

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

FORM 10-Q

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED June 30, 2012 OR**
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _____ TO**

Commission File Number: N/A

UNITED STATES POSTAL SERVICE

(Exact name of registrant as specified in its charter)

Washington, D.C.
(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, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Not Applicable

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

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

Common Stock

No Common Stock

Outstanding Shares as of August 9, 2012

N/A

United States Postal Service Quarterly Financial Report Index

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Part I

Item 1 – Financial Statements

United States Postal Service Statements of Operations (Unaudited)

(Dollars in millions)	Three Months ended June 30,		Nine Months Ended June 30,	
	2012	2011	2012	2011
Operating revenue	\$ 15,613	\$ 15,766	\$ 49,517	\$ 49,877
Operating expenses				
Compensation and benefits	11,745	11,806	35,929	36,336
Retiree health benefits	3,712	1,995	11,104	5,943
Workers' compensation	1,486	802	2,255	1,000
Transportation	1,604	1,557	5,048	4,770
Other	2,208	2,671	6,706	7,375
Total operating expenses	<u>20,755</u>	<u>18,831</u>	<u>61,042</u>	<u>55,424</u>
Loss from operations	(5,142)	(3,065)	(11,525)	(5,547)
Interest and investment income	6	6	18	19
Interest expense	(49)	(41)	(142)	(129)
Net loss	<u>\$ (5,185)</u>	<u>\$ (3,100)</u>	<u>\$ (11,649)</u>	<u>\$ (5,657)</u>

See accompanying notes to the financial statements. (unaudited)

**United States Postal Service
Balance Sheets - Assets**

(Dollars in millions)	June 30, 2012	September 30, 2011
	(Unaudited)	(Audited)
Current Assets		
Cash and cash equivalents	\$ 893	\$ 1,488
Receivables:		
Foreign countries	538	669
U.S. Government	98	154
Other	243	255
Receivables before allowances	879	1,078
Less: Allowances	38	37
Total receivables, net	841	1,041
Supplies, advances and prepayments	134	120
Total Current Assets	1,868	2,649
Noncurrent Assets		
Property and equipment, at cost:		
Buildings	24,473	24,263
Equipment	20,245	20,409
Land	2,928	2,952
Leasehold improvements	1,179	1,112
	48,825	48,736
Less: Allowances for depreciation and amortization	29,929	29,023
	18,896	19,713
Construction in progress	365	624
Total property and equipment, net	19,261	20,337
Other assets - principally revenue forgone receivable	379	427
Total Noncurrent Assets	19,640	20,764
Total Assets	\$ 21,508	\$ 23,413

See accompanying notes to the financial statements. (unaudited)

United States Postal Service
Balance Sheets - Liabilities and Net Deficiency

(Dollars in millions)	June 30, 2012 (Unaudited)	September 30, 2011 (Audited)
Current Liabilities		
Compensation and benefits	\$ 2,239	\$ 2,338
Retiree health benefits	9,222	7
Workers' compensation	1,320	1,255
Payables and accrued expenses:		
Trade payables and accrued expenses	997	1,041
Foreign countries	608	652
U.S. government	99	119
Total payables and accrued expenses	<u>1,704</u>	<u>1,812</u>
Deferred revenue-prepaid postage	3,942	3,497
Customer deposit accounts	1,278	1,386
Outstanding postal money orders	721	688
Prepaid box rent and other deferred revenue	488	502
Short-term portion of debt	7,135	7,500
Total Current Liabilities	<u>28,049</u>	<u>18,985</u>
Noncurrent Liabilities		
Workers' compensation costs	14,773	13,887
Employees' accumulated leave	2,057	2,082
Deferred appropriation and other revenue	276	326
Long-term portion capital lease obligations	424	460
Deferred gains on sales of property	315	345
Contingent liabilities and other	703	768
Long-term portion of debt	5,500	5,500
Total Noncurrent Liabilities	<u>24,048</u>	<u>23,368</u>
Total Liabilities	52,097	42,353
Net Deficiency		
Capital contributions of the U.S. Government	3,132	3,132
Deficit since 1971 reorganization	(33,721)	(22,072)
Total Net Deficiency	<u>(30,589)</u>	<u>(18,940)</u>
Total Liabilities and Net Deficiency	<u>\$ 21,508</u>	<u>\$ 23,413</u>

See accompanying notes to the financial statements. (unaudited)

United States Postal Service
Changes in Net Deficiency
(Unaudited)

(Dollars in millions)	Capital Contributions of U.S. Government	Deficit Since Reorganization	Total Net Deficiency
Balance, September 30, 2010	\$ 3,132	\$ (17,005)	\$ (13,873)
Net loss	-	(5,657)	(5,657)
Balance, June 30, 2011	<u>\$ 3,132</u>	<u>\$ (22,662)</u>	<u>\$ (19,530)</u>
Balance, September 30, 2011	\$ 3,132	\$ (22,072)	\$ (18,940)
Net loss	-	(11,649)	(11,649)
Balance, June 30, 2012	<u>\$ 3,132</u>	<u>\$ (33,721)</u>	<u>\$ (30,589)</u>

See accompanying notes to the financial statements. (unaudited)

United States Postal Service
Statements of Cash Flows
(Unaudited)

(Dollars in millions)	Nine Months Ended	
	June 30, 2012	June 30, 2011
Cash flows from operating activities:		
Net loss	\$ (11,649)	\$ (5,657)
Adjustments to reconcile net loss to cash provided by operations:		
Depreciation and amortization	1,579	1,738
Loss (gain) on disposals of property and equipment, net	6	(5)
Increase in other assets - primarily appropriations receivable revenue forgone	23	13
Increase (decrease) in noncurrent workers' compensation liability	886	(231)
Decrease in noncurrent employees accumulated leave	(25)	(40)
Decrease in noncurrent deferred appropriations and other revenue	(3)	(2)
(Decrease) increase in other noncurrent liabilities	(65)	441
Changes in current assets and liabilities:		
Receivables, net	185	15
Supplies, advances and prepayments	(14)	(6)
Compensation and benefits	(99)	(946)
Retiree health benefits	9,215	4,125
Workers' compensation	65	55
Payables and accrued expenses	(108)	(242)
Customer deposit accounts	(108)	(62)
Deferred revenue-prepaid postage	445	744
Outstanding postal money orders	33	7
Prepaid box rent and other deferred revenue	(41)	(1)
Net cash provided by (used in) operating activities	325	(54)
Cash flows from investing activities:		
Purchases of property and equipment	(575)	(893)
Proceeds from deferred building sale	38	12
Proceeds from sales of property and equipment	65	68
Net cash used in investing activities	(472)	(813)
Cash flows from financing activities:		
Issuance of notes payable	3,700	3,700
Payments on notes payable	(4,100)	(2,400)
Net change in revolving credit line	35	(608)
Payments on capital lease obligations	(36)	(38)
U.S. Government appropriations - expensed	(47)	(47)
Net cash (used in) provided by financing activities	(448)	607
Net decrease in cash and cash equivalents	(595)	(260)
Cash and cash equivalents at beginning of year	1,488	1,161
Cash and cash equivalents at end of period	\$ 893	\$ 901
Supplemental cash flow disclosures:		
Interest paid	\$ 142	\$ 128

See accompanying notes to the financial statements. (unaudited)

Notes to Financial Statements (Unaudited)

Note 1 – Basis of Presentation

The interim financial statements have been prepared in accordance with United States (U.S.) generally accepted accounting principles (GAAP) for interim financial statements and, accordingly, do not include all the information and footnotes required by GAAP for complete financial statements. These interim financial statements should be read in conjunction with the significant accounting policies and other disclosures in the Annual Report on Form 10-K for the year ended September 30, 2011. As in the Annual Report on Form 10-K, all references to years are to the fiscal year beginning October 1 and ending September 30, unless otherwise stated. All references to quarters, unless otherwise indicated, are to quarters within fiscal years 2012 and 2011.

In Quarter II, 2012, the Postal Service improved the estimation technique employed to estimate deferred revenue-prepaid postage for Forever Stamps. The Postal Service obtained new information regarding its customers' stamp usage and retention habits. This enabled the Postal Service to update its estimate of stamps that will never be used for mailing. As a result of this enhancement, deferred revenue-prepaid postage was decreased by \$59 million. The change was accounted for as a change in accounting estimate, and was therefore reflected in operating results as an increase to revenue in Quarter II, 2012.

In the opinion of management, the accompanying unaudited interim financial statements reflect all adjustments (including normal recurring adjustments) necessary to fairly present the financial position of the Postal Service as of June 30, 2012, and the results of operations and cash flows for the three and nine months ended June 30, 2012, and 2011. Operating results for the three and nine month periods ended June 30, 2012, are not necessarily indicative of the results that may be expected for all of fiscal year 2012. Subsequent events have been evaluated through August 9, 2012, the date the Postal Service filed its Form 10-Q for the quarter ended June 30, 2012, with the Postal Regulatory Commission (PRC).

The Postal Service has significant transactions with other U.S. Government agencies, as disclosed throughout this report. In addition to the amounts disclosed elsewhere, deferred revenue of \$27 million at June 30, 2012, and \$39 million at September 30, 2011, related to government deposits are included in the Balance Sheets in "Customer Deposit Accounts".

Note 2 – Subsequent Events

As noted in *Note 8- Health Benefit Programs*, in the Notes to the Financial Statements, the Postal Service was required to pay a \$5.5 billion prefunding payment to the Postal Service Retiree Health Benefit Fund (PSRHBF) by August 1, 2012. However, due to insufficient cash resources, the Postal Service was unable to make this payment and was forced to default. The statutory requirement establishing the payment schedule (*Postal Accountability and Enhancement Act*, Public Law 109-435 (P.L. 109-435)) contains no provisions addressing a payment default, so the Postal Service is uncertain what consequences, if any, will result. The Postal Service did, however, advise all its stakeholders of the imminent default, including the White House and the Congress.

As noted in previous filings, the Postal Service has asked Congress numerous times to restructure the PSRHBF prefunding payment schedule. To date, the 2007, 2008 and 2010 payments were paid in full. The \$5.4 billion payment due in 2009 was reduced (P.L. 111-68) by \$4.0 billion to \$1.4 billion. The 2011 payment of \$5.5 billion, initially due by September 30, 2011, was rescheduled a number of times, finally to August 1, 2012 (P.L. 112-74). Further, current law obligates the Postal Service to make a payment of \$5.6 billion by September 30, 2012, and additional payments of \$5.6 billion in 2013, \$5.7 billion in 2014 and 2015, and \$5.8 billion in 2016, each due by September 30 of each respective year.

On June 28, 2012, the Chairman of the Postal Service's Board of Governors and the Postmaster General informed the White House and Members of Congress that, absent intervening legislative action, the Postal Service would be forced to default on the August 1, 2012, prefunding payment of \$5.5 billion. Additionally, if there are no legislative changes, the Postal Service will default on the \$5.6 billion

prefunding payment due by September 30, 2012, and it sees no current means to satisfy the future payment of \$5.6 billion due by September 30, 2013.

While the President proposed comprehensive postal reform measures in the fiscal year 2012 budget and the Congress is actively considering bills that would comprehensively address the retiree health benefits prefunding and other postal reform measures, no legislative solution has yet been enacted. Therefore, the Postal Service remains statutorily obligated to pay PSRHBFB prefunding payments. However, given the low levels of the Postal Service's cash resources, it will be forced to prioritize payments to employees and suppliers to ensure that the Postal Service continues to be able to fulfill its other statutory obligations, including its obligation to provide universal mail service to the nation (as discussed in *Note 3 – Liquidity*).

In accordance with GAAP, the Postal Service has been accruing the full \$5.5 billion payment due by August 1, 2012, in equal amounts over the previous nine months. As of June 30, 2012, the financial statements include \$5.0 billion of the \$5.5 billion due by August 1, 2012, and \$4.2 billion of the \$5.6 billion due by September 30, 2012.

Note 3 – Liquidity

SUMMARY OF PROJECTED CASH SHORTFALL

The Postal Service continues to suffer from a severe lack of liquidity caused by over \$25 billion of cumulative net losses in the past five fiscal years. These losses were largely driven by \$21 billion of Congressionally-mandated payments for prefunding retiree health benefits. During those five years, the Postal Service's debt has increased by nearly \$11 billion to finance the losses and prefunding payments.

The trend of losses continues this year, as the Postal Service had net losses of \$5,185 million and \$11,649 million for the three and nine months ended June 30, 2012. These 2012 losses were largely the result of expenses for prefunding retiree health benefits of \$3,050 million and \$9,150 million for the three and nine months, respectively. In addition, the Postal Service's liquidity was limited to \$893 million of total cash and \$2.4 billion of remaining borrowing capacity on its \$15 billion debt facility at June 30, 2012.

As described in *Note 2 – Subsequent Events*, the Postal Service was forced to default on the required \$5.5 billion prefunding payment for retiree health benefits which was due by August 1, 2012. Further, the Postal Service notified the White House, the Congress, and OPM, that absent legislative change, it will also default on the \$5.6 billion payment due by September 30, 2012.

Even without making \$11.1 billion of scheduled PSRHBFB payments in the fourth quarter of 2012, current projections indicate that the Postal Service will have a low level of cash and liquidity at September 30, 2012. This position will worsen in October of 2012, when the Postal Service is required to make its annual reimbursement payment of approximately \$1.4 billion to the Department of Labor (DOL) for workers' compensation, in addition to paying its normal operating expenses. Although the cash position is projected to improve slightly for a few months during the fall mailing season, current projections indicate that, by spring 2013, the Postal Service will again have a low level of cash and borrowing capacity. Further, these projections also indicate that the Postal Service will be unable to make the \$5.6 billion prefunding payment due by September 30, 2013.

To address its long-term financial challenges, the Postal Service released in February 2012, a comprehensive five-year plan to achieve financial stability and repay debt. The Postal Service is aggressively pursuing new revenue streams, improving productivity and reducing costs in areas within its control. Additionally, the Postal Service has proposed legislative changes to Congress that are needed to provide it with the legal authority to implement certain measures to increase efficiency and cost savings, as specified in the plan. Legislation has been introduced in both houses of Congress and a bill has been passed by the Senate. The bill passed in the Senate, although representing a positive step, does not contain the authority necessary to implement all required improvements to increase productivity and cost savings. Given the vital role that the Postal Service plays in the U.S. economy, the Postal Service is requesting that Congress take the steps needed to enact legislative changes that will enable it to return to financial stability.

In the short-term, should circumstances leave the Postal Service with insufficient liquidity, it would consider emergency measures to ensure that mail deliveries continue. These measures could require that the Postal Service prioritize payments to its employees and suppliers ahead of those to the Federal Government. Additionally, the Postal Service continues to seek a refund of the overfunding of its Federal Employees' Retirement System (FERS) retirement plan, which currently amounts to approximately \$11 billion, as those funds would help alleviate short-term liquidity risks.

POSTAL INITIATIVES UNDERTAKEN TO IMPROVE LIQUIDITY

As noted in previous filings, the Postal Service has removed nearly \$14 billion from its annual cost base during the past five fiscal years. The Postal Service plans to continue its efforts to improve productivity and generate cost savings, as outlined in its five-year plan, to return to financial stability and repay debt. Many of the strategies that the Postal Service is aggressively pursuing are currently within its control. These include rationalizing the mail processing, retail and delivery networks in order to better align them with mail volumes, increasing revenue generation, and reducing workforce costs. Certain parts of the plan, such as transitioning to a five-day per week delivery schedule, obtaining a refund of \$11 billion overfunding in the FERS, and resolving the prefunding of retiree health benefits are beyond the control of management and require enactment of legislation.

Management is pursuing a strategy to increase the efficiency of its mail processing network. This requires a reduction in the number of mail processing and distribution plants and the rescheduling of transportation routes. In response to declining mail volumes, the Postal Service has already consolidated over 200 mail processing facilities in the past five years while continuing to provide record delivery service and to increase productivity. On May 17, 2012, the Postal Service announced a modified, phased plan to continue the consolidation of its network of 461 mail processing locations. The first phase will result in up to 140 consolidations through February 2013. Unless the Postal Service's circumstances change, a second and final phase of 89 additional consolidations is currently scheduled to begin in February 2014.

