of pieces delivered per delivery point per day from approximately 5.5 pieces in 2007 to 3.4 pieces in 2019, a reduction of approximately 39%, and has continued to decline in 2020.

As discussed in greater detail below, our operating expenses for both the three and nine months ended June 30, 2020, reflect the impacts of the COVID-19 pandemic. Specifically, we have incurred greater expenses for PPE, higher air transportation costs due to lower availability of commercial air flights, and greater compensation costs

representing both increased sick leave and labor costs associated with the higher volumes in our labor-intensive Shipping and Packages category.

Compensation and Benefits

Compensation and benefits is our largest operating expense category. These expenses consist of costs related to our active career and non-career employees other than retirement costs associated with U.S. government defined benefit pension programs and retiree health costs which are further discussed in *Retirement Benefits* and *Retiree Health Benefits*, respectively.

Overall, our compensation and benefits expenses increased 5.5% and 1.6% for the three and nine months ended June 30, 2020, compared to the same periods last year. The following table presents compensation and benefits expenses for the three and nine months ended June 30, 2020, and 2019:

| (in millions) | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|--|--------------------------------|------------------|-------------------------------|------------------|
| | 2020 | 2019 | 2020 | 2019 |
| Compensation | \$ 9,961 | \$ 9,374 | \$ 29,819 | \$ 29,335 |
| Employee health benefits | 1,281 | 1,271 | 3,871 | 3,843 |
| Social security | 555 | 522 | 1,670 | 1,640 |
| TSP | 290 | 282 | 879 | 854 |
| Other | 71 | 77 | 231 | 237 |
| Total compensation and benefits | \$ 12,158 | \$ 11,526 | \$ 36,470 | \$ 35,909 |

Compensation

Compensation expense increased 6.3% and 1.6% for the three and nine months ended June 30, 2020, compared to the same periods last year. The higher expenses resulted from contractual wage increases and an increase in paid leave used during the quarter, including regular sick leave, newly negotiated sick leave provided to our bargaining-unit employees, and new sick leave as provided by the *Families First Coronavirus Response Act*, enacted as Public Law 116-127 ("FFCRA"). The FFCRA authorized new paid sick leave that may be used by an employee in COVID-19 situations for themselves, or to care for sick family members, as well as Family and Medical Leave Act-protected unpaid and paid leave if a school/child care is closed. The FFCRA provides the means for companies and other government entities to receive federal reimbursement for payment of this FFCRA leave; however, we are not eligible for such reimbursement. For the three months ended June 30, 2020, we have recorded \$161 million in expense associated with this FFCRA leave. However, due to our unique status, we will not receive any reimbursement, and this FFCRA leave will be paid for from the sale of postal products and services, similar to the rest of our operating expenses.

Work Hours

For the three months ended June 30, 2020, total work hours were approximately 291 million, an increase of 1.0% compared to approximately 288 million total work hours for the three months ended June 30, 2019. This increase was reflective of the increase in Shipping and Packages volumes during the period from the surge in e-commerce growth due to the COVID-19 pandemic.

For the nine months ended June 30, 2020, total work hours were approximately 883 million, a decrease of 0.3%, compared to approximately 886 million total work hours for the nine months ended June 30, 2019. This decrease was the result of management's efforts to reduce work hours in line with volume workloads, partially offset by the increase in work hours needed for the higher Shipping and Packages volumes during the quarter.

Workforce Composition

The number of career employees at June 30, 2020, was approximately 497,500, a decrease of approximately 500 employees, or 0.1%, compared to the same date a year ago, as a result of natural attrition.

The number of non-career employees at June 30, 2020, was approximately 143,000, an increase of approximately 4,500 employees, or 3.2%, compared to the same date a year ago. This increase primarily reflects additions to

the workforce in the third quarter of 2020 to address the surge in Shipping and Packages volumes.

Collective Bargaining Agreements

In May 2019, we reached a tentative agreement with the National Rural Letter Carriers' Association (NRLCA) on a three-year collective bargaining agreement, which the union membership ratified in August 2019. The new contract will expire on May 20, 2021.

In March 2020, a three-member arbitration panel reached a decision in our legally mandated binding interest arbitration process with the American Postal Workers Union, AFL-CIO (APWU), establishing the terms of a new collective bargaining agreement. The new contract will expire on September 20, 2021.

In January 2020, we reached a tentative agreement with the National Postal Mail Handlers Union, AFL-CIO (NPMHU) on a new three-year collective bargaining agreement, which the union membership ratified on April 7, 2020. The new contract will expire on September 20, 2022.

In September 2019, we agreed to extend contract negotiations relating to a new collective bargaining agreement with the National Association of Letter Carriers, AFL-CIO ("NALC"). The previous contract with the NALC expired on September 20, 2019, and negotiations with the NALC are at an impasse. The parties bypassed mediation and interest arbitration in front of a tripartite panel is scheduled beginning September 23, 2020. The parties will continue to follow the current agreement until a new contract is reached through the dispute resolution process.

Employee Health Benefits

Our expense for employee health benefits (which includes the employer portion of Medicare taxes) is most significantly impacted by the number of employees electing coverage and the premium costs of the selected plans. Our active employees may participate in the Federal Employees Health Benefits ("FEHB") Program, which OPM administers. Separate from FEHB, we offer our own self-insured healthcare plan to certain non-career employees who are ineligible for FEHB.

Employee health benefits expense increased 0.8% and 0.7% for the three and nine months ended June 30, 2020, compared to the same periods last year, driven by average premium increases of 4.0% in calendar year 2020, and partially offset by the lower contribution rate of the employer portion of healthcare premiums that we paid, by management efforts to provide employees with information and tools for selecting the health benefit plans that best meet their needs, and by the small decrease in number of career employees, as previously discussed.

Our share of healthcare premiums for our employees represented 71.9% and 71.8% of the total healthcare premium costs for the three months ended June 30, 2020, and 2019, respectively. Our share of healthcare premiums for our employees represented 71.9% and 72.1% of the total healthcare premium costs for the nine months ended June 30, 2020, and 2019, respectively. This decrease in our share of healthcare premium costs for employees during the nine-month period was consistent with the terms of our contractual agreements.

Social Security

For the three and nine months ended June 30, 2020, our Social Security costs increased 6.4% and 1.8%, respectively, compared to the same periods last year. These fluctuations were consistent with the general changes in compensation for the period, as described above in *Compensation*.

The *CARES Act* offers certain employers the ability to defer payment of the employer's share of the Social Security payroll tax on wages incurred from March 27, 2020, through December 31, 2020. In accordance with this provision, we began deferring these payments in April 2020, and intend to continue the deferral for the remainder of calendar year 2020 for an estimated total deferral amount of approximately \$1.6 billion. One half of these deferred payments would be due by December 31, 2021, and the other half by December 31, 2022. As of June 30, 2020, we had deferred payments totaling approximately \$658 million. This amount is recorded within *Other noncurrent liabilities* in the accompanying *Balance Sheets*.

Thrift Savings Plan

Career employees may participate in the Thrift Savings Plan ("TSP"), a defined contribution retirement savings and investment plan administered by the Federal Retirement Thrift Investment Board. Our TSP expenses are

related only to our contributions for FERS employees who participate in the TSP. For these employees, we contribute 1% of basic pay and match voluntary employee contributions up to an additional 4% of basic pay.

For the three and nine months ended June 30, 2020, our TSP matching costs increased 2.8% and 2.9%, respectively, compared to the same periods last year. The increase in expenses correlates to the changing workforce composition of CSRS and FERS employees.

Retirement Benefits

The majority of our career employees participate in one of two U.S. government defined benefit pension programs, CSRS and FERS, based on the starting date of their employment with us or another U.S. government employer. We incur normal costs (the amount determined by OPM representing the employer portion of retirement benefits for participating employees and their qualifying survivors, upon retirement, for each employee's current year of service) for FERS employees; however, by law we do not pay normal costs for CSRS retirement benefits. FERS employees are further categorized as either FERS, FERS - Revised Annuity Employees (FERS - RAE), or FERS - Further Revised Annuity Employees (FERS - FRAE) depending on whether their date of hire was before, during, or after calendar year 2013, respectively. This categorization determines the percentage of basic pay that we are required to contribute for normal cost.

Our retirement benefits expenses consist of three components: 1) FERS normal costs, 2) CSRS unfunded retirement benefits amortization, and 3) FERS unfunded retirement benefits amortization. These retirement benefits expense components are further described in detail in the sections below. The following table presents the retirement benefits expenses for the three and nine months ended June 30, 2020, and 2019:

| (in millions) | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|---|-----------------------------|-----------------|----------------------------|-----------------|
| | 2020 | 2019 | 2020 | 2019 |
| FERS normal costs | \$ 939 | \$ 878 | \$ 2,830 | \$ 2,635 |
| CSRS unfunded retirement benefits amortization ¹ | 450 | 360 | 1,349 | 1,080 |
| FERS unfunded retirement benefits amortization ² | 321 | 239 | 964 | 718 |
| Total retirement benefits | \$ 1,710 | \$ 1,477 | \$ 5,143 | \$ 4,433 |

¹ Expense for the accrual for the annual payment due to OPM by September 30 of the respective year, based on information provided by OPM, to amortize the unfunded CSRS retirement obligation. Payments are to be made through 2043 based on OPM invoices.

² Expense for the accrual for the annual payment due to OPM by September 30 of the respective year, based on information provided by OPM, to amortize the unfunded FERS retirement obligation. Payments are to be made over a 30-year rolling period based on OPM invoices.

Our retirement benefits expenses increased 15.8% and 16.0% for the three and nine months ended June 30, 2020, respectively, compared to the same periods last year. This increase was due to rising employer contributions rates for FERS normal cost, as well as increases in the CSRS and FERS unfunded retirement benefits amortization, as discussed below.

For additional information, see *Item 1. Financial Statements, Notes to Unaudited Financial Statements, Note 9 - Retirement Plans*.

FERS Normal Costs

We record our contributions to FERS normal costs as they are incurred. Any unpaid employer amounts at the end of a period, along with any employee amounts withheld but not remitted at the end of a period, are recorded as a current liability within *Retirement benefits* in the accompanying *Balance Sheets*.

As determined by OPM, our FERS normal cost contribution rates increased from 13.7% to 14.7% of basic pay for 2020, an increase of 7.3% from the prior year, affecting most of our FERS participants. As a result of this contribution rate increase, FERS normal cost expenses increased 6.9% and 7.4% for the three and nine months ended June 30, 2020, respectively, compared to the same periods last year.

CSRS and FERS Unfunded Retirement Benefits

OPM periodically notifies us regarding its revaluation of unfunded CSRS and FERS retirement benefits. The amounts we record as expenses for our unfunded CSRS and FERS liabilities may be significantly impacted by changes in actuarial assumptions used by OPM to revalue the unfunded liabilities.

In October 2019, OPM provided an actuarial report projecting the annual amortization payments due September 30, 2020, to be \$1.6 billion for CSRS and \$1.1 billion for FERS.

On April 2, 2020, the Board of Actuaries of the CSRS, which establishes the key actuarial assumptions used in OPM's calculation of the actuarial liabilities for CSRS and FERS, recommended changes to the actuarial assumptions used to calculate CSRS and FERS unfunded retirement liabilities, including lowering the discount rate from 4.25% to 4.00%, as well as decreasing the inflation rate, the cost-of-living adjustment ("COLA") rate and the general wage increase rate. Although we have no certainty, we have estimated that the impact of these changes in actuarial assumptions on the annual CSRS and FERS amortization expense, will result in revised projected amortization payments due September 30, 2020, of approximately \$1.8 billion for the CSRS obligation and approximately \$1.3 billion for the FERS obligation, increases of \$181 million and \$226 million, respectively.