The Postal Service is also working to increase the efficiency and reduce the costs of its retail network, while continuing to provide excellent service to all communities throughout America. On May 9, 2012, the Postal Service announced a strategy to preserve the Post Offices serving rural America while providing a framework to achieve significant cost savings. This strategy, called the POSTPlan, will allow Post Offices to remain operational with modified window hours and will also allow the affected towns to retain their ZIP Codes.

Along with the operational changes discussed above, the Postal Service is seeking to reduce workload and staffing by better aligning staffing levels with projected mail volume. It is expected that this will be achieved largely through attrition, as approximately one-half of career employees are eligible for retirement or early retirement. In Quarter III, 2012, two voluntary incentive separation offers were announced: one to approximately 21,000 postmasters with an incentive of \$20,000 and one to approximately 45,000 mail handlers with an incentive of \$15,000. The incentives for both programs will be payable in two equal installments on December 21, 2012, and on December 20, 2013. To receive the incentive, eligible employees were required to have formally accepted the incentive to leave the Postal Service by July 2, 2012. Approximately 8,000 employees accepted the incentive offer and will leave the Postal Service no later than August 31, 2012. In compliance with GAAP, the full amount of the incentive payments will be recorded as an expense in Quarter IV, 2012 although the cash payments will be paid in future periods.

The Postal Service continues to implement innovative new products to generate new revenue and to prevent existing revenue streams from migrating to electronic alternatives. Existing products and online services have been enhanced with "ease of use" in mind in an effort to grow business. However, it is not possible to achieve financial stability through revenue initiatives alone, without a fundamental change in the business model.

As mentioned above, portions of the Postal Service's plan require targeted legislative changes. One legislative change sought by the Postal Service is a directive for the return of the overfunding of the FERS contributions. The Office of Personnel Management (OPM) has determined that the amount of

overfunding was approximately \$11 billion as of September 2011. Although the refund would not be a recurring annual savings, it would provide vital cash flow to help ease the current liquidity difficulties.

Additionally, the Postal Service has proposed that it sponsor its own health care program independent of other federal health insurance programs. Establishing a Postal Service-sponsored health care program would account for over \$7 billion of projected annual savings. The plan would allow for the elimination of the retiree health benefit prefunding obligation established in the *Postal Service Accountability and Enhancement Act of 2006*, which would save the Postal Service over \$5 billion dollars annually through 2016. The plan also proposes to transfer current retirees into the Postal Service-sponsored health care program, an action that requires legislation. The Postal Service's plan is expected to be more cost effective, is forecasted to reduce health care costs significantly, and will result in equivalent or better coverage for the vast majority of retirees and current employees.

MITIGATING CIRCUMSTANCES

The Postal Service's status as an independent establishment of the executive branch that does not receive tax dollars for its operations presents unique requirements and restrictions, but also potentially mitigates some of the financial risk that would otherwise be associated with a cash shortfall. Despite falling mail volume, the Postal Service is still widely recognized as the provider of an essential government service to the American people and for its importance in the \$1 trillion mailing industry. There are a few potential legislative remedies that could resolve the short-term liquidity concerns. Therefore, it is unlikely that, in the event of a cash shortfall, the Federal Government would cause or allow the Postal Service to significantly curtail or cease operations.

More than a dozen different postal reform-related bills have been introduced in the 112th Congress, in addition to a plan proposed by the Administration. On April 25, 2012, the Senate passed S. 1789, the *21st Century Postal Service Act of 2012*, which includes provisions to refund the Postal Service's FERS overfunding, permit five-day mail delivery after two years (under certain conditions), and reduce funding of PSRHB, but also restricts service standard changes. A House bill H.R. 2309, the *Postal Reform Act of 2011* is out of committee but has not yet reached the floor for a full House vote. No individual bill proposed or passed in either the House or Senate contains all the necessary components to ensure the long-term financial viability of the Postal Service. The Postal Service continues to inform the White House, Congress, the Postal Regulatory Commission (PRC), and other stakeholders of the immediate and longer-term financial issues the Postal Service faces and the legislative changes that would help provide financial stability. Given the vital role the Postal Service plays in the U.S. economy, the Postal Service is hopeful that Congress will enact, and the President will sign, legislation which will mitigate the Postal Service's short-term financial challenges and provide it with the authority to make needed changes to ensure long-term financial stability. However, there can be no assurances that the requests to restructure the PSRHB prefunding payment schedule, or any other legislative changes, will be made in time to impact 2012, or at all.

Note 4 – Debt

Debt payable to the Federal Financing Bank (FFB), a government-owned corporation under the general supervision of the Secretary of the Treasury, consisted of the following at June 30, 2012 and September 30, 2011:

Indebtedness to Federal Financing Bank						
(Dollars in millions)						
Maturity	Debt Type	June 30, 2012		September 30, 2011		
		Balance	Rate	Balance	Rate	
		<u>(Unaudited)</u>		<u>(Audited)</u>		
Fixed rate notes - short term						
October 20, 2011	Fixed rate-payable at maturity	\$ -	- %	\$ 1,300	0.338	%
November 17, 2011	Fixed rate-payable at maturity	-	-	1,200	0.201	
November 15, 2012	Fixed rate-payable at maturity	1,300	0.227	-	-	
May 30, 2013	Fixed rate-payable at maturity	1,200	0.298	-	-	
Fixed rate notes - long term						
January 31, 2014	Fixed rate-payable at maturity	300	2.035	300	2.035	
May 2, 2016	Fixed rate-payable at maturity	300	2.844	300	2.844	
November 15, 2018	Fixed rate-payable at maturity	500	3.048	500	3.048	
February 15, 2019	Fixed rate-payable at maturity	700	3.296	700	3.296	
May 15, 2019	Fixed rate-payable at maturity	1,000	3.704	1,000	3.704	
May 15, 2019	Fixed rate-payable at maturity	500	3.513	500	3.513	
August 16, 2021	Fixed rate-payable at maturity	1,000	2.066	1,000	2.066	
May 17, 2038	Fixed rate-payable at maturity	200	3.770	200	3.770	
February 15, 2039	Fixed rate-payable at maturity	1,000	3.790	1,000	3.790	
Floating rate notes and revolving credit line - short term						
December 15, 2011	Floating rate	-	-	700	0.135	
June 15, 2012	Floating rate	-	-	300	0.135	
June 15, 2012	Floating rate	-	-	800	0.135	
December 14, 2012	Floating rate ¹	700	0.227	-	-	
October 15, 2012	Floating rate ²	700	0.218	-	-	
	Short-term revolving credit line	2,935	0.186	3,200	0.125	
	Overnight revolving credit line	300	0.166			
Total debt		\$ 12,635		\$ 13,000		
Current portion of debt		\$ 7,135		\$ 7,500		
Long-term portion of debt		\$ 5,500		\$ 5,500		

¹ Floating Rate Note — Repurchasable at par on each interest rate reset date and the interest rate resets on September 14, 2012.

² Floating Rate Note — Repurchasable at par on each interest rate reset date and the interest rate resets on July 16, 2012.

The Postal Service has two credit lines with the FFB, both of which are available until May 2013. One, a short-term credit line, enables it to draw up to \$3,400 million with two days prior notice. Borrowings under this credit line are typically on an overnight basis, but can have a maximum term of up to one year. The second credit facility, which only allows for borrowings on an overnight basis, enables borrowings of up to \$600 million on the same business day that funds are requested. In addition, the Postal Service can use a series of other notes with varying provisions to draw upon with two days prior notice. These credit facilities and note arrangements provide the flexibility to borrow short- or long-term, using fixed- or floating-rate notes. Fixed-rate notes can be either callable or non-callable at the option of the Postal Service. Debt, all of which is unsecured and not subject to sinking fund requirements, can be repaid at any time at a price determined by the Secretary of the Treasury, based on prevailing interest rates in the Treasury Security market at the time of repayment.

The Postal Service is limited by statute to net annual debt increases of \$3 billion. Total debt cannot exceed \$15 billion. For 2012, the amount of any additional borrowing is constrained by the total debt ceiling limitation of \$15 billion, allowing a \$2 billion increase in the year over the September 30, 2011 balance of \$13 billion.

Scheduled principal repayments, exclusive of capital leases, as of June 30, 2012, are as follows:

Scheduled Debt Principal Repayments - By Fiscal Year	
(Dollars in millions)	
	(Unaudited)
2012	\$ 3,235
2013	3,900
2014	300
2015	-
2016	300
After 2016	4,900
Total Debt	\$ 12,635

Note 5 – Property and Equipment

Property and equipment are recorded at cost, which includes the interest on borrowings used to pay for the construction of major capital additions. Interest capitalized during the three and nine month periods ended June 30, 2012 and 2011 was not significant. Property and equipment are depreciated over estimated useful lives that range from 3 to 40 years, except for buildings with historic status, which are depreciated over 75 years, using the straight-line method.

Assets classified as held for sale of \$133 million as of June 30, 2012, and \$58 million as of September 30, 2011, are included on the Balance Sheets in “Land” and “Buildings”. Impairment charges for the three and nine month periods ended June 30, 2012, were \$8 million and \$36 million, respectively, as compared to \$6 million and \$21 million, for the three and nine month periods ended June 30, 2011, respectively.

In September 2011, the Postal Service announced plans to realign its mail processing, delivery, and retail networks. These plans were further modified in 2012. See *Note 3 - Liquidity* for details. As a result, an initial assessment was performed on both the real estate and equipment associated with the proposed realignment efforts to determine if any impairment should be recognized. As of June 30, 2012, the Postal Service is continuing to evaluate the potential consolidation of facilities that are impacted by the network realignment efforts. For the facilities being consolidated during the fourth quarter of 2012, and through February 2013, any facility identified as lacking utility to the network will be marked for disposal. Once a property is marked for disposal, determination of impairments, if any, will be made by management. For the three and nine-months ended June 30, 2012, there were no significant impairment charges related to these plans.

Note 6 – Leases and Other Commitments

Leases

At June 30, 2012, the future minimum payments on non-cancelable operating and capital leases were as follows:

Lease Obligations		
(Dollars in millions)	Operating	Capital
(Unaudited)		
2012	\$ 195	\$ 25
2013	723	98
2014	665	92
2015	605	90
2016	536	87
After 2016	4,212	292
Total Lease Obligations	\$ 6,936	\$ 684
Less: Interest		203
Total Capital Lease Obligations		\$ 481
Less: Current portion of Capital Lease Obligations		57
Long-term portion of Capital Lease Obligations		\$ 424

The current portion of the capital lease obligation is included in "Trade payables and accrued expenses" on the Balance Sheets.

Rent expense for the three and nine month periods ended June 30, 2012, and 2011, was as follows:

Rental Expense	Three Months Ended		Nine Months Ended	
(Dollars in millions)	June 30,		June 30,	
(Unaudited)	2012	2011	2012	2011
Non-cancelable real estate leases including related taxes	\$ 223	\$ 232	\$ 710	\$ 727
Facilities leased from GSA* subject to 120-day cancellation	11	10	31	31
Equipment and other short-term rentals	40	39	130	113
Total Rental Expense	\$ 274	\$ 281	\$ 871	\$ 871

*General Services Administration

Capital Commitments

At June 30, 2012, commitments to acquire capital assets were \$482 million, compared to \$881 million at September 30, 2011, as summarized in the following table:

Capital Commitments	As of	
(Dollars in millions)	June 30, 2012	September 30, 2011
(Unaudited)	(Unaudited)	(Audited)
Mail Processing Equipment	\$ 265	\$ 481
Building Improvements, Construction, and Building Purchase	200	320
Postal Support Equipment	11	75
Vehicles	6	5
Total Capital Commitments	\$ 482	\$ 881

Note 7 – Contingent Liabilities

Contingent liabilities consist mainly of claims and lawsuits resulting from labor, employment, and environmental matters, property damage claims, injuries on postal properties, issues arising from postal contracts, personal claims, and traffic accidents.

Contingent Liabilities (Dollars in millions)	As of	
	June 30, 2012 (Unaudited)	September 30, 2011 (Audited)
Labor - Employment	\$ 660	\$ 662
Environmental	48	48
Tort	42	39
Contractual	12	13
Total Contingent Liabilities	\$ 762	\$ 762

Each quarter, significant new claims and litigation are evaluated for the probability of an adverse outcome. If the claim is deemed probable of an unfavorable outcome and the amount of the potential resolution is reasonably estimable, a liability for the loss is recorded. Each quarter, any pre-existing claims and litigation are reviewed and adjusted for resolutions or revisions to prior estimates. This evaluation of cases did not result in a net change to the liability for the nine months ended June 30, 2012, as compared to prior year end. The table summarizes contingent liabilities provided for in the Postal Service's financial statements as of the dates indicated.

As previously reported, on January 14, 2010, the Equal Employment Opportunity Commission's (EEOC) Office of Federal Operations certified a class action case against the Postal Service in a matter captioned *McConnell v. Donahoe* (first instituted in 2006). The class currently consists of all permanent rehabilitation employees and limited duty employees who have been subjected to the National Reassessment Process (NRP) from May 5, 2006, to July 1, 2011. The Postal Service used the NRP to ensure that its records were correct and that employees receiving workers' compensation benefits were placed in jobs consistent with their abilities. The 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 creation by the NRP 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 on behalf of a yet unidentified population of employees. If the plaintiffs were able to prove their allegations in this matter and to establish the damages they assert, then an adverse ruling could have a material adverse impact on the Postal Service. However, the Postal Service disputes the claims asserted in this class action case and is vigorously contesting the matter. There was no material change in the status of this case during the nine months ended June 30, 2012.

Based on currently available information, adequate provision has been made for probable losses arising from claims and suits. The current portion of this liability of \$112 million at June 30, 2012, and \$72 million as of September 30, 2011, is included on the Balance Sheets in "Trade payables and accrued expenses". The long-term portion of this liability was \$650 million at June 30, 2012, and \$690 million at September 30, 2011, and is included on the Balance Sheets in "Contingent liabilities and other".

In addition to the amounts accrued in the financial statements, the Postal Service also has claims and lawsuits which it deems reasonably possible of an unfavorable outcome which range from \$650 million to \$675 million at June 30, 2012. No provisions for these reasonably possible losses are accrued or included in the financial statements.

Note 8 – Health Benefits Programs

CURRENT EMPLOYEES HEALTH BENEFITS

Substantially all career employees are covered by the Federal Employees Health Benefits Program (FEHBP). The Office of Personnel Management (OPM) administers the program and allocates the cost of the program to the participating government agency employers. The Postal Service cannot direct the costs, benefits, or funding requirements of the plan and, therefore, accounts for program expenses using accounting standards for multiemployer plans. The Postal Service portion of the cost is based on the weighted-average premium cost of the various employee coverage choices and the specific coverage choices made by current employees. Employees paid approximately 22% of the premium costs in the three months ended June 30, 2012, and 2011. For the nine months ended June 30, 2012 and 2011, employees paid approximately 22% and 21% of premium costs, respectively, while the Postal Service paid the remainder. The employer share of health care expense was \$1,292 million and \$1,311 million in Quarter III, 2012, and 2011, respectively. For the nine months ended June 30, 2012, and 2011, the employer share of health care expense was \$3,902 million, and \$3,906 million, respectively. These expenses are included in "Compensation and benefits" in the Statements of Operations.

RETIREE HEALTH BENEFITS

Employees who participate in the FEHBP for at least the five years immediately before retirement may participate in the FEHBP during retirement. The Postal Service is required to pay the employer's share of health insurance premiums for all retired postal employees and their survivors who participate in the FEHBP and who retired on or after July 1, 1971. Costs attributable to federal civil service before that date are not included.

Because the Postal Service cannot direct the costs, benefits or funding requirements for the federally-sponsored plan, it accounts for these retiree costs using accounting standards for multiemployer plans and records expenses in the year in which payments are due to OPM.