Accordingly, we have accrued \$450 million and \$1.3 billion for the three and nine months ended June 30, 2020, respectively, for the CSRS amortization expense. Likewise, we have accrued \$321 million and \$964 million for the three and nine months ended June 30, 2020, respectively, for the FERS amortization expense.

Our CSRS and FERS unfunded retirement benefits amortization expenses increased 28.7% and 28.6% for the three and nine months ended June 30, 2020, respectively, compared to the same periods last year, due to higher estimated annual amortization payments resulting from revised actuarial assumptions.

We expect to receive invoices from OPM for the actual amounts due September 30, 2020, for CSRS and FERS during the fourth quarter of 2020, and the amounts invoiced could differ from the projected amounts, due to further changes in experience and/or actuarial assumptions as of the calculation date.

Retiree Health Benefits

We participate in federal employee benefit programs for retiree health benefits. Retirees who participated in FEHB for the five years immediately preceding their retirement may continue to participate in the plan during retirement. Qualifying survivors of retirees are also eligible to receive benefits.

In accordance with PAEA, since the beginning of 2017, the PSRHBF has funded our share of retiree health benefit premiums. Also since 2017, we have been obligated to pay into the PSRHBF the actuarially determined normal costs of retiree health benefits attributable to the service of our employees, as well as the amortization payment for the PSRHBF unfunded liability. Our total retiree health benefits expenses therefore consist of both the normal and the amortization costs. We record the required contributions to the plan as an expense in the period in which each contribution is due.

Based on preliminary calculations provided by OPM in October 2019, we had projected the PSRHBF amortization payment amount due September 30, 2020, to be \$900 million. However, on July 22, 2020, we received OPM's invoice for 2020, which indicated the year-end amortization payment amount due is \$810 million. This amount was lower than our original estimate largely due to a lower-than-estimated number of career postal employees enrolled in FEHB. Because of the lower-than-estimated invoiced amount, we adjusted our accrual for the amortization payment, resulting in expenses of \$158 million and \$608 million for the three and nine months ended June 30, 2020, respectively.

Also, based on preliminary calculations provided by OPM in October 2019 using updated discount rate assumptions, we had estimated the amount of our PSRHBF normal cost payment due September 30, 2020, to be \$4.0 billion. However, OPM's July 22, 2020 invoice indicated the normal cost payment amount due is approximately \$3.8 billion. This amount was lower than our original estimate largely due to a lower-than-estimated number of career postal employees enrolled in FEHB. Because of the lower-than-estimated invoiced amount, we adjusted our accrual for the normal cost payment, resulting in expenses of \$887 million and \$2.9 billion for the three and nine months ended June 30, 2020, respectively.

For the three months ended June 30, 2020, our total retiree health benefits expenses increased by \$172 million, or 19.7%, compared to the same period last year. Expenses for both the three months ended June 30, 2020, and 2019, included adjustments between the estimated and invoiced amounts for the respective years.

For the nine months ended June 30, 2020, our total retiree health benefits expenses increased by \$72 million, or 2.1%, compared to the same period last year, driven by higher invoiced amounts for 2020, due to differences in actuarial assumptions, which are outside of management's control.

For additional information, see *Item 1. Financial Statements, Notes to Unaudited Financial Statements, Note 10 - Health Benefits Plans, Retirees*.

Workers' Compensation

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

On a daily basis we focus on costs that can be managed in the course of normal business operations. Certain aspects of workers' compensation can be managed through human resource initiatives, safety measures and training. Other workers' compensation costs cannot be managed in the course of normal business operations and are less predictable, including expenses caused by actuarial revaluation and discount rate changes. We subtract the cash payments made by DOL on behalf of workers' compensation obligations, which are relatively predictable, from total workers' compensation expense in order to determine the non-cash component of workers' compensation expense, a non-GAAP financial measure.

The following table presents the components of workers' compensation expense, including the cash payments made by DOL on behalf of workers' compensation obligations, for the three and nine months ended June 30, 2020, and 2019:

| (in millions) | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|---|--|-----------------|---------------------------------------|-----------------|
| | 2020 | 2019 | 2020 | 2019 |
| Impact of discount rate changes | \$ (55) | \$ 697 | \$ 2,030 | \$ 1,656 |
| Actuarial revaluation of existing cases | (124) | 28 | (128) | 80 |
| Cost of new cases | 311 | 291 | 983 | 893 |
| Administrative fee | 21 | 22 | 63 | 67 |
| Total workers' compensation expense | \$ 153 | \$ 1,038 | \$ 2,948 | \$ 2,696 |
| Less cash payments made by DOL on behalf of workers' compensation obligations | (303) | (332) | (1,006) | (1,029) |
| Total workers' compensation non-cash (benefit) expense | \$ (150) | \$ 706 | \$ 1,942 | \$ 1,667 |

For the three months ended June 30, 2020, the portion of workers' compensation expense due to the impact of discount rate changes decreased approximately \$752 million, compared to the same period last year. For the nine months ended June 30, 2020, the portion of workers' compensation expense due to the impact of discount rate changes increased approximately \$374 million, compared to the same period last year. These changes are the result of changes in interest rates, outside of management's control.

The combined costs of new workers' compensation cases and revaluation of existing workers' compensation cases decreased by \$132 million and \$118 million for the three and nine months ended June 30, 2020, compared to the same periods last year. Changes in actuarial valuation are primarily attributable to the combined impacts of routine changes in actuarial estimation, the progression of existing cases and updated COLA assumptions, which are largely outside of management's control.

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

For additional information, see *Item 1. Financial Statements, Notes to Unaudited Financial Statements, Note 11 - Workers' Compensation*.

Transportation

Transportation expenses include the costs we incur to transport mail and packages between our facilities, comprising highway, air and international transportation contracts, plus contract delivery services.

With the exception of contract delivery services, our costs to deliver mail and other products to delivery points are not included within *Transportation* but in *Compensation and benefits* for employee costs and in *Other operating expenses* for fuel, vehicle maintenance and repair, and other costs. Furthermore, transportation expenses do not include the compensation and related costs of employees responsible for transporting mail and packages between our facilities.

Variations in the volume and weight of mail transported, the mode of transportation used, and fuel prices have significant impact on transportation expenses.

The components of transportation expenses for the three and nine months ended June 30, 2020, and 2019, are presented in the following table:

| (in millions) | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|--------------------------------------|--------------------------------|-----------------|-------------------------------|-----------------|
| | 2020 | 2019 | 2020 | 2019 |
| Highway | \$ 1,114 | \$ 1,040 | \$ 3,618 | \$ 3,462 |
| Air | 951 | 790 | 2,527 | 2,375 |
| International | 105 | 130 | 407 | 441 |
| Other | 12 | 8 | 35 | 32 |
| Total transportation expenses | \$ 2,182 | \$ 1,968 | \$ 6,587 | \$ 6,310 |

Overall, transportation expenses increased 10.9% and 4.4% for the three and nine months ended June 30, 2020, respectively, compared to the same periods last year.

Highway transportation expenses increased 7.1% and 4.5% for the three and nine months ended June 30, 2020, respectively, compared to the same periods last year. For the three months ended June 30, 2020, highway contract expenses increased, primarily due to an increase in the number of miles driven, but partially offset by lower average diesel fuel prices. Highway transportation expenses increased for the nine months ended June 30, 2020, primarily due to a one-time adjustment whereby we recorded transportation expenses associated with embedded leases in certain of our transportation contracts during the first quarter of 2020.

Air transportation expenses increased 20.4% and 6.4% for the three and nine months ended June 30, 2020, respectively, compared to the same periods last year. For the three months ended June 30, 2020, air transportation expenses increased due to a significant shift from commercial to chartered air carriers. Commercial air carrier availability declined as a result of travel restrictions associated with the COVID-19 pandemic. For the nine months

ended June 30, 2020, the increase was due primarily to higher volumes, but partially offset by lower average jet fuel prices.

International transportation expenses are related only to outbound services that allow customers in the U.S. to send mail and packages to other countries. For the three and nine months ended June 30, 2020, international transportation expenses decreased 19.2% and 7.7%, respectively, compared to the same periods last year, primarily due to decreases in our international service volumes.

Other Operating Expenses

Other operating expenses for the three and nine months ended June 30, 2020, and 2019, are detailed in the following table:

| (in millions) | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|---|--------------------------------|-----------------|-------------------------------|-----------------|
| | 2020 | 2019 | 2020 | 2019 |
| Supplies and services | \$ 857 | \$ 695 | \$ 2,326 | \$ 2,107 |
| Depreciation and amortization | 429 | 430 | 1,283 | 1,271 |
| Rent and utilities | 403 | 410 | 1,318 | 1,274 |
| Information technology and communications | 247 | 223 | 657 | 631 |
| Vehicle maintenance service | 157 | 151 | 467 | 471 |
| Rural carrier equipment maintenance | 150 | 143 | 449 | 441 |
| Fuel - delivery vehicles | 67 | 124 | 326 | 372 |
| Miscellaneous other | 252 | 275 | 752 | 778 |
| Total other operating expenses | \$ 2,562 | \$ 2,451 | \$ 7,578 | \$ 7,345 |

Other operating expenses increased by 4.5% and 3.2% for the three and nine months ended June 30, 2020, respectively, compared to the same periods in the prior year, driven by an increase in supplies and services costs, including costs for PPE, but partially offset by the costs delivery vehicle fuel costs. Supplies and services costs increased 23.3% and 10.4% for the three and nine months ended June 30, 2020, respectively, compared to the same periods in the prior year, largely due to additional spending associated with the COVID-19 pandemic. Fuel for delivery vehicles decreased 46.0% and 12.4% for the three and nine months ended June 30, 2020, respectively, compared to the same periods in the prior year, primarily due to lower average fuel costs. Aside from these two categories, the period-over-period changes in the components of other operating expenses, were relatively immaterial for the three and nine months ended June 30, 2020.

LIQUIDITY AND CAPITAL RESOURCES

Our liquidity consists of unrestricted cash and cash equivalents plus our authorized borrowing capacity under the *Postal Reorganization Act*, as amended by Public Laws 101-227 and 109-435 (the "PRA"). As of June 30, 2020, and September 30, 2019, we held unrestricted cash and cash equivalents of \$12.9 billion and \$8.8 billion, respectively. During the nine months ended June 30, 2020, our average daily liquidity balance was \$12.7 billion. This amount represented approximately 58 days of liquidity, which we define as liquidity divided by estimated average cash disbursements (including capital expenditures) per calendar day (365 days per year).

We face certain incremental risks caused by the COVID-19 pandemic, including the disruptions to our revenue and business operations, which will have a material effect on our financial condition and results of operations. Quarantines, shelter-in-place orders, and travel and logistics restrictions in connection with the outbreak have affected our retail and commercial customers, as well as suppliers and mail service providers. While the disruption is expected to be temporary, its depth and duration remain uncertain. A protracted loss in customer demand for our services is likely to have a material adverse effect on our financial condition, results of operations and liquidity. The sudden drop in mail volumes, our most profitable revenue stream, is steep and may never fully recover to levels prior to the pandemic.