In addition to payments to OPM for the Postal Service's share of FEHBP retiree premiums, the *Postal Accountability and Enhancement Act*, Public Law 109-435 (P.L. 109-435) as amended, established the Postal Service Retiree Health Benefit Fund (PSRHBF), which requires prefunding of retiree health benefit premiums from 2007 through 2016. The current schedule as of June 30, 2012 of these remaining prefunding payments is as follows:

Postal Service Retiree Health Benefit Fund Commitment	
(Dollars in millions)	P.L. 109-435 Requirement
	(Unaudited)
2012	\$ 11,100
2013	5,600
2014	5,700
2015	5,700
2016	5,800
Total Postal Service Retiree Health Benefit Fund Commitment	\$ 33,900

Although P.L. 109-435 includes a ten year, \$55,800 million payment prefunding schedule that dictates the amounts and timing of payments through 2016, the amounts to be paid and the timing of the payments can be rescheduled at any time with the passage of a new law, or amendment of the existing law. On October 1, 2009, P.L. 111-68, *Continuing Appropriations Resolution, 2010*, decreased the scheduled payment in 2009 by \$4.0 billion — from \$5.4 billion to \$1.4 billion. This law affected only the payment scheduled in 2009 and did not reschedule any future payment requirements. On September 30, 2011, P.L. 112-33, *Continuing Appropriations Act, 2012*, rescheduled the required PSRHBF payment of \$5.5 billion scheduled to be due by September 30, 2011, to be due by October 4, 2011. This was then rescheduled again by five subsequent laws. P.L. 112-74, *Consolidated Appropriations Act, 2012*, the most recent law affecting the PSRHBF payment, rescheduled the due date of the \$5.5 billion originally

due September 30, 2011 to August 1, 2012. As a result, the total required PSRHBF payment in 2012 is \$11.1 billion: \$5.5 billion due by August 1, 2012, and \$5.6 billion due by September 30, 2012. To date, no legislative changes have altered the payment requirements for the \$5.6 billion due by September 30, 2012, or for the 2013 to 2016 scheduled payments. The Postal Service is accruing the \$5.5 billion payment due by August 1, 2012, in equal amounts over ten months and the \$5.6 billion due by September 30, 2012, in equal amounts throughout the year. The Postal Service has asked Congress to resolve the retiree health benefits prefunding for 2012 and future years. However, there can be no assurance that Congress will restructure any of the scheduled payments.

On August 1, 2012, and subsequent to the end of Quarter III, the \$5.5 billion PSRHBF payment became due. However, due to insufficient cash resources, the Postal Service was unable to make this payment and was forced to default. The statutory requirement establishing the payment schedule (P.L. 109-435) contains no provisions addressing a payment default, so the Postal Service is uncertain what consequences, if any, will result. See *Note 2 – Subsequent Events*.

Under existing law, commencing in 2017, the PSRHBF will be used to pay the Postal Service’s share of health insurance premiums for current and future Postal Service retirees. Also in 2017, the Postal Service will be required to fund the actuarially determined normal cost of providing retiree health benefits for current employees.

The law also requires that, not later than 2017, OPM must perform an actuarial valuation to determine if additional payments to the PSRHBF are required. If OPM determines that additional payments are required, it will design an amortization schedule to fully fund any remaining liability by September 30, 2056.

The Postal Service has contributed \$38 billion to the PSRHBF from inception to date. These funds, which are invested by OPM, earn interest at rates between 2% and 5%. The PSRHBF balance, as calculated by OPM at June 30, 2012, was \$45.3 billion. For further details, see the Annual Report on Form 10-K for the year ended September 30, 2011.

Retiree Health Benefits (Dollars in millions) (unaudited)	Three Months Ended June 30,		Nine Months Ended June 30,	
	2012	2011	2012	2011
Employer Premium Expense	\$ 662	\$ 620	\$ 1,954	\$ 1,818
P.L. 109-435 Payment to PSRHBF	3,050	1,375	9,150	4,125
Total Retiree Health Benefit Expense	\$ 3,712	\$ 1,995	\$ 11,104	\$ 5,943

Total retiree health benefits expense was \$3,712 million and \$1,995 million for the three months ended June 30, 2012 and 2011, respectively. For the nine months ended June 30, 2012, and 2011, total retiree health benefits expense was \$11,104 million, and \$5,943 million, respectively. These costs which are reflected as “Retiree health benefits” in the Statement of Operations consists of payments to OPM for the Postal Service’s share of FEHBP retiree premiums currently being paid plus required prefunding payments to the PSRHBF for current employees who will retire in the future.

The employer premium expense for retiree health benefits for the three months ended June 30, 2012, and 2011, was \$662 million and \$620 million, respectively. For the nine months ended June 30, 2012, and 2011, the employer premium expense for retiree health benefits expense was \$1,954 million, and \$1,818 million, respectively.

The Postal Service recognized \$3,050 million and \$1,375 million of PSRHBF expense for the three months ended June 30, 2012 and 2011, respectively. PSRHBF expense for the nine months ended June 30, 2012, and 2011, was \$9,150 million, and \$4,125 million, respectively. Because the amounts to be paid into the PSRHBF are set by legislation, the Postal Service retiree health expense may represent more or less than the full cost of the benefits earned by Postal Service employees. Also as discussed in

Note 2- Subsequent Event, the Postal Service was unable to make the \$5.5 billion payment due by August 1, 2012, and was forced to default, and additionally, if there are no legislative changes, the Postal Service will default on the \$5.6 billion prefunding payment due by September 30, 2012.

Note 9 – Retirement Programs

Employees participate in one of three defined benefit pension programs based upon the starting date of their employment with the Federal Government. Employee contributions are made to the Civil Service Retirement System (CSRS), the Dual CSRS/Social Security (Dual/CSRS) or the Federal Employees' Retirement System (FERS), all of which are administered by OPM. Employees may also participate in the Thrift Savings Plan (TSP), which is a defined contribution retirement savings and investment plan administered by the Federal Retirement Thrift Investment Board.

EMPLOYEE/EMPLOYER CONTRIBUTIONS

P.L. 109-435 suspends the employer contributions to CSRS that would otherwise have been required under Title 5, Section 8334(a)(1) of the United States Code until 2017. At that time, OPM will determine whether additional funding is required for the benefit of postal CSRS retirees.

As required by law, the Postal Service contribution rate was 11.9% of base salary for current FERS employees for the three and nine months ended June 30, 2012 and 11.7% of base salary for FERS employees for the three and nine months ended June 30, 2011. The Postal Service is required to contribute to the TSP a minimum of 1% per year of the basic pay of employees covered by this system, and is also required to match a voluntary employee contribution up to 3% of the employee's basic pay, and 50% of an employee's contribution of between 3% and 5% of basic pay.

The Postal Service has overfunded its FERS obligations by \$10.9 billion at September 30, 2010, the latest actual data available. OPM's most recent calculation shows that the FERS surplus was projected to have grown to approximately \$11 billion by September 30, 2011. In June 2011, to conserve cash and avoid an interruption of mail service, the Postal Service suspended employer contributions to FERS. The Postal Service resumed the regular biweekly payments for FERS employer's contributions and remitted all previously withheld payments in December 2011, including the \$911 million accrued at September 30, 2011. The Postal Service continues to seek a refund of the approximate \$11 billion overfunded balance.

Retirement expense was \$1,470 million and \$1,455 million for the three months ended June 30, 2012 and 2011, respectively. For the nine months ended June 30, 2012 and 2011, retirement expense was \$4,406 million, and \$4,409 million, respectively. Retirement expense is recorded in "Compensation and benefits" in the Statements of Operations.

Note 10 – Workers' Compensation

Postal employees injured on the job are covered by the Federal Employees' Compensation Act (FECA), administered by the DOL's Office of Workers' Compensation Programs (OWCP), which makes all decisions regarding injured workers' eligibility for benefits. However, the Postal Service annually reimburses the DOL for all workers' compensation benefits paid to or on behalf of employees, and pays an administrative fee to the DOL. The law does not permit the Postal Service to settle claims or to contest claims, both of which are allowed for private sector employers. The law also does not allow the Postal Service to administer its own workers compensation program.

An estimation model that combines four generally accepted actuarial valuation techniques is used to project future claim payments based upon currently open claims and past claim payment experience.

A liability is recorded for the present value of estimated future payments to postal employees, or their qualified survivors, who have been injured through the end of the reporting period. The estimated total cost of a claim is based on the date of the injury, pattern of historical payments, frequency or severity of the claim-related injury or injuries, and the expected trend in future costs. The liability for claims arising more than ten years ago is determined by an independent actuary. Because the FECA benefit structure

allows payments superior to benefits available under normal federal retirement, the payments will, in some cases, be for the rest of the lives of the claimants.

To record the liability and annual expense, an estimate is made of the amount of funding that would need to be invested at current interest rates in order to fully fund all estimated future payments. Inflation and discount (interest) rates are updated as of the date of the financial statements to determine the present value of the workers' compensation liability at fair value in accordance with GAAP. The impact of changes in the discount and inflation rates is accounted for as a change in accounting estimate and included in operating expenses.

The estimation of the liability is highly sensitive to changes in inflation and discount rates. The inflation and discount rates used to estimate the workers' compensation liability and related expense are shown in the following table.

Workers' Compensation Liability Inflation and Discount Rates	Quarter Ended			
	June 30, 2012	September 30, 2011	June 30, 2011	September 30, 2010
(Unaudited)				
Compensation Claims Liability:				
Discount Rate	2.1%	2.3%	3.5%	2.9%
Wage Inflation	2.9%	2.9%	2.9%	2.9%
Medical Claims Liability:				
Discount Rate	2.1%	2.4%	3.5%	3.0%
Medical Inflation	8.9%	8.6%	8.3%	7.4%

An increase of 1% in the discount rate would decrease the June 30, 2012 liability and Quarter III, 2012 expense by approximately \$1.7 billion. A decrease of 1% in the discount rate would increase the June 30, 2012 liability and Quarter III, 2012 expense by approximately \$2.1 billion.

At June 30, 2012, the present value of the liability for future workers' compensation payments was \$16,093 million, compared to \$15,142 million at September 30, 2011, an increase of \$951 million. The current portion of the 2012 liability was \$1,320 million at June 30, 2012, compared to \$1,255 million at September 30, 2011, an increase of \$65 million. These amounts are accrued under "Workers' compensation costs" on the Balance Sheets.

Workers' compensation expense, including the impact of changes in the discount rates, for the three- and nine-month periods ended June 30, 2012, and 2011, was as follows:

Workers' Compensation Expense	Three Months Ended		Nine Months Ended	
	June 30,		June 30,	
(Dollars in millions)	2012	2011	2012	2011
(Unaudited)				
Impact of Discount Rate Changes	\$ 897	\$ 280	\$ 386	\$ (749)
Actuarial valuation of new cases and revaluation of existing cases	572	507	1,819	1,703
Subtotal	<u>1,469</u>	<u>787</u>	<u>2,205</u>	<u>954</u>
Administrative Fee	17	15	50	46
Total Workers' Compensation Expense	\$ 1,486	\$ 802	\$ 2,255	\$ 1,000

Note 11 – Fair Value Measurements

The Postal Service estimates that the carrying value of current assets and liabilities approximates fair values. The Postal Service also has non-current financial instruments, such as the long-term portion of debt (see *Note 4-Debt*) and long-term receivables (see *Note 12-Revenue Forgone*), that must be measured for disclosure purposes on a recurring basis under authoritative accounting literature in GAAP. The Postal Service also applies these requirements to various non-recurring measurements of financial and non-financial assets and liabilities, such as the impairment of property and equipment. Measurement of assets and liabilities at fair value is performed using inputs from the following three levels of the fair value hierarchy as defined in the authoritative literature:

- Level 1 inputs include unadjusted quoted prices in active markets for identical assets or liabilities as of the balance sheet date.
- Level 2 inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, observable data, other than quoted market prices, for the asset or liability (i.e., interest rates, yield curves, etc.) and inputs that are derived from, or corroborated by, observable market data.
- Level 3 inputs include unobservable data that reflect current assumptions about the judgments and estimates that market participants would use when pricing the asset or liability. These inputs are based on the best information available, including internal data.

Because no active market exists for the debt with the FFB, the fair value of the noncurrent portion of these notes has been estimated using prices provided by the FFB, a Level 3 input.

The fair value of revenue forgone has been estimated using the income method and discount rates on similar assets, such as noncurrent U.S. Treasury securities that have a similar maturity, a level 2 input.

The carrying values and the fair values of noncurrent assets and liabilities that qualify as financial instruments in accordance with the accounting literature are as indicated in the table below:

Fair Value of Long-Term Financial Assets and Liabilities (Dollars in millions)	June 30, 2012		September 30, 2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(Unaudited)		(Audited)	
Revenue Forgone	\$ 378	\$ 535	\$ 393	\$ 540
Total Long-Term Financial Assets	\$ 378	\$ 535	\$ 393	\$ 540
Long-Term Portion of Debt	\$ 5,500	\$ 6,286	\$ 5,500	\$ 6,148
Total Long-Term Financial Liabilities	\$ 5,500	\$ 6,286	\$ 5,500	\$ 6,148

The above table is presented for disclosure purposes only. The Postal Service has not recorded a charge or credit to its operations for the differences between carrying and fair values of the above assets and liabilities.

The reconciliation of the fair values of the noncurrent portion of debt calculated using level 3 inputs is below:

Reconciliation of Fair Value of Level 3 Instruments (Dollars in millions)	
(Unaudited)	
Debt	
Balance at September 30, 2011	\$ 6,148
New Indebtedness	-
Repayment of Debt	-
Unrealized Loss	138
Balance at June 30, 2012	\$ 6,286

For the quarter ended June 30, 2012, there were no significant transfers between Level 1 and Level 2 assets or liabilities.

Non-financial assets, such as property and equipment, are measured at fair value when there is an indicator of impairment or when a decision is made to dispose of an asset, and recorded at fair value only when impairment is recognized. Independent appraisals, adjusted for estimated selling costs, are used to determine the fair value of non-financial assets deemed impaired or being held for sale. Independent third party appraisals are deemed Level 2 inputs as defined above. See *Note 5–Property and Equipment* for details on impairments.

Note 12 – Revenue Forgone

Revenue forgone is an appropriation that is intended to reimburse the Postal Service for the annual cost of statutorily-required free and reduced rate mailing services to specified groups. It also includes amounts authorized in the *Revenue Forgone Reform Act of 1993* for services performed and revenue forgone for the years 1991 through 1998, which is scheduled to be reimbursed at a rate of \$29 million each year from 1993 through 2035.

For the three months ended June 30, 2012, the Postal Service recognized revenue of \$21 million, including \$5 million of imputed interest income from these appropriations, compared to \$26 million, including \$6 million of imputed interest, for the three months ended June 30, 2011. For the nine months ended June 30, 2012, the Postal Service recognized \$47 million of such revenue, including \$17 million of imputed interest, compared to revenue of \$76 million, including \$18 million of imputed interest, for the same period in 2011.

As the result of the passage of P.L. 112-10, *Department of Defense and Full-Year Continuing Appropriations Act, 2011*, effective April 15, 2011, the Postal Service received only \$12 million of the scheduled \$29 million of the 2011 amount due under the *Revenue Forgone Reform Act of 1993*. As the result of the passage of P.L. 112-74, *Consolidated Appropriations Act 2012*, effective December 23, 2011, the Postal Service will not receive any of the scheduled \$29 million of the 2012 amount due. There was no impact to the 2012 or 2011 Statement of Operations because the revenue was previously recognized upon the enactment of the *Revenue Forgone Reform Act of 1993* and the impact of P.L. 112-10 and P.L. 112-74 only represents a change in the timing of the funding but not a change to the requirement for reimbursement. The unfunded amounts will be included as part of the 2013 and 2014 appropriations requests. Current proposed legislation does not contain a provision for funds to be paid to the Postal Service regarding these amounts due under the *Revenue Forgone Reform Act of 1993*. However, there has been no final legislation enacted regarding the 2013 appropriation requests.

The related amount of the receivable was \$440 million at June 30, 2012, and \$467 million at September 30, 2011. The current portion of this receivable was \$62 million at June 30, 2012, and \$74 million at September 30, 2011, and is recorded under “Receivables – U.S. Government” on the Balance Sheets.

Item 2 – Management’s Discussion and Analysis of Financial Condition and Results of Operations

Cautionary Statements

Forward-looking statements contained in this report represent our best estimates of known and anticipated trends believed relevant to future operations. However, actual results may differ significantly from current estimates. Certain forward-looking statements are included in this report and use such words as “may,” “will,” “could,” “expect,” “believe,” “plan,” “estimate,” “project,” or other similar terminology. These statements reflect current expectations regarding future events and operating performance as of the date of this report. These forward-looking statements involve a number of risks and uncertainties.