We estimate that the COVID-19 pandemic may increase our net operating loss by more than \$10.0 billion through 2021. Assuming we prioritize payments to the FFB, employees and suppliers ahead of some payments to fund retirement and retiree health benefits, if necessary to ensure that we can fulfill our primary universal service mission as has been done in the past, we expect that we will have sufficient liquidity to continue to operate through at least August 2021.

Although our liquidity has generally increased since 2012, it remains insufficient to support an organization with approximately \$80 billion in annual operating expenses, to make capital investments necessary for continuity of operations and to prepare for unexpected contingencies. Much of this liquidity improvement as of June 30, 2020, would not have occurred but for the temporary exigent surcharge, which allowed us to collect a total of \$4.6 billion in incremental revenue between January 2014 and April 2016.

Aside from the temporary exigent surcharge, we defaulted on \$33.9 billion of statutorily specified PSRHBF prefunding payments from 2012 through 2016, and did not make the approximately \$495 million in payments due for FERS unfunded liabilities between 2014 and 2016, or the approximately \$21.0 billion in payments due for PSRHBF normal cost and amortization on PSRHBF, CSRS and FERS unfunded liabilities between 2017 and 2019, in order to preserve liquidity, and to ensure that our ability to fulfill our primary universal service mission was not placed at undue risk. The combination of these defaults and non-payments, plus the incremental revenue associated with the temporary exigent surcharge referred to above, and the increased revenue from growth in our Shipping and Packages business, are the primary reasons why our cash and liquidity have improved.

CASH FLOW ANALYSIS

Operating Activities

Cash provided by operating activities increased \$712 million for the nine months ended June 30, 2020, compared to the same period last year, largely the result of the deferred payment for the employer contribution of Social Security benefits.

Investing Activities

We invested \$1.2 billion in the purchase of property and equipment for the nine months ended June 30, 2020, which is an increase of \$234 million, or 24.6%, compared to the same period last year. As of the date of this report, the amount of our full year projected capital expenditures is approximately \$1.7 billion, which is approximately \$600 million less than our original forecast of \$2.3 billion.

Financing Activities

Except as described otherwise in this quarterly report, the nature and amounts of our payment obligations under our debt, capital and operating lease agreements, purchase commitments and other liabilities as of June 30, 2020, have not materially changed from those described in our Annual Report.

On April 3, 2020, we drew \$3.4 billion on a revolving credit facility with the FFB. In order to comply with the annual net increase limit, we must repay \$400 million from this credit facility by September 30, 2020. Given that the credit facility has a maximum term of up to one year, we must repay or refinance any outstanding balance of the credit facility by April 2, 2021.

As of June 30, 2020, the aggregate principal balance of our outstanding debt was \$14.4 billion. Of this amount, \$3.4 billion from the revolving credit facility was included in short-term debt, and \$11.0 billion from fixed-rate notes and floating-rate notes was included in long-term debt.

As of September 30, 2019, the aggregate principal balance of our outstanding debt was \$11.0 billion consisting of a combination of fixed-rate note and floating-rate notes, all of which we considered long-term debt.

DEBT

The PRA authorizes us to raise cash through the issuance of debt obligations. The PRA requires us to notify the Secretary of the Treasury of our intent to issue debt, allowing the U.S. Treasury the first option to purchase such obligations. However, if the Secretary of the Treasury elects not to purchase such obligations, the PRA authorizes

us to issue and sell such obligations to a party or parties other than the U.S. Treasury, which may include a transaction in the public or private debt markets.

As of June 30, 2020, our incremental borrowing capacity under the PRA was \$600 million. However, \$400 million of our outstanding debt balance will require repayment by September 30, 2020, to comply with the PRA's annual debt net increase limit. Furthermore, notwithstanding our \$15.0 billion statutory debt limit, and the \$3.0 billion annual limitation on new borrowing, the *CARES Act* allows us to borrow up to an additional \$10.0 billion in financing from the U.S. Treasury to fund operating expenses. The U.S. Treasury may lend up to this amount at our request, upon terms and conditions mutually agreed upon. On July 29, 2020, we announced that we had reached an agreement in principle with the U.S. Treasury on the terms and conditions associated with the *CARES Act* financing. The agreed-upon terms and conditions must be memorialized in loan documents and satisfied before we will have access to the *CARES Act* borrowing, as limited by such terms and conditions.

In 1974, we began issuing debt through individual debt agreements to the FFB, a government-owned corporation under the general supervision of the Secretary of the Treasury. In 1999, we entered into a Note Purchase Agreement ("NPA") with the FFB to establish standardized procedures for issuing debt. Under the NPA, we were able to issue a series of notes with established terms and conditions by providing two days prior notice. Also under the NPA, we could make borrowings against two annually renewable revolving credit line facilities. These note arrangements and credit line facilities provided the flexibility to borrow short or long-term, using floating or fixed-rate instruments.

The NPA was extended each year through September 30, 2018, and in shorter increments between that date and August 31, 2019, at which time the NPA expired. This expiration did not affect the terms of any of our outstanding debt with the FFB as of June 30, 2020, including the April 3, 2020, revolving credit facility draw of \$3.4 billion, all of which was issued under the NPA.

Furthermore, while the expiration of the NPA did not remove our statutory ability to issue debt under the PRA, if we are unable to renew or replace the NPA with the FFB, we have no assurance that we would be able to raise additional cash through debt financing with the FFB, or that such financing would be provided on terms comparable to those under the NPA. Alternatively, if we were to use our authority under the PRA to issue and sell obligations to a party or parties other than the FFB, we have no assurance that we would be successful in raising additional cash, or that such financing would be provided on terms comparable to those under the NPA.