Management's Discussion and Analysis of Financial Condition and Results of Operations and other parts of this report include statements representing expectations about the United States Postal Service business and financial results. These may be affected by risks and uncertainties discussed here and in the Annual Report on Form 10-K for the year ended September 30, 2011, such as, but not limited to, effectiveness of operating initiatives; rate of electronic diversion; changes in laws and regulations; costs and delays associated with new regulations imposed by the Postal Regulatory Commission (PRC) or other regulatory bodies; the amount of required prefunding payments to the Postal Service Retiree Health Benefits Fund (PSRHBF); success in advertising and promotional efforts; changes in national and local business and economic conditions, including their impact on consumer and business confidence; fluctuations in currency exchange and interest rates; labor and other operating costs; oil, fuel, and other transportation costs; the effects of war and terrorist activities; competition, including pricing and marketing initiatives and new service offerings by our competitors; consumer preferences or perceptions concerning our service offerings; spending patterns and demographic trends; availability of qualified personnel; severe weather conditions; labor relations, particularly the results of collective bargaining; effects of legal claims; cost and deployment of capital; and changes in applicable accounting policies and practices. The foregoing list of important factors is not all-inclusive. Some of these and other factors, many of which we cannot control or influence, may cause actual results to differ materially from those currently contemplated. We have no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise. Operating results for the three- and nine-month periods ended June 30, 2012, are not necessarily indicative of the results to be expected for the year ending September 30, 2012. This report should be read in conjunction with the United States Postal Service Annual Report on Form 10-K for the year ended September 30, 2011. As in that report, all references to years, unless otherwise stated, refer to the fiscal year beginning October 1 and ending September 30. All references to quarters, unless otherwise noted, refer to quarters within fiscal years 2012 and 2011.

Introduction

The United States Postal Service (we) commenced operations on July 1, 1971, as an “independent establishment of the executive branch of the Government of the United States.” We are governed by an eleven-member Board of Governors (the Board). Nine independent Governors are appointed by the President of the United States with the advice and consent of the Senate. The Postmaster General, who is appointed by the independent Board members, also serves on the Board, as does the Deputy Postmaster General, who is appointed by the independent Board members and the Postmaster General. Under the *Postal Reorganization Act*, and its successor, the *Postal Accountability and Enhancement Act*, Public Law 109-435 (P.L. 109-435), we have a legal mandate to offer a “fundamental service” to the American people “at fair and reasonable rates.” We fulfill this legal mandate to provide universal service at a fair price by offering a variety of classes of mail services without undue discrimination among our many customers. This means that, within each class of mail service, prices do not vary unreasonably by customer for the level of service provided. However, P.L. 109-435 provides greater flexibility in the pricing of Shipping Services, as discussed below.

We serve individual and commercial customers in the communications, distribution and delivery, advertising and retail markets throughout the nation and, as a result, have a very diverse customer base and are not dependent upon a single customer or small group of customers. No single customer represents more than 1.6% of operating revenue.

Prices and fees are subject to a review process by the Board and by the independent PRC.

P.L. 109-435 divides postal services into two broad categories: Market Dominant and Competitive. Market Dominant services include, but are not limited to, First-Class Mail, Standard Mail, Periodicals, and certain Package Services. Price increases for these services are subject to a price cap by class of mail based on the Consumer Price Index–All Urban Consumers (CPI-U). Competitive services, such as Priority Mail, Express Mail, Bulk Parcel Post, and Bulk International Mail have greater pricing flexibility and are commonly referred to as “Shipping Services”. On July 20, 2012, the PRC conditionally approved the transfer of Parcel Post from Market Dominant to Competitive.

Despite the legal classifications of postal services into Market Dominant and Competitive, the Market Dominant Package Services, First-Class Mail Parcels, and Standard Mail Parcels are more reflective of our competitive services and the manner by which we manage our business. In the management of the business and throughout this document, Competitive services which include the Market Dominant Package Services, First-Class Mail Parcels, and Standard Mail Parcels are referred to as “Shipping Services plus Market Dominant packages”. Market Dominant services without packages and parcels are referred to as “Mailing Services without Market Dominant packages”.

Mailing and Shipping Services are sold through a network of approximately 31,000 postal-managed Post Offices, stations, and branches, plus thousands of contract postal units, community post offices, Village Post Offices, retail establishments that sell postage stamps and other services, and our website, <http://www.usps.com>. Mail deliveries are made to over 151 million city, rural, Post Office box, and highway delivery points. Operations are conducted primarily in the domestic market, with international sales representing approximately 4% of total revenue.

In December 2011, Oxford Strategic Consulting named USPS the best postal service within the world's top 20 largest economies for access to services, resource efficiency, and public trust after their comprehensive review of the performance of universal postal service providers. The report found that the Postal Service delivers nearly double the number of letters per employee as its closest ranking global competitor.

We operate and manage a very extensive and integrated retail, distribution, transportation and delivery network. As such, the physical infrastructure and labor force are not, with limited exceptions, dedicated to individual business lines. Expenses are incurred and managed by functional groupings that align with the integrated network structure. Reporting of expenses on a functional basis in this report conforms to the management and structure of expense incurrence within the organization.

The labor force is primarily represented by the American Postal Workers Union, AFL-CIO (APWU), the National Association of Letter Carriers, AFL-CIO (NALC), the National Postal Mail Handlers Union, AFL-CIO (NPMHU), and the National Rural Letter Carriers Association (NRLCA). More than 85% of career employees are covered by collective bargaining agreements. The current contract with the APWU became effective May 23, 2011, and extends through May 20, 2015.

The NRLCA contract expired on November 20, 2010. Interest arbitration hearings began on December 5, 2011, resulting in the issuance of an Interest Arbitration Award on July 3, 2012. The award set the term of the contract as November 10, 2010, through May 20, 2015. The new agreement includes cost-savings provisions that will benefit us over the life of the contract; such as a two-year wage freeze followed by modest increases, an increase in the employee share of health insurance premiums, and certain work standard changes which will improve productivity.

The NALC and NPMHU contracts expired on November 20, 2011. We reached an impasse in negotiations with the NALC and the NPMHU, as agreements with both unions were not reached during

negotiations. Impasses in collective bargaining negotiations may ultimately be resolved through arbitration. We are proceeding towards interest arbitration with both unions. We and the NALC will be commencing the interest arbitration process in August 2012.

We're required by law to consult with management associations representing supervisory and managerial employees and postmasters prior to making final decisions concerning changes to pay and benefits for such employees.

We recently completed the consultation processes with the National Association of Postal Supervisors (NAPS), representing supervisory and managerial employees, and with the National Association of Postmasters of the United States (NAPUS) and the National League of Postmasters of the United States (NLPM), representing postmasters.

Our final decisions concerning changes to pay and benefits for postmasters, and for supervisory and managerial employees, were rendered, May 8, 2012, and June 29, 2012, respectively. These decisions are effective for 2011 through 2015. Employees covered by these decisions will not receive salary increases for 2011 or 2012, and will pay greater shares of their health insurance premiums. Employees hired into Postal Service supervisory or managerial jobs, or as postmasters, after October 1, 2012, will earn less leave than current postal employees.

We participate in federal employee benefit programs for retirement, health and workers' compensation benefits. Under P.L. 109-435, we are obligated to fully fund the employer's portion of the established health and retirement benefits of current retirees and current postal employees who have not yet retired. To accomplish this, the law established the Postal Service Retiree Health Benefits Fund (PSRHBF) and requires that we make prefunding payments of between \$5.6 billion and \$5.8 billion into the PSRHBF between 2012 and 2016. These amounts are in addition to the \$38 billion contributed from 2007 through 2010 and in addition to the premiums paid for the health benefits of current retirees. No contribution was made to the PSRHBF in 2011 because the payment was rescheduled by Congress to be due by August 1, 2012. On August 1, 2012, we were forced to default on the \$5.5 billion prefunding payment for retiree health benefits due no later than that date due to insufficient cash to make the payment. We have asked Congress to restructure the payment schedule for 2012 and future years. However, there can be no assurance that Congress will restructure any of the scheduled payments. Further, if no legislation is passed which impacts the \$5.6 billion payment due by September 30, 2012, we will also be forced to default on that payment. See *Note 8 – Health Benefits Programs* for further discussions regarding the PSRHBF prefunding payments.

The Postal Service is not a reporting company under the Securities Exchange Act of 1934, as amended, and is not subject to regulation by the Securities and Exchange Commission (SEC). However, it is required under P.L.109-435 to file with the PRC certain financial reports containing information prescribed by the SEC under Section 13 of the Securities Exchange Act of 1934. These reports include annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K, which are available at <http://about.usps.com/who-we-are/financials/welcome.htm>. The Postal Service is required by law and regulations to disclose operational and financial information well beyond what the law requires of other government agencies and most private sector companies.

Pursuant to Title 39 and PRC regulations, additional disclosures on the organization and finances, including Cost and Revenue Analysis reports, Revenue, Pieces, and Weight reports, financial and strategic plans, and the *Comprehensive Statement on Postal Operations* are filed with the PRC and may also be found online at <http://about.usps.com>. Information on the website is not incorporated by reference into this document.

Critical Accounting Judgments and Estimates

The preparation of financial statements in accordance with United States (U.S.) generally accepted accounting principles (GAAP) requires management to make significant judgments and estimates to develop certain amounts reflected and disclosed in the financial statements. In many cases, there are

alternative policies or estimation techniques that could be used. We maintain a thorough process to review the application of 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 on Form 10-K for the year ended September 30, 2011. Management discusses the development and selection of accounting policies and estimates with the Audit and Finance Committee of the Board.

In Quarter II, 2012, we improved the estimation technique employed to estimate deferred revenue-prepaid postage for Forever Stamps. We obtained new information regarding our customers' stamp usage and retention habits. This enabled us to update our estimate of stamps that will never be used for mailing. As a result of this enhancement, deferred revenue-prepaid postage was decreased by \$59 million. The change was accounted for as a change in accounting estimate, and was therefore reflected in operating results as an increase to revenue in Quarter II, 2012.

Recent Accounting Pronouncements

New Accounting Standards

There were no accounting standards adopted during the nine months ended June 30, 2012, that had a material impact on our financial statements.

Standards Issued But Not Yet Effective

In September 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-09, to Accounting Standards Codification (ASC) No. 715-80: *Compensation-Retirement Benefits-Multiemployer Plans* which outlines new required disclosures about an organization's involvement in those plans. The amendments are effective for annual periods for fiscal years ending after December 15, 2011, with early adoption permitted. Retrospective application of the new disclosures will also be required. We will be adopting the new rules beginning with our Annual Report on Form 10-K for the year ending September 30, 2012.

Results of Operations

Our net losses were \$5,185 million for the three months ended June 30, 2012, compared to net losses of \$3,100 million for the same period last year, an increase of \$2,085 million. For the nine months ended June 30, 2012, our net losses were \$11,649 million, compared to net losses of \$5,657 million for the nine months ended June 30, 2011, an increase of \$5,992 million.

For the three months ended June 30, 2012, operating revenue was \$15,613 million, compared to \$15,766 million for the three months ended June 30, 2011, a decrease of \$153 million, or less than 1%. For the nine months ended June 30, 2012, and 2011, operating revenue was \$49,517 million, and \$49,877, respectively, a decrease of \$360 million, or less than 1%.

Although significant efforts continue to be made to increase revenues and contain controllable costs to offset declining volume, the accrual of the large PSRHBF prefunding requirement, high fuel costs, and legally-required continuation of six-days-per-week delivery have adversely affected our financial results.

Key Operating Statistics	Three Months Ended		Nine Months Ended	
	June 30,		June 30,	
	2012	2011	2012	2011
(Dollars and mail volume per day in millions)				
Operating Revenue	\$ 15,613	\$ 15,766	\$ 49,517	\$ 49,877
PSRHBF Expense	\$ 3,050	\$ 1,375	\$ 9,150	\$ 4,125
Loss from Operations	\$ (5,142)	\$ (3,065)	\$ (11,525)	\$ (5,547)
Net Loss	\$ (5,185)	\$ (3,100)	\$ (11,649)	\$ (5,657)
Total Mail Volume	38,521	39,940	121,743	127,638
Average Mail Volume per day	500	517	536	563

As explained further in the Revenue and Volume section below, we are making efforts to offset continuing decreases in revenue and volume due to the migration of First-Class Mail to electronic alternatives. New products and successful marketing campaigns continue to fuel growth in our package business. Through the introduction of new service offerings and better educational marketing information, we are showing customers new ways that the mail can be used in conjunction with current technologies. We continue to encourage mailers to try new products and services that can add value to their mail and connect with customers in a more individualized way. Products and services, such as Every Door Direct Mail, Click n' Ship, Business Connect, and ePostage, offer new ways of doing business with us. Customers are also increasingly using free package pickup during carrier route deliveries.

For the three months ended June 30, 2012, Shipping Services plus Market Dominant packages revenue of \$3,284 million increased \$272 million, or 9.0%, on a volume increase of 43 million pieces, or 5.2%, compared to the same period last year. For the nine months ended June 30, 2012, revenue in this same category was \$10,553 million, an increase of \$949 million, or 9.9%, as compared to the same nine month period last year. Higher consumer spending, higher e-commerce retail sales plus increased marketing efforts drove much of the growth in Shipping Services plus Market Dominant package revenue and volume seen during the first nine months of 2012.

However, these increases were not enough to offset the declines in Mailing Services. Revenue from Mailing Services without Market Dominant packages totaled \$12,329 million, a decrease of \$425 million, or 3.3%, and volume totaled 37,646 million pieces, a decrease of 1,462 million pieces, or 3.7%, for the three months ended June 30, 2012. For the nine months ended June 30, 2012, total Mailing Services revenue without Market Dominant packages was \$38,964 million, a decrease of \$1,309 million or 3.3%.

Operating expenses were \$20,755 million for the three months ended June 30, 2012, compared to \$18,831 million for the same period last year, an increase of \$1,924 million, or 10.2%, driven primarily by expenses accrued for the legally mandated prefunding PSRHBF payments scheduled to be paid in Quarter IV, 2012, and increases in workers' compensation expenses related to discount rate changes.

As described in *Note 8 – Health Benefits Programs*, the PSRHBF payment of \$5.5 billion scheduled to be due by September 30, 2011, was rescheduled to be due by August 1, 2012, resulting in two payments due in 2012: \$5.5 billion due by August 1, 2012, plus the originally scheduled \$5.6 billion due by September 30, 2012. Including the accruals for PSRHBF prepayments of \$3,050 million and \$1,375 million for the three months ended June 30, 2012, and 2011 respectively, total retiree health benefit costs were \$3,712 million for the three months ended June 30, 2012, compared to \$1,995 million for the same period last year. For the nine months ended June 30, 2012, and 2011, the PSRHBF prepayment accruals were \$9,150 million and \$4,125 million, respectively. Total retiree health benefit costs were \$11,104 million for the nine months ended June 30, 2012, compared to \$5,943 million for the nine months ended June 30, 2011. Note that, while no PSRHBF prepayments were made in 2011, during the first three quarters of the year the expense was ratably accrued. This was reversed in Quarter IV, 2011, when the prepayment due by September 30, 2011, was rescheduled by Congress ultimately to be due by August 1, 2012.

For the three months ended June 30, 2012, compensation and benefits expense decreased by \$61 million, or 0.5%, compared to the same period last year due primarily to a decrease in work hours. Workers' compensation expenses were \$1,486 million for the three months ended June 30, 2012, compared to \$802 million for the same period ended June 30, 2011. The \$684 million increase was driven primarily by the impact of discount rate changes that occurred in Quarter III, 2012. Transportation expenses increased by \$47 million, or 3%, due to rising fuel costs, while other expenses decreased by \$463 million, or 17.3%, for the three months ended June 30, 2012 as compared to the same period last year.

For the nine months ended June 30, 2012, operating expenses were \$61,042 million, compared to \$55,424 million, an increase of \$5,618 million, or 10.1%. Compensation and benefits expense decreased by \$407 million, or 1.1%, primarily due to a work hour reduction of 20 million hours, or 2.3%. Retiree health benefits premiums expense increased by \$136 million, or 7.5%, and the required accrual for prefunding of the PSRHBF increased \$5,025 million, or 121.8%, compared to the same period last year. Workers' compensation expenses increased \$1,255 million, or 125.5%, compared to last year, reflecting the impact of discount rate changes. Transportation expenses increased by \$278 million, or 5.8% while other expenses decreased by \$669 million, or 9.1%.