LIQUIDITY OUTLOOK

We are constrained by laws and regulations, including the PAEA, which restrict revenue sources and mandates certain expenses. Statutorily mandated expenses include amortization payments to provide full funding of retirement benefits under the CSRS and the FERS, as well as FERS normal costs, described in greater detail in *Note 9 - Retirement Plans*. Additionally, the PAEA established the PSRHBF and mandated certain obligations for paying normal costs, the present value of the estimated retiree health benefits attributable to active employees' current year of service, and amortization payments for full prefunding of retiree health benefits. These prefunding obligations, described in greater detail in *Note 10 - Health Benefits Plans*, are unlike expenses imposed on most other federal entities or private-sector businesses that offer such benefits.

We continue to face challenges from the ongoing migration of mail to electronic alternatives, and we are legally limited under current law in how we can price our products and streamline our legacy business model. Our operations will require significant capital investment over the next few years to modernize and improve our processing and delivery infrastructure and update our delivery fleet in order to continue to meet our primary statutory obligation to provide prompt, reliable and efficient postal services to the nation.

Absent legislative and regulatory change, we project continuing annual net losses in the future. As a result of these losses and our liquidity concerns, we may not have sufficient cash balances to meet all of our existing legal obligations and make all of the critical investments in our infrastructure that are necessary for operational continuity and that have been deferred in recent years.

In the event that circumstances leave us with insufficient liquidity to continue operating, we may deem it necessary to implement additional contingency plans to ensure that our primary mission is fulfilled and that mail deliveries continue. These measures include prioritizing payments to the FFB, our employees and suppliers ahead of some

payments to fund retirement and retiree health benefits, as we have done in the past. By exercising these contingency plans, we expect that we will have sufficient liquidity to continue operating through at least August 2021.

With the anticipated continued migration to electronic communication and transactional alternatives, we continue to pursue long-term financial sustainability by focusing on the following items:

1. Continued efforts to control costs and drive efficiencies, innovate to keep mail relevant and generate increased revenue;
2. Postal Service reform legislation that addresses our overall cost structure and enhances our revenue-generating opportunities; and
3. Favorable outcome of the PRC's ten-year review (discussed below), which would allow additional pricing flexibility.

Although we continue to inform the executive branch, Congress, the PRC and other stakeholders of the immediate and long-term financial challenges we face, we have no assurances that our requests will result in meaningful reform in the foreseeable future.

PRC Ten-year Review

In December 2016, the PRC initiated its ten-year review of the system for regulating rates and classes for Market-Dominant products as required by the PAEA. The purpose of the ten-year review was to determine if the system for regulating such rates and classes has achieved the objectives Congress established in the PAEA. As part of this review, the PRC evaluated the CPI-U price cap for our Market-Dominant services.

On December 1, 2017, the PRC announced its initial decision in connection with its ten-year review. The PRC concluded that the rates system has not achieved its objectives and needs to be changed, primarily because it does not enable us to achieve our mission of providing prompt, reliable, and efficient universal postal services to the American people in a financially sustainable manner. The PRC's proposed changes to the system thus far do not include the elimination of the CPI-U price cap; however, its proposal does provide for some additional pricing authority within a price cap system.

On December 5, 2019, the PRC announced a revised decision in connection with its ten-year review. The PRC's proposed changes to the system still do not include the elimination of the CPI-U price cap. Moreover, while the revised proposal does include adjustment factors as we had requested to provide more flexibility for the regulatory system to better deal with future exogenous changes, the new proposal no longer includes any "true-up" authority to provide us with a reasonable opportunity to cover all of our costs. We continue to assert that the price cap should be eliminated, and that if the PRC insists on maintaining a price cap that the system must include both a resetting of rates so they are compensable, as well as adjustment factors to ensure the system is sufficiently flexible going forward.

The PRC was expected to issue a final rule after considering the comments and reply comments of any interested stakeholders, which were due no later than February 3, 2020, and March 4, 2020, respectively. As of the date of this report, the PRC has not issued a final rule. Additional information regarding the ten-year review may be found at the PRC website: <https://www.prc.gov/press-releases/prc-revises-proposals-second-rulemaking-modify-rate-system-classes-market-dominant>.

2020 and Beyond

We anticipate that given our ongoing liquidity concerns, and without legislative action and regulatory reform, we may not be able to pay all legally required obligations and also invest in much-needed capital expenditures in 2020 and future years that are necessary to ensure our ability to fulfill our primary mission. Furthermore, we believe that continuing productivity improvements alone will not be sufficient to address the challenges presented by declining Market-Dominant volume and revenue, and any future growth in operating revenue would unlikely keep pace with increased costs.

Legally Required Obligations

In addition to our previously discussed obligations for unfunded retirement and retiree health benefits of approximately \$7.7 billion due on September 30, 2020, we expect to pay the DOL approximately \$1.3 billion in October 2020, representing the workers' compensation claims paid by DOL for the chargeback year July 1, 2019, to June 30, 2020, plus the estimated administrative fee.

The *CARES Act* offers certain employers the ability to defer payment of the employer's share of the Social Security payroll tax on wages incurred from March 27, 2020, through December 31, 2020. In accordance with this provision, we began deferring these payments in April 2020, and intend to continue the deferral for the remainder of calendar year 2020 for an estimated total deferral amount of approximately \$1.6 billion. One half of these deferred payments would be due by December 31, 2021, and the other half by December 31, 2022. As of June 30, 2020, we had deferred approximately \$658 million.

Capital Investments

We currently estimate that our required cash outlays for capital investments necessary to ensure that we can continue to perform our universal service obligation will amount to approximately \$500 million for the remainder of 2020, and an additional \$11.0 billion for years 2021 through 2024, as we plan to invest in a new fleet of delivery vehicles and other appropriate capital assets. Although our future projections include these capital cash outlays, the severity and duration of the COVID-19 pandemic may impact these outlays and the future cash flow from operations alone may not generate the cash needed to enable us to fully fund such necessary capital investments.

Mitigating Circumstances

We continue to pursue strategies within our control to increase operational efficiency and improve liquidity. We have managed capital in recent years by spending only what we believed was essential to maintain our existing facilities and service levels, and to increase efficiencies. However, continued increases in capital investment are necessary to upgrade our facilities, fleet of vehicles and processing equipment in order to remain operationally viable. Aggressive management of the business operations, as well as legislative and regulatory reforms that will enable us to increase revenue and reduce costs, will all be necessary to restore our financial health.

Our status as an independent establishment of the executive branch that does not receive tax dollars for our operations presents unique requirements and restrictions, but also potentially mitigates some of the financial risk that would otherwise be associated with a cash shortfall. With annual total revenue in 2019 of approximately \$71 billion, a financially sound Postal Service continues to be vital to U.S. commerce.

The U.S. economy benefits greatly from the Postal Service and the many businesses that provide the printing and mailing services that we support. Disruption of the mail would cause undue hardship to businesses and consumers as it would significantly inhibit the remittance of payments through the mail, and in the event of a cash shortfall, the U.S. government would likely prevent us from significantly curtailing or ceasing operations. We continue to inform the executive branch, Congress, the PRC and other stakeholders of the immediate and long-term financial challenges we face and the legislative and regulatory changes that are required to restore our financial stability.

LEGISLATIVE UPDATE

As a self-funded independent establishment of the executive branch, our business model and operations are significantly influenced by congressional oversight and legislation. Additionally, Congress intended for us to be governed by an eleven-member Board of Governors ("Board") which generally consists of our Postmaster General, a Deputy Postmaster General and nine independent governors ("Governors"). The President appoints the Governors with the advice and consent of the Senate. We have six Senate-confirmed Governors currently in office.

APPROPRIATIONS

On July 15, 2020, the House Appropriations Committee approved the *Financial Services and General Government Appropriations Act, 2021* ("H.R. 7668"), which includes \$55.3 million in funding for free mail for the blind and overseas voting. The bill requires continuation of six-day delivery and prohibits any of the appropriated funds from being used to consolidate or close small rural or other small Post Offices. The bill was incorporated into a six-bill appropriations package ("H.R. 7617"), which was amended to additionally prohibit the Postal Service from using any of the appropriated funds to implement any changes to standards and operations that will delay mail delivery,

and to increase funding by \$2 million for the Postal Service to carry out pilot programs to expand its current postal banking services to surcharge free automated teller machines, wire transfers, check cashing, and bill payment. H.R. 7617 was passed by the House on July 31, 2020.

LEGISLATION

On May 15, 2020, the House passed H.R. 6800, the *Health and Economic Recovery Omnibus Emergency Solutions (HEROES) Act*, which would provide \$25 billion for payment to the Postal Service Fund for revenue forgone due to the COVID-19 pandemic, as well as \$15 million for the Postal Service Inspector General to conduct audits and investigations of activities carried out with the funds provided. It would also repeal certain restrictions on the \$10 billion in borrowing authority provided to the Postal Service in the *CARES Act*. The bill is currently awaiting action by the Senate.

H.R. 7015, the *Postal Preservation Act*, introduced in the House on May 26, 2020, would also provide \$25 billion for payment to the Postal Service Fund for revenue forgone due to the COVID-19 pandemic, as well as \$15 million for the Postal Service Inspector General to conduct audits and investigations of activities carried out with the funds provided. The bill was referred to the House Oversight and Reform and Budget Committees.

On July 1, 2020, the House passed H.R. 2, the *Moving Forward Act*, a bill to invest in American infrastructure. The bill would authorize \$25 billion in funding for us for the modernization of our infrastructure and operations, and reserves \$6 billion for the purchase of new vehicles. It would require that any of the authorized funds used to purchase vehicles be spent on electric or zero-emission vehicles to replace our current right-hand-drive vehicles to the maximum extent practicable, mandating that 75 percent of the new fleet be such vehicles. The bill would also require that no less than 50 percent of the total number of new medium or heavy-duty vehicles that we purchase on or before December 31, 2029, be electric or zero-emission vehicles, and that all vehicles purchased after January 1, 2040, be electric or zero-emission. The bill now awaits action in the Senate.

S. 4174, the *Postal Service Emergency Assistance Act*, a bill to provide emergency appropriations to cover losses related to the COVID-19 crisis and to direct the Postmaster General and Board to develop a plan for ensuring our long-term solvency, was introduced in the Senate on July 2, 2020. The bill would establish a Postal Service COVID-19 Emergency Fund within the U.S. Treasury and allow for an appropriation of up to \$25 billion to remain available until September 30, 2022. Prior to accessing these funds, we would be required to certify in its audited quarterly and annual reports to the PRC that there is a need to cover revenue losses or operational expenses resulting from the COVID-19 pandemic. It additionally clarifies that the Secretary of Treasury should make the borrowing authority provided in the *CARES Act* available to us at our request subject to the terms and conditions of the NPA as it was in effect on September 29, 2018. The bill was referred to the Senate Homeland Security and Governmental Affairs Committee.

POSTAL SERVICE REFORM

The 116th Congress has not introduced any major Postal Service reform bills to date. Legislative and regulatory reforms remain critical for us to meet the needs of the American public, and we will continue to work with Congress and all of our stakeholders to enact Postal Service reform legislation.

BOARD OF GOVERNORS

The Board is required by law to have a quorum of six members in order to take certain actions. In December 2014, the Board issued a resolution that established a Temporary Emergency Committee of the Board ("TEC") to exercise certain powers reserved to the Board that are necessary for continuity of operations during a period in which it is unable to assemble a quorum.

For a brief period in June 2020, the Board was reduced to five members and the quorum was not obtained, and the TEC operated during this time. On June 18, 2020, the Senate confirmed the nominations of William Zollars and Donald Lee Moak to serve on the Board. Their appointments to the Board became effective on June 22, 2020, at which time the Board was again able to assemble a quorum.