As discussed above, included in our total expenses and net losses are items related to legislative mandates for the funding of the PSRHBF and discount rate changes affecting our workers' compensation liability. PSRHBF payments are legally mandated by P.L. 109-435 which dictates the amounts to be paid and the timing of the payments through 2016. These payments can be rescheduled at any time with the passage of a new law, or amendment of the existing law. Discount rates are updated quarterly, based on prevailing market rates for a basket of Treasury securities with maturities corresponding to the expected duration of the future cash payments for workers' compensation. Although these rate changes increase the workers' compensation expenses during periods of falling interest rates, or reduce expenses when rates rise, they do not impact actual cash outflows.

Because these factors are not subject to management's control, we believe that analyzing operating results without the impact of these items provides a more meaningful insight into operations. The table below illustrates the loss from business activities when these factors are not considered, and reconciles these amounts to our GAAP net loss.

Loss before Impact of PSRHBF Expense and Discount Rate Changes	Three Months Ended		Nine Months Ended	
	June 30,		June 30,	
(Dollars in millions)	2012	2011	2012	2011
Net Loss	\$ (5,185)	\$ (3,100)	\$ (11,649)	\$ (5,657)
Impact of:				
PSRHBF Expense	3,050	1,375	9,150	4,125
Discount Rate Changes on Workers' Compensation	897	280	386	(749)
Loss before Impact of PSRHBF Expense and Discount Rate Changes	\$ (1,238)	\$ (1,445)	\$ (2,113)	\$ (2,281)

Without the impact of these non-controllable factors, the net loss would have been \$1,238 million for the quarter ended June 30, 2012, compared to a net loss of \$1,445 million for the quarter ended June 30, 2011. For the nine months ended June 30, 2012, the net loss would have been \$2,113 million compared to a net loss of \$2,281 million for the nine months ended June 30, 2011.

Revenue and Volume

Reclassification of Certain Revenue and Volume Data

Periodic reclassifications and expansions of services between Market Dominant and Competitive Products, which require approval from the PRC, are necessary to rationalize product offerings and address the limitations of our Market Dominant category, such as price caps based on the Consumer Price Index (CPI). The additional flexibility provided in Competitive Products allows us to better offer services that meet customer needs, to increase business for the Postal Service, and to allow us to price our products and services competitively within the markets in which we operate.

In order to facilitate a comparison of year-over-year mailing and shipping revenue and volume results, First-Class Mail Parcels, Standard Mail Parcels, as well as, Package Services currently categorized as Market Dominant products by the PRC for regulatory purposes, will be discussed in the next section below in combination with Shipping Services. This total grouping is referred to as "Shipping Services plus Market Dominant packages". The remainder of the Market Dominant category will be referred to as "Mailing Services". This not only provides a better comparison, it is also more reflective of the way we manage our business.

In Quarter I, 2012, with the concurrence of the PRC, we reclassified certain light weight commercial parcels previously classified in Mailing Services as First-Class Mail Parcels to the newly created First-Class Package Services in Shipping Services. In addition, in Quarter II, certain Standard Mail parcels were reclassified to Parcel Select in the Shipping Services categories. There were no new reclassifications in Quarter III.

Summary of Revenue and Volume Results

Revenue and volume are closely linked to the strength of the U.S. economy and changes in how our customers use the mail. Historically, the more significant factor has been cyclical changes in the rate of economic growth. However, recently the more significant factor has been the rate that relevant new technology has been introduced and accepted into the marketplace and supplanted the role of traditional hard-copy mail. In addition, revenue is also constrained by laws and regulations restricting the types of products and services we can offer and by our ability to implement products and services and the speed with which we can bring them to market.

The recession that began in the fall of 2007 and its lingering effects, accompanied by the acceptance and growth of major new technological platforms, has changed how the internet and mobile communication technologies are used by businesses and consumers. This has had a significant negative impact on some of our traditional sources of revenue. These two factors simultaneously impacted us, as the recession accelerated the shift to electronic communication alternatives.

Between 2008 and 2010, the American economy experienced its worst economic downturn since the Great Depression, and mail volume fell precipitously. The recovery from the recession has been slow and uneven. Gross domestic product (GDP) grew a modest 1.5% in the three months ended June 30, 2012, with the unemployment rate still over 8%. Recently, concerns about a possible recession in Europe, slowing growth in China, and the impending "fiscal cliff" in the United States have contributed to a perceived slowdown in economic growth. To date, consumer spending and business investment have not provided the growth stimulus necessary to return mail volumes to levels approaching the levels we experienced in the mid-2000s. Due to the long-term impact of technological change, discussed above, we do not anticipate volume ever returning to these levels. In fact, we anticipate that mail volume will, for the most part, decrease for the foreseeable future.

For the nine months ending June 30, 2012, our revenues were somewhat stronger than anticipated, although still below the comparable period last year. Although Mailing Services' revenues for the first nine months of 2012 are down compared to last year; Shipping Services including market dominant package services have shown strong growth thus far in 2012.

In January 2011, prices for Shipping Services increased by an average of 3.6%. In April 2011, we increased prices for Mailing Services by an average of 1.7%. On January 22, 2012, we increased Mailing Services prices an average of 2.1%, and increased Shipping Services prices an average of 4.6%.

However, these price increases were not enough to offset the loss in revenue due to the continuing impact that technology has had on the mail. Volume and revenue continue to be lost to electronic alternatives and are not expected to return because the movement constitutes a fundamental and permanent change in mail use by households and businesses. Technological change has had an especially negative effect on our First-Class Mail revenues, as First-Class Mail revenue in 2011 declined more than 16%, on a volume decline of 24%, from the 2007 revenue peak.

As discussed below, First-Class Mail revenue dropped another 3.1% in the first nine months of 2012. The nature of the recent recession and uneven recovery, which saw traditional media lag in the overall economic recovery, as well as technological change, has also negatively impacted Standard Mail. Standard Mail revenue, not including Standard Mail packages, declined 4.3% in the first nine months of 2012. Advertisers have become more selective in targeting their mailings and have more platforms from which to choose, which negatively impacts mail volume.

New technology, however, has helped us grow our Shipping Services business. New products and successful marketing campaigns continue to fuel growth in our package business. Shipping Services plus Market Dominant package revenue totaled \$3,284 million, a \$272 million, or 9.0%, increase for the three months ended June 30, 2012, and \$10,553 million, a \$949 million or 9.9%, increase for the nine months ended June 30, 2012, compared to the same periods last year. However, because Shipping Services plus Market Dominant packages represents approximately 21% of our total revenues, these increases did not fully offset the declines in total Mailing Services revenue.

Moreover, unlike a private-sector business, we are restricted by law from taking certain steps, such as entering new lines of business that might generate additional revenue to help offset the decline in First-Class Mail revenue. In short, there currently is no foreseen revenue growth solution that would completely resolve our financial problems.

MAILING SERVICES

Revenue of \$12,329 million from Mailing Services without Market Dominant packages, decreased by \$425 million, or 3.3%, for the three months ended June 30, 2012, compared to the three months ended June 30, 2011, on a volume decrease of 1,462 million pieces. This revenue reduction reflects the continued decline in First-Class Mail and a decline in Standard Mail in Quarter III. For the nine months ended June 30, 2012, revenue of \$38,964 million from Mailing Services without Market Dominant packages decreased by \$1,309 million, or 3.3%, on a volume decrease of 6,075 million pieces, from the comparable 2011 period.

In recent years, there have been fundamental changes in the way businesses and consumers use the mail. Correspondence mail has long been a declining part of mail volume. With the availability of inexpensive telephone service, e-mail, and other internet-based forms of communication such as e-cards and social networking, the declining trend in correspondence mail will not be reversed. Customer usage of postal services continues to shift away from transactions, correspondence, and Periodicals Mail. For the three months ended June 30, 2012, combined First-Class Mail and Standard Mail which represents approximately 93% of our total mail volume, decreased 1,402 million pieces, or 3.8%, compared to the same period last year, with an associated drop in revenue of \$344 million, or 3%. For the nine month period ended June 30, 2012, combined First-Class Mail and Standard Mail revenue decreased \$1,287 million, or 3.5%, on a volume decrease of 5,831 million pieces, or 4.9%, over the same period last year.

Mailing Services Revenue (Dollars in millions)	Three Months Ended June 30,		Nine Months Ended June 30,	
	2012	2011	2012	2011
First-Class Mail ¹	\$ 7,237	\$ 7,478	\$ 22,901	\$ 23,628
First-Class Mail Parcels	151	208	509	848
Standard Mail ²	3,913	4,016	12,364	12,924
Standard Mail Parcels	15	164	268	485
Periodicals	438	454	1,318	1,377
Package Services	343	357	1,202	1,207
Other Mailing Services ³	741	806	2,381	2,344
Total Mailing Services Revenue	\$ 12,838	\$ 13,483	\$ 40,943	\$ 42,813
Less Market Dominant packages:				
FCM Parcels	151	208	509	848
Standard Mail Parcels	15	164	268	485
Package Services	343	357	1,202	1,207
Total Mailing Services Revenue without Market Dominant packages	\$ 12,329	\$ 12,754	\$ 38,964	\$ 40,273

¹ Excludes First Class Mail (FCM) Parcels

² Excludes Standard Mail (SM) Parcels

³ Includes Certified Mail, Return Receipts, PO Boxes, Insurance, Other Ancillary Fees.

Note: The totals for certain mail categories for the prior year have been reclassified to better reflect classifications used in the current year. These reclassifications did not impact total mail revenue for the prior year.

Mailing Services Volume (Pieces in millions)	Three Months Ended June 30,		Nine Months Ended June 30,	
	2012	2011	2012	2011
First-Class Mail ¹	16,864	17,634	53,485	55,973
First-Class Mail Parcels	67	101	232	426
Standard Mail ²	18,945	19,577	59,889	63,232
Standard Mail Parcels	15	177	288	555
Periodicals	1,729	1,785	5,139	5,378
Package Services	133	142	477	499
Other Mailing Services ³	108	112	382	387
Total Mailing Services Volume	37,861	39,528	119,892	126,450
Less Market Dominant packages:				
FCM Parcels	67	101	232	426
Standard Mail Parcels	15	177	288	555
Package Services	133	142	477	499
Total Mailing Services Volume without Market Dominant packages	37,646	39,108	118,895	124,970

¹ Excludes First Class Mail (FCM) Parcels

² Excludes Standard Mail (SM) Parcels

³ Includes Certified Mail, Return Receipts, PO Boxes, Insurance, Other Ancillary Fees.

Note: Prior year balances have been restated to conform to the current year's presentation.

Single-piece First-Class letter revenue declined \$280 million, or 10.3%, for the quarter, compared to the same period last year on a volume decline of 12.1%. Year-to-date single piece First-Class letter revenue declined \$818 million, or 9.4%, on a volume decline of 10.5%. The largest contributing factor to this decline was the fundamental change in the way businesses and consumers use the mail, the continuing

migration away from First-Class Mail toward electronic alternatives. Single-piece First-Class letters now constitute only one-third of total First-Class Mail revenue, compared to 53% in 2006 and almost 60% in 2001. This significant decline is expected to continue.

Standard Mail revenue of \$3,913 million decreased \$103 million, or 2.6%, in the three months ended June 30, 2012, as volume decreased 632 million pieces, or 3.2%, compared to the three months ended June 30, 2011. For the nine month period ended June 30, 2012, Standard Mail revenue of \$12,364 million decreased \$560 million, or 4.3%, on a volume decline of 3,343 million pieces, or 5.3%, compared to the first nine months of 2011. Standard Mail volumes were significantly impacted by the decline in advertising spending resulting from the continued muted growth of the economy. In addition, advertisers continue to become more sophisticated in the targeting of their mailings and utilizing alternative media, which also offsets some potential volume growth. To take advantage of this targeted marketing, we introduced Every Door Direct Mail. This service continues to grow as local businesses can target their audiences to specific mailing communities and have capitalized on the product's ease of use.

Revenue from Periodicals decreased \$16 million, or 3.5%, in the three months ended June 30, 2012, compared to the same period last year. For the three months ended June 30, 2012, the average per piece weights for Periodicals decreased by 2.5%, compared to the same period last year. Year-to-date Periodicals revenue decreased \$59 million, or 4.3%, compared to the same period last year. Periodicals continue to be depressed by trends in reading behavior and shifts of advertising away from print. More and more publications are now available in multiple electronic formats.

SHIPPING SERVICES

Total revenue of \$3,284 million from Shipping Services plus Market Dominant packages increased \$272 million, or 9.0%, for the three months ended June 30, 2012, compared to the same period last year, as volume increased 43 million pieces, or 5.2%. Year-to-date revenue from Shipping Services plus Market Dominant packages increased \$949 million, or 9.9%, on a volume increase of 180 million pieces, or 6.7%.

Shipping Services Revenue (Dollars in millions)	Three Months Ended June 30,		Nine Months Ended June 30,	
	2012	2011	2012	2011
Priority Mail	\$ 1,358	\$ 1,352	\$ 4,497	\$ 4,337
First Class Package Service ¹	214	114	621	114
Parcel Select Services ²	389	168	1,036	536
Express Mail	205	202	606	606
International Mail	424	368	1,372	1,230
Other Shipping Services Revenue ³	185	79	442	241
Total Shipping Services Revenue	\$ 2,775	\$ 2,283	\$ 8,574	\$ 7,064
Plus Market Dominant packages:				
FCM Parcels ¹	151	208	509	848
Standard Mail Parcels ²	15	164	268	485
Package Services	343	357	1,202	1,207
Total Shipping Services Revenue plus Market Dominant packages	\$ 3,284	\$ 3,012	\$ 10,553	\$ 9,604

¹ For comparative analytics, First Class Package Service and First Class Mail Parcels should be combined.

² For comparative analytics, Parcel Select Services and Standard Mail Parcels should be combined. Parcel Select Services includes Parcel Select Returns.

³ Other Shipping Services Revenue includes PO Boxes, shipping and mailing supplies, premium forwarding services, greeting cards, and nonpostal services and fees.

Note: The totals for certain mail categories for the prior year have been reclassified to better reflect classifications used in the current year. These reclassifications did not impact total mail revenue for the prior year.

Shipping Services Volume (Pieces in millions)	Three Months Ended June 30,		Nine Months Ended June 30,	
	2012	2011	2012	2011
Priority Mail	190	192	621	606
First Class Package Service ¹	99	57	293	57
Parcel Select Services ²	295	90	693	287
Express Mail	10	10	30	31
International Mail	66	63	214	207
Total Shipping Services Volume	660	412	1,851	1,188
Plus Market Dominant packages:				
FCM Parcels ¹	67	101	232	426
Standard Mail Parcels ²	15	177	288	555
Package Services	133	142	477	499
Total Shipping Services Volume plus Market Dominant packages	875	832	2,848	2,668

¹ For comparative analytics, First Class Package Service and First Class Mail Parcels should be combined.

² For comparative analytics, Parcel Select Services and Standard Mail Parcels should be combined.

Note: Prior year balances have been restated to conform to the current year's presentation.

Priority Mail, which represented 48.9% of our total Shipping Services revenue, increased \$6 million, or 0.4%, for the three months ended June 30, 2012, compared to the same period last year. Year-to-date Priority Mail revenue increased \$160 million, or 3.7%, compared to the nine months ended June 30, 2011. Priority Mail Flat Rate advertising campaigns continued to contribute to increased revenues in that category. Initially launched in May 2009, this campaign reinforces the message that the Postal Service is a convenient, simpler solution for shipping.

The combined First-Class Package Service and First-Class Mail (FCM) parcels generated revenue of \$365 million and \$1,130 million for the three and nine months ended June 30, 2012, respectively. This was an increase of \$43 million or 13.4%, and a \$168 million, or 17.5%, for the three and nine months ended June 30, 2012, respectively. The combined volume increased 8 million pieces, or 5.1% for the three months ended June 30, 2012, and 42 million pieces, or 8.7%, for the nine months ended June 30, 2012. First-Class Package Service and FCM Parcels performed especially well as a result of management's continued emphasis on package service options. The strong growth in these combined services from the prior year reflects the consumer's response to a product that provides a high level of service at a reasonable price.