FAIR VALUE MEASUREMENTS

As required by authoritative accounting literature, certain fair value disclosures for the periods ended June 30, 2020, and September 30, 2019, are discussed in *Item 1. Financial Statements, Notes to Unaudited Financial Statements*. We did not recognize gains as a result of valuation measurements during the three and nine months ended June 30, 2020. All recognized losses have been incorporated into our financial statements as of June 30, 2020. See *Item 1. Financial Statements, Notes to Unaudited Financial Statements, Note 13 - Fair Value Measurement*.

RELATED PARTY TRANSACTIONS

As disclosed throughout this quarterly report, we have significant transactions with other U.S. government entities, which are considered related parties for reporting purposes. For a more detailed description, see *Item 1. Financial Statements, Notes to Unaudited Financial Statements, Note 5 - Related Parties*.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in accordance with GAAP requires management to make significant judgments and estimates to develop certain amounts reflected and disclosed in the financial statements. In many cases, alternative policies or estimation techniques may be used.

We maintain a thorough process to review the application of accounting policies and to evaluate the appropriateness of the many estimates that are required to prepare the financial statements of a large organization. However, even under optimal circumstances, estimates routinely require adjustment based on changing circumstances and new or better information.

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

RECENT ACCOUNTING STANDARDS

See *Item 1. Financial Statements, Notes to Unaudited Financial Statements, Note 2 - Recent Accounting Pronouncements*, for a description of recently announced accounting standards.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

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

We also have provisions in our debt agreements that allow us to prepay our \$14.4 billion debt at any time at a price determined by the Secretary of the Treasury, based on prevailing interest rates in the U.S. Treasury market at the time of repayment.

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

ITEM 4. CONTROLS AND PROCEDURES

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

DISCLOSURE CONTROLS

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

We carried out an evaluation under the supervision and with the participation of management, including the Postmaster General and the Chief Financial Officer, of the effectiveness of the design and operation of disclosure controls and procedures as of June 30, 2020. Based upon and as of the date of the evaluation, the Postmaster General and the Chief Financial Officer concluded that our disclosure controls and procedures were effective.

INTERNAL CONTROLS

We have made no changes in our internal control over financial reporting during the three months ended June 30, 2020, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

For a discussion of legal proceedings affecting us, please refer to *Item 1. Financial Statements, Notes to Unaudited Financial Statements* and *Note 8 - Commitments and Contingencies*, as well as our Annual Report.

ITEM 1A. RISK FACTORS

No material changes have transpired in our risk factors from those disclosed in *Item 1A. Risk Factors* of our Annual Report and in *Item 1A. Risk Factors* of our quarterly report for the period ended March 31, 2020.

ITEM 6. EXHIBITS

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

Signatures

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

United States Postal Service

/s/Louis DeJoy

Louis DeJoy

Postmaster General and Chief Executive Officer

Date: August 6, 2020

/s/Joseph Corbett

Joseph Corbett

Chief Financial Officer and Executive Vice
President

Date: August 6, 2020

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

I, Louis DeJoy, certify that:

1. I have reviewed this quarterly report on Form 10-Q of the United States Postal Service ("Postal Service");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Postal Service as of, and for, the periods presented in this report;
4. The Postal Service's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Postal Service and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Postal Service, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the Postal Service's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the Postal Service's internal control over financial reporting that occurred during the Postal Service's most recent fiscal quarter (the Postal Service's fourth fiscal quarter in the case of an Annual Report) that has materially affected, or is reasonably likely to materially affect, the Postal Service's internal control over financial reporting; and
5. The Postal Service's other certifying officer and I have disclosed based on our most recent evaluation of internal control over financial reporting, to the Postal Service's independent registered accounting firm and the Audit and Finance Committee of the Postal Service's Board of Governors:
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Postal Service's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have significant role in the Postal Service's internal control over financial reporting.

Date: August 6, 2020

/s/Louis DeJoy

Louis DeJoy

Postmaster General and Chief Executive Officer

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

I, Joseph Corbett, certify that:

1. I have reviewed this quarterly report on Form 10-Q of the United States Postal Service ("Postal Service");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Postal Service as of, and for, the periods presented in this report;
4. The Postal Service's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Postal Service and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Postal Service, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the Postal Service's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the Postal Service's internal control over financial reporting that occurred during the Postal Service's most recent fiscal quarter (the Postal Service's fourth fiscal quarter in the case of an Annual Report) that has materially affected, or is reasonably likely to materially affect, the Postal Service's internal control over financial reporting; and
5. The Postal Service's other certifying officer and I have disclosed based on our most recent evaluation of internal control over financial reporting, to the Postal Service's independent registered accounting firm and the Audit and Finance Committee of the Postal Service's Board of Governors:
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Postal Service's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have significant role in the Postal Service's internal control over financial reporting.

Date: August 6, 2020

/s/Joseph Corbett

Joseph Corbett

Chief Financial Officer and Executive Vice President

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

In connection with the Quarterly Report of the United States Postal Service ("Postal Service") on Form 10-Q for the period ended June 30, 2020, (the "Report"), I, Louis DeJoy, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the *Sarbanes-Oxley Act of 2002* that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the *Securities Exchange Act of 1934*; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Postal Service.

Dated: August 6, 2020

/s/Louis DeJoy

Louis DeJoy

Postmaster General and Chief Executive Officer

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

In connection with the Quarterly Report of the United States Postal Service ("Postal Service") on Form 10-Q for the period ended June 30, 2020, (the "Report"), I, Joseph Corbett, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the *Sarbanes-Oxley Act of 2002* that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the *Securities Exchange Act of 1934*; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Postal Service.

Dated: August 6, 2020

/s/Joseph Corbett

Joseph Corbett

Chief Financial Officer and Executive Vice President