Together Parcel Select Services, including Parcel Returns, of \$389 million plus the Standard Mail Parcels of \$15 million totaled \$404 million for the three months ended June 30, 2012, an increase of \$72 million, or 21.7%, compared to the same period of the prior year. For the nine months ended June 30, 2012, the combined services totaled \$1,304 million, an increase of \$283 million, or 27.7%, over the same period of the prior year.

Package Services revenue of \$343 million decreased \$14 million, or 3.9%, for the three months ended June 30, 2012, compared to the three months ended June 30, 2011. Volume decreased 9 million pieces, or 6.3%. Year-to-date Package Services revenue decreased \$5 million, or 0.4%, as volume decreased 22 million pieces, or 4.4%, compared to the same period last year.

International mail revenues for the three months ended June 30, 2012, and 2011, were \$424 million, and \$368 million, respectively. Year-to-date International mail revenues were \$1,372 million, an increase of \$142 million, or 11.5%, over the nine months ended June 30, 2011. A newly designed price information

tool for Express and Priority Mail International that gives customers on-the-spot price comparisons helped boost this category.

Detailed data on Mailing Services product volume and revenue may be found in the Quarterly Revenue, Pieces and Weight reports on <http://about.usps.com/who-we-are/financials/welcome.htm>.

Operating Expenses – Compensation and Benefits

COMPENSATION AND BENEFITS

Compensation and benefits expense for the three months ended June 30, 2012, was \$11,745 million, a \$61 million, or 0.5% decrease compared to the three months ended June 30, 2011. Compensation expense decreased by \$49 million, or 0.5%, in the quarter ended June 30, 2012, compared to the same period last year. This was primarily due to a reduction in work hours of 6 million, or 2%, in 2012 compared to 2011. Health benefits expense of \$1,292 million decreased \$19 million, or 1.4%, and other compensation of \$85 million decreased \$8 million or 8.6%, compared to the same period prior year. These savings were partially offset by an increase of \$15 million, or 1%, in retirement expense for the three months ended June 30, 2012, compared to the same period last year. Retirement expenses did not drop commensurately with work hours due to higher FERS contribution rates required by OPM beginning October 1, 2011. These higher rates were required by OPM in spite of the fact that the Postal Service's portion of FERS is overfunded by an estimated \$11.4 billion.

Compensation and Benefits Expense (Dollars in millions)	Three Months Ended June 30,		Nine Months Ended June 30,	
	2012	2011	2012	2011
Compensation	\$ 8,898	\$ 8,947	\$ 27,332	\$ 27,718
Retirement	1,470	1,455	4,406	4,409
Health Benefits	1,292	1,311	3,902	3,906
Other	85	93	289	303
Total Compensation and Benefits	\$ 11,745	\$ 11,806	\$ 35,929	\$ 36,336

Year-to-date compensation and benefits expense was \$35,929 million, a \$407 million, or 1.1%, decrease compared to the nine months ended June 30, 2011. Year-to-date compensation expense decreased \$386 million, or 1.4%, from the same period last year as a result of a 20 million, or 2.3%, reduction in work hours used. Retirement expense of \$4,406 million decreased \$3 million, or 0.1%, for the nine months ended June 30, 2012, compared to the same period last year. Health benefits expense of \$3,902 million for the nine months ended June 30, 2012, decreased \$4 million, or 0.1%, when compared to the same period last year. Other expense of \$289 million decreased by \$14 million, or 4.6%, for the nine months ended June 30, 2012, as compared to the same period last year.

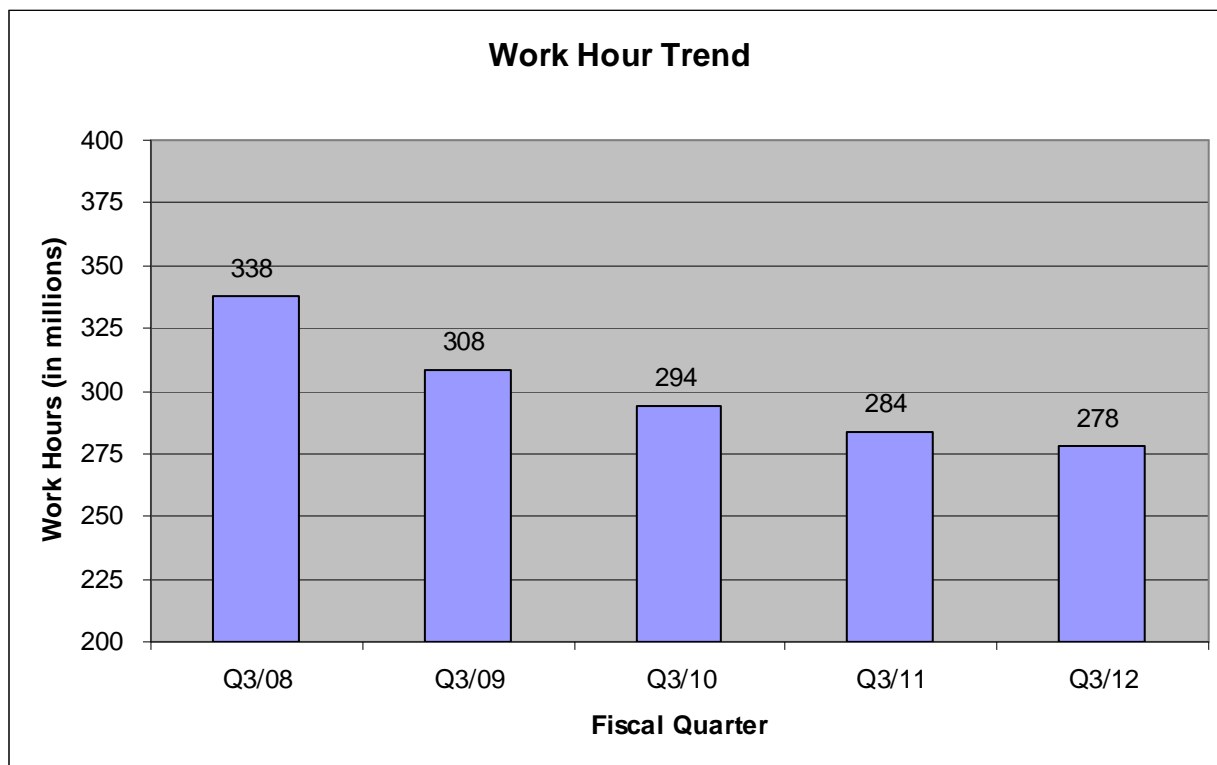
WORK HOURS

The Postal Service reduced work hours in the quarter ended June 30, 2012, by 6 million hours, or 2%, compared to the same period last year. Cumulative year-to-date work hour reductions, compared to the same nine month period last year, total 20 million hours, or 2.3%. This represents a reduction of approximately 11,170 full time equivalent employees.

Work Hours (Hours in Thousands)	Three Months Ended June 30,		Nine Months Ended June 30,	
	2012	2011	2012	2011
City Delivery	97,026	99,025	293,552	300,512
Mail Processing	50,391	51,700	159,958	163,562
Customer Services Operations	35,821	36,934	109,658	114,140
Rural Delivery	44,828	45,034	133,323	132,813
Postmasters	14,836	14,941	43,579	44,233
Other, including Retail, Plant, Vehicle Services, Operational Support, & Administration	35,773	36,836	107,089	111,559
Total	278,675	284,470	847,159	866,819

Since 2000, we have increased our efficiency and removed 497 million work hours from our cost base. At our current average hourly compensation and benefit rate, this equates to annual savings of approximately \$21 billion.

The following chart illustrates our third quarter work hour usage since 2008, and which declined by 17% over the succeeding four years:

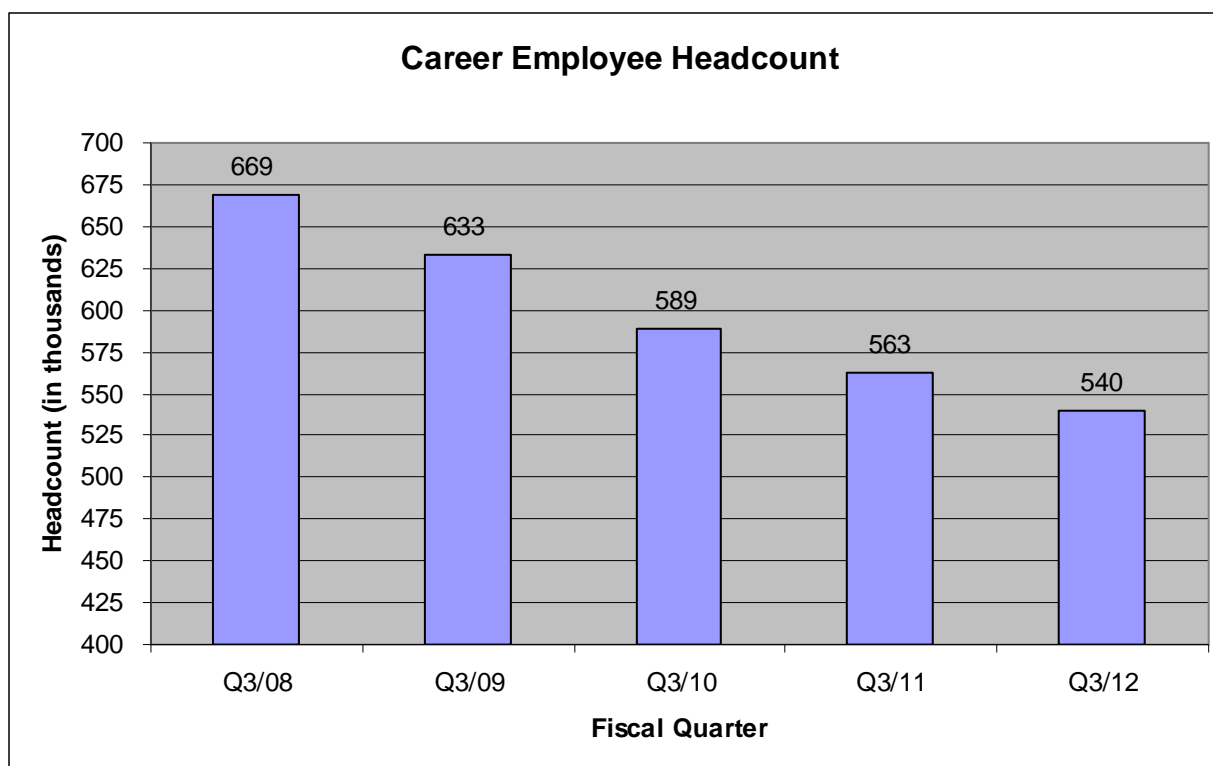


EMPLOYEE WORKFORCE

The total number of employees at June 30, 2012, was approximately 638,000, of which approximately 540,000 were career employees, reflecting a reduction of 3,281 career employees during the three months ended June 30, 2012. There has been a cumulative reduction of approximately 248,000, or 31%, of our career employees from the total of approximately 788,000 as of September 30, 2000. Career

employees have decreased by approximately 23,000 since June 30, 2011. These reductions have been accomplished primarily through attrition and separation incentives to retire or resign.

The following graph depicts the number of Postal Service career employees as of the third quarter each year since 2008, and which declined by 19% over the succeeding four years:



As disclosed in our Quarter II, 2012, Form 10-Q, we will begin to modify certain Postal offices' retail window operating hours to match customer use as part of a new strategy to keep the nation's smallest Post Offices open for business. This was communicated in a press release on May 9, 2012. Later that month, on May 17, 2012, we announced that we would move ahead with a modified network rationalization plan to consolidate our network of 461 mail processing locations in phases. The overall plan provides a framework to increase efficiency and achieve significant cost savings as part of our strategy to return the organization to financial stability.

To reduce the impact on existing employees, two voluntary separation incentives were offered: one to approximately 21,000 postmasters with an incentive of \$20,000 and one to approximately 45,000 mail handlers represented by the NPMHU with an incentive of \$15,000. The incentive for both programs will be payable in equal installments on December 21, 2012, and on December 20, 2013. Eligible postmasters or mail handlers include those qualifying under the Voluntary Early Retirement authority (VER), as well as, those who have already reached their minimum retirement age and service requirements and employees who chose to voluntarily resign from the Postal Service. Employees were required to have formally accepted the incentive to leave by July 2, 2012. Approximately 8,000 employees accepted the separation incentive. All of those electing to take the incentive must leave the Postal Service no later than August 31, 2012.

In compliance with GAAP, the full amount of these payments will be recorded as an expense in Quarter IV, 2012, although the cash payments will be paid in future periods. For the three and nine months ended June 30, 2012, and 2011, no amounts have been accrued in the financial statements.

RETIREMENT EXPENSE AND HEALTH BENEFITS EXPENSE- CURRENT EMPLOYEES

Retirement expense was \$1,470 million, compared to \$1,455 million for the same period last year, an increase of \$15 million, or 1%. The increase was driven by a 0.2% OPM-mandated increase in the employer contribution rate for the Federal Employment Retirement System (FERS) employees. The rate increased to 11.9% of eligible payroll in 2012, up from 11.7% in 2011. This 0.2% increase in 2012 is in addition to a 0.5% increase that occurred in 2011. Year-to-date retirement expense was \$4,406 million, compared to \$4,409 million for the same period last year, a decrease of \$3 million, or 0.1%.

According to the Office of Personnel Management (OPM), we have overfunded our FERS obligations by \$10.9 billion as of September 30, 2010, the latest actual data available. OPM's most recent calculation shows that the FERS surplus was projected to grow to \$11.4 billion by September 30, 2011. We continue to seek a refund of the overfunded balance which will require congressional action.

Our share of the health care premiums for our employees was \$1,292 million, or 78%, of the total health care premium cost for the three months ended June 30, 2012, compared to \$1,311 million, or 78%, for the three months ended June 30, 2011. The \$19 million decrease was driven by an approximate decrease of 3,300, or 0.5%, in the number of career employees. For the nine months ended June 30, 2012, our contribution to health care premiums was \$3,902 million, or 78%, of the total health care premium cost, compared to \$3,906 million, or 79%, for the same period last year.

Operating Expenses – Retiree Health Benefits

P.L. 109-435 included a 10 year, \$55,800 million payment prefunding schedule. However, although P.L. 109-435 dictates the amounts and timing of payments through 2016, the amounts to be paid and the timing of the payments can be rescheduled at any time with the passage of a new law, or amendment of the existing law.

On September 30, 2011, P.L. 112-33, *Continuing Appropriations Act, 2012*, rescheduled the required PSRHBF payment of \$5.5 billion previously scheduled to be due by September 30, 2011, to be due by October 4, 2011. This date was then rescheduled by a number of laws subsequently passed. The most recent law affecting the PSRHBF payment, P.L. 112-74, *Consolidated Appropriations Act, 2012*, rescheduled the due date to August 1, 2012. As a result, the total required PSRHBF payment in 2012 is \$11.1 billion: \$5.5 billion due by August 1, 2012, and \$5.6 billion due by September 30, 2012. To date, no law changes have altered the payment requirements for the \$5.6 billion due by September 30, 2012, or the 2013 to 2016 scheduled payments. As a result of these legislative changes, we are accruing the \$5.5 billion payment due by August 1, 2012, in equal amounts over ten months, and the \$5.6 billion due by September 30, 2012, in equal amounts throughout the year.

On August 1, 2012, subsequent to the end of Quarter III, when the \$5.5 billion PSRHBF prefunding payment became due we had insufficient funds to make this payment and were forced to default. The statutory requirement establishing the payment schedule (P.L. 109-435) contains no provisions addressing a payment default, so we are uncertain what consequences, if any, will result. We did, however, advise all our stakeholders of the imminent default, including the White House and the Congress.

As noted in previous filings, we have asked Congress numerous times to restructure the PSRHBF prefunding payment schedule. To date, the 2007, 2008, and 2010 payments were paid in full. The \$5.4 billion payment due in 2009 was reduced (P.L. 111-68) by \$4.0 billion to \$1.4 billion. The 2011 payment of \$5.5 billion, initially due by September 30, 2011, was rescheduled a number of times, finally to August 1, 2012 (H. Rept. 112-331). Further, current law obligates us to make a payment of \$5.6 billion by September 30, 2012, and additional payments of \$5.6 billion in 2013, \$5.7 billion in 2014 and 2015, and \$5.8 billion in 2016, each due by September 30 of each respective year.

On June 28, 2012, the Chairman of our Board of Governors and the Postmaster General informed the White House and Members of Congress that, absent intervening legislative action, we would be forced to default on the August 1, 2012, prefunding payment of \$5.5 billion. Additionally, if there are no legislative

changes, we will default on the \$5.6 billion payment due by September 30, 2012, and we see no current means to satisfy the future payment of \$5.6 billion due by September 30, 2013.

While the President proposed comprehensive postal reform measures in the fiscal year 2012 budget and the Congress is considering bills that would comprehensively address retiree health benefits prefunding and other postal reform measures, no legislative solution has yet been enacted and we remain statutorily obligated to pay PSRHBF prefunding payments. However, given the low levels of our cash resources, we may be forced to prioritize payments to our employees and our suppliers to ensure that we continue to be able to fulfill our other statutory obligations, including our obligation to provide universal mail service to the nation (as discussed in *Note 3 – Liquidity*).

In accordance with GAAP, we have been accruing the full \$5.5 billion payment due by August 1, 2012, in equal amounts over the previous nine months. As of June 30, 2012, the financial statements include \$5.0 billion of the \$5.5 billion due by August 1, 2012, and \$4.2 billion of the \$5.6 billion due by September 30, 2012.

The components of retiree health benefits expense for the three month and nine month periods ended June 30, 2012, and 2011, are as follows:

Retiree Health Benefits (Dollars in millions)	Three Months Ended June 30,		Nine Months Ended June 30,	
	2012	2011	2012	2011
Employer Premium Expense	\$ 662	\$ 620	\$ 1,954	\$ 1,818
P.L. 109-435 Payment to PSRHBF	3,050	1,375	9,150	4,125
Total Retiree Health Benefit Expense	\$ 3,712	\$ 1,995	\$ 11,104	\$ 5,943

Note that, while no PSRHBF prepayments were made in 2011, during the first three quarters of the year the expense was ratably accrued. The accrual was reversed in the fourth quarter when the prepayment due by September 30, 2011, was rescheduled to ultimately being due by August 1, 2012. Expenses for the three months ended June 30, 2012, for retiree health benefits employer premiums increased \$42 million, or 6.8%, from the same period last year. For the nine months ended June 30, 2012, retiree health benefits employer premiums increased \$136 million, or 7.5%, from the same period last year. The major drivers of retiree health benefit employer premium expense are the number of current participants on the rolls and premium costs of the plans they select. As of June 30, 2012, there were approximately 469,000 participants, approximately the same number of participants reported at June 30, 2011. Despite nominal fluctuations in the number of plan participants, retiree health benefit premium expense increased due to an increase in the cost of premiums.

Operating Expenses – Workers’ Compensation

Postal employees injured on the job are covered by the Federal Employees’ Compensation Act (FECA), administered by the Department of Labor’s (DOL) Office of Workers’ Compensation Programs (OWCP), which makes all decisions regarding injured workers’ eligibility for benefits. However, we annually reimburse the DOL for all workers’ compensation benefits paid to or on behalf of postal employees, and pay an administrative fee to the DOL.

An estimation model that combines four generally accepted actuarial valuation techniques is used to project future claim payments based upon currently open claims and past claim payment experience.

A liability is recorded for the present value of estimated future payments to postal employees, or their qualified survivors, who have been injured through the end of the reporting period. The estimated total cost of a claim is based on the date of the injury, pattern of historical payments, frequency or severity of the claim-related injury or injuries, and the expected trend in future costs. The liability for claims arising more than 10 years ago is determined by an independent actuary. Because the FECA benefit structure

allows payments superior to benefits available under normal federal retirement, the payments will, in some cases, be for the rest of the lives of the claimants.

To record the liability and annual expense, an estimate is made of the amount of funding that would need to be invested at current interest rates in order to fully fund all estimated future payments. Inflation and discount (interest) rates are updated as of the date of the financial statements to determine the present value of the workers' compensation liability at fair value in accordance with GAAP. The impact of changes in the discount and inflation rates is accounted for as a change in accounting estimate and included in operating expenses.

The estimation of the liability is highly sensitive to changes in inflation and discount rates. The inflation and discount rates used to estimate the workers' compensation liability and related expense are shown in the following table.

Workers' Compensation Liability Inflation and Discount Rates	Quarter Ended			
	June 30, 2012	September 30, 2011	June 30, 2011	September 30, 2010
Compensation Claims Liability:				
Discount Rate	2.1%	2.3%	3.5%	2.9%
Wage Inflation	2.9%	2.9%	2.9%	2.9%
Medical Claims Liability:				
Discount Rate	2.1%	2.4%	3.5%	3.0%
Medical Inflation	8.9%	8.6%	8.3%	7.4%

An increase of 1% in the discount rate would decrease the June 30, 2012 liability and Quarter III, 2012 expense by approximately \$1.7 billion. A decrease of 1% in the discount rate would increase the June 30, 2012 liability and Quarter III, 2012 expense by \$2.1 billion.

At June 30, 2012, the present value of the liability for future workers' compensation payments was \$16,093 million, compared to \$15,142 million at September 30, 2011, an increase of \$951 million. The current portion of the liability was \$1,320 million at June 30, 2012, compared to \$1,255 million at September 30, 2011.

Workers' compensation expense, including the impact of changes in the discount rates, for the three month and nine month periods ended June 30, 2012, and 2011, was as follows:

Workers' Compensation Expense (Dollars in millions)	Three Months Ended June 30,		Nine Months Ended June 30,	
	2012	2011	2012	2011
Impact of Discount Rate Changes	\$ 897	\$ 280	\$ 386	\$ (749)
Actuarial valuation of new cases and revaluation of existing cases	572	507	1,819	1,703
Subtotal	<u>1,469</u>	<u>787</u>	<u>2,205</u>	<u>954</u>
Administrative Fee	17	15	50	46
Total Workers' Compensation Expense	\$ 1,486	\$ 802	\$ 2,255	\$ 1,000

On a quarterly basis, changes in the number of claims and amounts paid are highly volatile and depend on a number of factors including, but not limited to, the following: the number, timing and severity of

injuries; the number of new claims and closed claims within the period; and the amount and timing of payments made by the OWCP on our behalf. Medical and compensation claims payments fluctuate significantly from quarter to quarter so the change in the number of paid medical and compensation claims for any quarter compared to the same period last year may not necessarily be representative of the results to be expected for the full year. In the three and nine months ended June 30, 2012, we experienced a \$9 million, or 5.1%, and a \$41 million, or 7.2%, increase in compensation claim payments. The increase in compensation payments for the nine month period ended June 30, 2012, continues to be pronounced after a reassessment of employees on light or limited duty status resulted in an increase in workers compensation benefits payments to some beneficiaries. For the three months ended June 30, 2012, there was a \$3 million, or 2.4%, increase in medical claims. However, for the nine months ended June 30, 2012, there was an \$11 million, or 3.1%, decrease in medical claims payments compared to the same period last year.

Operating Expenses – Transportation

Transportation expenses are primarily comprised of highway, air, and international transportation costs. Transportation expenses for the three months ended June 30, 2012, were \$1,604 million, an increase of \$47 million, or 3%, compared to \$1,557 million for the same period last year. For the nine months ended June 30, 2012, transportation expenses were \$5,048 million, a \$278 million, or 5.8%, increase from \$4,770 million expense incurred during the first nine months of 2011.

Transportation Expense (Dollars in millions)	Three Months Ended June 30,		Nine Months Ended June 30,	
	2012	2011	2012	2011
Highway Transportation	\$ 817	\$ 829	\$ 2,557	\$ 2,525
Air Transportation	564	518	1,723	1,573
International Transportation	216	198	735	633
Other Transportation	7	12	33	39
Total Transportation Expense	\$ 1,604	\$ 1,557	\$ 5,048	\$ 4,770

In Quarter III, 2012, highway transportation expenses were \$817 million, a decrease of \$12 million, or 1.4%, compared to expenses of \$829 million in Quarter III, 2011. For the first nine months of 2012, highway transportation expenses were \$2,557 million, an increase of \$32 million, or 1.3% over expenses of \$2,525 million for the same period of the prior year, primarily attributable to increases in the cost of diesel fuel. Diesel fuel, which makes up approximately 93% of fuel purchased for highway contracts, had an average cost of \$3.95 per gallon during Quarter III, 2012, compared to \$3.93 per gallon in Quarter III, 2011, an increase of 0.5%. For the first nine months of 2012, the price of diesel fuel averaged \$3.93 per gallon, compared to \$3.55 per gallon during the first nine months of 2011, an increase of 10.7%.

Partially offsetting the increases in fuel costs during the first nine months of 2012 was a 41 million mile, or 3%, decrease in contracted highway miles driven compared to the first nine months of 2011. This is a result of continuing national and local surface transportation utilization improvement initiatives.

Air transportation expenses of \$564 million for the quarter ended June 30, 2012, increased by \$46 million, or 8.9%, from \$518 million for the same quarter last year. For the nine months ended June 30, 2012, air transportation expenses of \$1,723 million were \$150 million, or 9.5%, greater than the first nine months of 2011. Similar to highway transportation, air transportation expenses were highly influenced by rising fuel prices. At the same time, however, declining volume has allowed us to partially offset some of these increases.

International transportation expenses of \$216 million for the quarter ended June 30, 2012, increased \$18 million, or 9.1%, compared to last year. Expenses for the nine months ended June 30, 2012, also increased \$102 million, or 16.1%, compared to last year, as international foreign postal transaction rates increased, and as the ratio of packages to the less expensive letter mail increased. The largest component of international transportation expense is the fee that we pay to foreign postal administrations

for transportation and delivery of mail within their country. These foreign postal transaction fees represented 71% and 79% of the total international transportation expense for the nine months ended June 30, 2012, and 2011, respectively.

Operating Expenses – Other Operating Expense

Other operating expenses of \$2,208 million for the three months ended June 30, 2012, were \$463 million, or 17.3%, less than the \$2,671 million of other operating expenses for the same period last year. For the nine months ended June 30, 2012, other operating expenses of \$6,706 million were \$669 million, or 9.1%, less than the \$7,375 million of other operating expense for the first nine months of 2011.

Other Operating Expenses (Dollars in millions)	Three Months Ended June 30,		Nine Months Ended June 30,	
	2012	2011	2012	2011
Supplies and Services	\$ 557	\$ 519	\$ 1,638	\$ 1,656
Depreciation and Amortization	509	587	1,579	1,738
Rent and Utilities	380	398	1,211	1,263
Vehicle Maintenance Service	248	253	748	725
Information Technology and Communications	173	174	483	485
Rural Carrier Equipment Maintenance Allowance	144	140	431	403
Other	197	600	616	1,105
Total Other Operating Expenses	\$ 2,208	\$ 2,671	\$ 6,706	\$ 7,375

For the three and nine months ended June 30, 2012, decreases in depreciation of \$78 million, or 13.3% and \$159 million, or 9.1%, and in rent expense of \$18 million or 4.5% and \$52 million, or 4.1%, were driven by a freeze in non-essential capital spending and our overall efforts to reduce square footage of postal facilities. While supplies and services increased \$38 million, or 7.3%, for the three months ended June 30, 2012, this expense item decreased for the nine months then ended by \$18 million, or 1.1% as compared to last year. The year to date result reflects management's continued efforts to control such costs.

Other expense decreased by \$403 million, or 67.2%, for the three months ended June 30, 2012, compared to the same period in the prior year. The high amount of other expenses in the prior year was driven by legal expenses associated with the contingent liability reevaluation process of \$370 million incurred during Quarter III, 2011. No similar expenses were incurred in 2012. For the nine months ended June 30, 2012, other expense decreased by \$489 million, or 44.3%, compared to the same period in the prior year reflecting the Quarter III legal expenses in 2011, as well as losses due to equipment disposals and building repair expenses incurred in prior quarters of 2011. No similar expenses or disposals occurred in 2012.

These decreases were partially offset by increases in rural carrier equipment maintenance of \$4 million or 2.9%, and \$28 million, or 6.9%, for the three and nine months ended June 30, 2012, respectively. While vehicle maintenance services experienced a \$5 million, or 2%, decrease for the three months ended June 30, 2012; year-to-date results were a \$23 million, or 3.2%, increase as compared to last year. These vehicle and equipment maintenance expenses include fuel and vehicle supply parts. Fuel costs accounted for 53%, and 50%, of the total vehicle maintenance service expense for the nine months ended June 30, 2012, and 2011, respectively.

Liquidity and Capital Resources

CASH FLOW ACTIVITY

Cash and cash equivalents totaled \$893 million at June 30, 2012, compared to \$1,488 million and \$901 million at September 30, 2011, and June 30, 2011, respectively. The following table provides a summary of our cash flows for the nine month periods ended June 30, 2012, and 2011:

Cash Flow Statement	Nine Months Ended	
	June 30,	
(Dollars in millions)	2012	2011
Operating activities:		
Net loss	\$ (11,649)	\$ (5,657)
Noncash depreciation and gains on sales	1,585	1,733
Changes in assets and liabilities	10,389	3,870
Cash provided by (used by) operating activities	<u>325</u>	<u>(54)</u>
Investing activities:		
Capital expenditures, net of proceeds	(472)	(813)
Cash used by investing activities	<u>(472)</u>	<u>(813)</u>
Financing activities:		
Net change in notes payable	(400)	1,300
Net change in revolving credit line	35	(608)
Other	(83)	(85)
Cash (used by) provided by financing activities	<u>(448)</u>	<u>607</u>
Net Decrease in Cash and Cash Equivalents	\$ (595)	\$ (260)

Operating Activities: Operating activities generated \$325 million of cash during the nine months ended June 30, 2012, compared to \$54 million of cash used by operating activities for the nine months ended June 30, 2011, an increase of \$379 million. In Quarter I, 2012, we resumed our regular biweekly payments for FERS employer's contributions as well as the remittance of all previously withheld payments, including the \$911 million accrued at September 30, 2011. Had we not made the additional FERS contributions in Quarter I, 2012, to compensate for the funds withheld in 2011, operating cash flow for the nine months ended June 30, 2012, would have generated \$1,236 million.

Investing Activities: Purchases of property and equipment were \$575 million for the nine months ended June 30, 2012, compared to \$893 million in the same period last year, a decrease of \$318 million or 35.6%, as capital spending continued to decrease in order to conserve cash. Proceeds from the sale of property and equipment were \$103 million, and \$80 million for the nine months ended June 30, 2012, and 2011, respectively.

Financing Activities: In addition to the cash generated by operations, we use credit lines and notes payable to the Federal Financing Bank to help fund operations. During the nine months ended June 30, 2012, we issued \$3,700 million in notes payable and repaid \$4,100 for a net repayment of \$400 million. For the same period last year, we issued \$3,700 in notes payable and repaid \$2,400 million for a net issuance of \$1,300 million. The revolving credit line increased by \$35 million and decreased \$608 million for the nine months ended June 30, 2012, and June 30, 2011, respectively.

LIQUIDITY CHALLENGES

SUMMARY OF PROJECTED CASH SHORTFALL

We continue to suffer from a severe lack of liquidity caused by over \$25 billion of cumulative net losses in the past five fiscal years. These losses were largely driven by \$21 billion of Congressionally-mandated payments for prefunding retiree health benefits. During those five years, our debt has increased by nearly \$11 billion to finance the losses and prefunding payments.

The trend of losses continues this year, as we had net losses of \$5,185 million and \$11,649 million for the three and nine months ended June 30, 2012. These 2012 losses were largely the result of expenses for prefunding retiree health benefits of \$3,050 million and \$9,150 million for the three and nine months, respectively. In addition, our liquidity was limited to \$893 million of total cash and \$2.4 billion of remaining borrowing capacity on our \$15 billion debt facility at June 30, 2012.

As described in *Note 2 – Subsequent Events*, we were forced to default on the required \$5.5 billion prefunding payment for retiree health benefits which was due by August 1, 2012. Further, we notified the White House, the Congress, and OPM, that absent legislative change, we will also default on the \$5.6 billion payment due by September 30, 2012.

Even without making \$11.1 billion of scheduled PSRHBF payments in the fourth quarter of 2012, current projections indicate that we will have a low level of cash and liquidity at September 30, 2012. This position will worsen in October of 2012, when we are required to make our annual reimbursement payment of approximately \$1.4 billion to the DOL for workers' compensation, in addition to paying our normal operating expenses. Although the cash position is projected to improve slightly for a few months during the fall mailing season, current projections indicate that by spring 2013, we will again have a low level of cash and borrowing capacity. Further, these projections also indicate that we will be unable to make the \$5.6 billion prefunding payment due by September 30, 2013.

To address our long-term financial challenges, we released in February 2012, a comprehensive five-year plan to achieve financial stability and repay debt. We are aggressively pursuing new revenue streams, improving productivity and reducing costs in areas within our control. Additionally, we have proposed legislative changes to Congress that are needed to provide us with the legal authority to implement certain measures to increase efficiency and cost savings, as specified in the plan. Legislation has been introduced in both houses of Congress and a bill has been passed by the Senate. The bill passed in the Senate, although representing a positive step, does not contain the authority necessary to implement all required improvements to increase productivity and cost savings. Given the vital role that we play in the U.S. economy, we are requesting that Congress take the steps needed to enact legislative changes that will enable us to return to financial stability.

In the short-term, should circumstances leave us with insufficient liquidity, we would consider emergency measures to ensure that mail deliveries continue. These measures could require that we prioritize payments to our employees and suppliers ahead of those to the Federal Government. Additionally, we continue to seek a refund of the overfunding of our FERS retirement plan, which currently amounts to approximately \$11 billion, as those funds would help alleviate short-term liquidity risks.

POSTAL INITIATIVES UNDERTAKEN TO IMPROVE LIQUIDITY

As noted in previous filings, we have removed nearly \$14 billion from our annual cost base during the past five fiscal years. We plan to continue our efforts to improve productivity and generate cost savings, as outlined in our five-year plan, to return to financial stability and repay debt. Many of the strategies that we are aggressively pursuing are currently within our control. These include rationalizing the mail processing, retail and delivery networks in order to better align them with mail volumes, increasing revenue generation and reducing workforce costs. Certain parts of the plan, such as transitioning to a five-day per week delivery schedule, obtaining a refund of \$11 billion overfunding in the FERS, and resolving the prefunding of retiree health benefits are beyond the control of management and require enactment of legislation.

Management is pursuing a strategy to increase the efficiency of its mail processing network. This requires a reduction in the number of mail processing and distribution plants and the rescheduling of transportation routes. In response to declining mail volumes, we have already consolidated over 200 mail processing facilities in the past five years while continuing to provide record delivery service and to increase productivity. On May 17, 2012, we announced a modified, phased plan to continue the consolidation of our network of 461 mail processing locations. The first phase will result in up to 140 consolidations through February 2013. Unless our circumstances change, a second and final phase of 89 additional consolidations is currently scheduled to begin in February 2014.

We are also working to increase the efficiency and reduce the costs of our retail network, while continuing to provide excellent service to all communities throughout America. On May 9, 2012, we announced a strategy to preserve the Post Offices serving rural America while providing a framework to achieve significant cost savings. This strategy, called the POSTPlan, will allow Post Offices to remain operational with modified window hours and will also allow the affected towns to retain their ZIP Codes.

Along with the operational changes discussed above, we are seeking to reduce workload and staffing by better aligning staffing levels with projected mail volume. It is expected that this will be achieved largely through attrition, as approximately one-half of career employees are eligible for retirement or early retirement. In Quarter III, 2012, two voluntary incentive separation offers were announced: one to approximately 21,000 postmasters with an incentive of \$20,000 and one to approximately 45,000 mail handlers with an incentive of \$15,000. The incentives for both programs will be payable in two equal installments on December 21, 2012, and on December 20, 2013. To receive the incentive, eligible employees were required to have formally accepted the incentive to leave the Postal Service by July 2, 2012. Approximately 8,000 employees accepted the incentive offer and will leave the Postal Service no later than August 31, 2012. In compliance with GAAP, the full amount of the incentive payments will be recorded as an expense in Quarter IV, 2012, although the cash payments will be paid in future periods.

We continue to implement innovative new products to generate new revenue and to prevent existing revenue streams from migrating to electronic alternatives. Existing products and online services have been enhanced with "ease of use" in mind in an effort to grow business. However, it is not possible to achieve financial stability through revenue initiatives alone, without a fundamental change in the business model.

As mentioned above, portions of our plan require targeted legislative changes. One legislative change sought by us is a directive for the return of the overfunding of the FERS contributions. OPM has determined that the amount of overfunding was \$11 billion as of September 2011. Although the refund would not be a recurring annual savings, it would provide vital cash flow to help ease the current liquidity difficulties.

Additionally, we have proposed that we sponsor our own health care program independent of other federal health insurance programs. Establishing a Postal Service-sponsored health care program would account for over \$7 billion of projected annual savings. The plan would allow for the elimination of the retiree health benefit prefunding obligation established in the *Postal Service Accountability and Enhancement Act of 2006*, which would save us over \$5 billion dollars annually through 2016. The plan also proposes to transfer current retirees into the Postal Service-sponsored health care program, an action that requires legislation. Our plan is expected to be more cost effective, is forecasted to reduce health care costs significantly, and will result in equivalent or better coverage for the vast majority of retirees and current employees.

MITIGATING CIRCUMSTANCES

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. Despite falling mail volume, we are still widely recognized as the provider of an essential government service to the American people and for our importance in the \$1 trillion mailing industry. There are a few potential legislative remedies that could resolve the short-term liquidity concerns. Therefore, it is unlikely that, in the event of a cash shortfall, the Federal Government would cause or allow us to significantly curtail or cease operations.

More than a dozen different postal reform-related bills have been introduced in the 112th Congress, in addition to a plan proposed by the Administration. On April 25, 2012, the Senate passed S. 1789, the *21st Century Postal Service Act of 2012*, which includes provisions to refund our FERS overfunding, permits five-day mail delivery after two years (under certain conditions), and reduces funding of PSRHF, but also restricts service standard changes. A House bill H.R. 2309, the *Postal Reform Act of 2011* is out of committee but has not yet reached the floor for a full House vote. No individual bill proposed or passed in either the House or Senate contains all the necessary components to ensure the long-term financial viability of the Postal Service. We continue to inform the White House, Congress, the PRC, and other stakeholders of the immediate and longer-term financial issues we face and the legislative changes that would help provide financial stability. Given the vital role we play in the U.S. economy, we are hopeful that Congress will enact, and the President will sign, legislation which will mitigate our short-term financial

challenges and provide us with the authority to make needed changes to ensure long-term financial stability. However, there can be no assurances that the requests to restructure the PSRHBF prefunding payment schedule, or any other legislative changes, will be made in time to impact 2012, or at all.

Contractual Obligations

Our cash flow obligations as of June 30, 2012, for 2012 and future years are scheduled in the following table.

Contractual Obligations (Dollars in millions)	Payments Due by Period Ending June 30,				
	Total	Less than 1 Year	1-3 Years	3-5 Years	After 5 Years
Debt ⁽¹⁾	\$ 12,635	\$ 3,235	\$ 4,200	\$ 300	\$ 4,900
Interest on debt ⁽¹⁾	2,114	180	342	329	1,263
PSHRBF	33,900	11,100	11,300	11,500	-
Capital lease obligations	684	50	188	227	219
Operating leases	6,936	376	1,359	2,042	3,159
Capital commitments ⁽²⁾	482	179	237	44	22
Purchase obligations ⁽²⁾	1,816	371	1,442	3	-
Workers' compensation ⁽³⁾	22,401	1,320	4,096	3,020	13,965
Employees' leave ⁽⁴⁾	2,317	261	113	245	1,698
	\$ 83,285	\$ 17,072	\$ 23,277	\$ 17,710	\$ 25,226

(1) For overnight and short-term debt, the table assumes the balance as of period end remains outstanding for all periods presented.

(2) Legally binding obligations to purchase goods or services. Capital commitments pertain to purchases of equipment, building improvements and vehicles. Purchase obligations generally pertain to items that are expensed when received or amortized over a short period of time. Capital commitments and purchase obligations are not reflected on the Balance Sheet.

(3) Assuming no new cases in future years. This amount represents the undiscounted expected workers' compensation payments. The discounted amount of \$16,093 million is reflected in our Balance Sheet at June 30, 2012.

(4) Employees' leave includes annual and holiday leave.

Legal Matters and Contingent Liabilities

An estimated loss contingency is accrued in our financial statements if it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Assessing contingencies is highly subjective and requires judgments about future events. We regularly review loss contingencies to determine the adequacy of our accruals and related disclosures. The amount of the actual loss may differ significantly from these estimates. As of June 30, 2012, the material claims outstanding have not changed significantly from September 30, 2011.

McConnell v. Donahoe: On January 14, 2010, the Equal Employment Opportunity Commission's (EEOC) Office of Federal Operations certified a class action case against the Postal Service in a matter captioned McConnell v. Donahoe. The class currently consists of all permanent rehabilitation employees and limited-duty employees who have been subjected to the National Reassessment Process (NRP) from May 5, 2006, to July 1, 2011. We used the NRP to ensure that our records were correct and that employees receiving workers' compensation benefits were placed in jobs consistent with their abilities. The 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 creation by the NRP 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 on behalf of a yet-unidentified population of

employees. If the plaintiffs were able to prove their allegations in this matter and to establish the damages they assert, then an adverse ruling could have a material adverse impact on us. However, we dispute the claims asserted in this class action case and are vigorously contesting the matter. See Note 7, *Contingent Liabilities*, in Notes to the Financial Statements for additional information.

Fair Value Measurements

As required by authoritative accounting literature, certain fair value disclosures for the three months ended June 30, 2012, are contained in the Notes to the Financial Statements. We did not recognize gains as a result of valuation measurements during Quarter III, 2012. All recognized losses have been incorporated into our financial statements as of June 30, 2012. See Note 11-*Fair Value Measurements*.

Legislative Update

Our legislative update section provides ongoing insights into the legislative and policy processes that may affect the Postal Service and its operations. Please also refer to the Legislative Update contained in our Annual Report on Form 10-K for the period ending September 30, 2011.

MAJOR CONGRESSIONAL POSTAL REFORM PROPOSALS

21st CENTURY POSTAL SERVICE ACT OF 2011

On April 25, 2012, the Senate passed S. 1789, the *21st Century Postal Service Act of 2011*. S. 1789 provides for reform on a variety of issues. S. 1789 would:

- Return the current FERS overpayment of approximately \$11 billion to the Postal Service, along with any future surpluses. The returned surplus may be used for incentive payments for retirement, or paying the value of incentives in the form of added service credits, for employees retiring before October 1, 2015. Additionally, the returned surplus may be used to pay down debt or make other payments to federal agencies, such as the workers' compensation reimbursement to DOL.
- Requires the Postal Service to offer retirement incentives to such an extent as would reasonably be expected to result in an 18% reduction in career employees by October 1, 2015.
- Restructure the existing pre-payment schedule for PSRHBF by cancelling the 2011 to 2017 annual payments and provide an amortized payment schedule with a pre-funding goal of 80 percent of the total pre-funding liability beginning September 30, 2013. Additionally, retiree premiums would be paid from the PSRHBF, rather than from Postal funds.
- Enact government-wide workers' compensation reforms.
- Prohibit the Postal Service from instituting five-day delivery for a two-year period, following enactment of S. 1789, but allows implementation after a GAO report on the financial necessity of five-day delivery and a second PRC advisory opinion.
- Modify existing procedures governing the Area Mail Processing (AMP) study process, particularly the public input process.
- Provide for other items, such as requiring an arbitrator to consider the financial condition of the Postal Service when making decisions on collective bargaining agreements, creating service standards for access to retail services, permitting the Postal Service to offer new non-postal services, and allowing for the mailing of wine, beer and distilled spirits.

POSTAL REFORM ACT OF 2011

On March 26, 2012, the House Rules Committee held a markup of its portion of amended legislation on H.R. 2309, the *Postal Reform Act of 2012*. The Committee approved by voice vote an Amendment in the Nature of a Substitute that would delete a provision in the bill requiring Congress to approve the disbandment of the financial oversight authority created in the bill. The bill was ordered reported favorably to the full House as amended. The amendment would:

- Make changes to House and Senate procedures for disapproval of a closure plan recommended by the Commission on Postal Reorganization (CPR), which would be created by the bill.
- The substitute amendment would give Congress 45 days, as opposed to 30 days, to disapprove of and therefore halt implementation of a plan submitted by CPR.

H.R. 2309 was introduced on June 23, 2011, and provides for reform on a variety of issues. H.R. 2309, as currently written, would:

- Create a Commission on Postal Reorganization (CPR), which would conduct proceedings regarding closures and discontinuances of the Postal infrastructure to achieve certain cost reduction targets, in areas such as retail facilities, mail processing facilities, and area and district offices.
- Provide the Postal Service the authority to change to a five-day delivery frequency schedule, after one year.
- Return the overfunded surplus of the FERS surplus to the Postal Service.
- Establish a Postal Service Financial Responsibility and Management Assistance Authority, which would operate during any control period. A control period commences whenever the Postal Service has been in default to the U.S. Treasury with respect to borrowing, for a period of 30 days. The Authority would have broad powers during such control period, including assuming all of the powers of the Postal Service Board of Governors.
- Provide guidance on other issues including: modifying collective bargaining agreements, placing limitations on postal contributions to life and health insurance programs under the Federal Employee Group Life Insurance (FEGLI) and the Federal Employees Health Benefit Program (FEHBP), modifying some postal rates, allowing the Postal Service to offer specific non-postal products and services, and making reforms in specific Postal Service contracting practices and provisions.

ADDITIONAL SIGNIFICANT POSTAL LEGISLATION

MOVING AHEAD FOR PROGRESS IN THE 21ST CENTURY ACT

On July 6, 2012, the President signed Public Law 112-141, a conference report for H.R. 4348, the *Moving Ahead for Progress in the 21st Century (MAP-21) Act*. H.R. 4348 provides for the establishment of a phased retirement program for qualified Federal employees. It amends Chapters 83 and 84 of Title 5, U.S.C., to allow Federal employees covered under both the Civil Service Retirement System (CSRS) and the Federal Employees' Retirement System (FERS) who are eligible for full-time retirement to enter phased retirement status. During phased retirement, Federal employees, including Postal Service employees, may work between 20 to 80 percent of their full-time schedule and receive a phased retirement annuity. Once the phased retiree reaches full-time retirement, they become eligible for a composite retirement annuity that includes the retirement annuity attributable to the reduced work schedule. Postal employees are exempted from a requirement to spend a minimum of 20 percent of their phased retiree workhours mentoring. Although the measure has been enacted into law, the Office of Personnel Management (OPM) has yet to promulgate the applicable rules for implementation of the law. At this time, the Postal Service has no information regarding the timeline for completion of this OPM action and has not assessed the potential impact of its adoption.

APPROPRIATIONS

On June 26, 2012, the full House Appropriations Committee reported H.R. 6020 (H. Rept. 112-550), the *Financial Services and General Government Appropriations Bill, 2013*. The funding level recommended by the Committee for free mail for the blind and overseas voters is \$89 million. No funding was provided for the \$29 million debt payment owed to the Postal Service under the *Revenue Forgone Reform Act of 1993*. The bill further directs the Postal Service to ensure continuation of the current six-day delivery schedule, and that none of the funds shall be used to consolidate or close small rural or other small Post Offices in fiscal year 2013. The measure was approved by the full committee on a voice vote. It now awaits consideration by the full House.

On June 14, 2012, the full Senate Appropriations Committee reported S. 3301 (S. Rept. 112-177), the *Financial Services and General Government Appropriations Act, 2013*. The funding level recommended by the Committee for free mail for the blind and overseas voters is \$89.1 million, which is the same level requested in the President's FY2013 budget request. No funding was provided for the \$29 million debt payment owed to the Postal Service under the *Revenue Forgone Reform Act of 1993*. The bill further directs the Postal Service to ensure continuation of the current six-day delivery schedule. It also directs that the Postal Service shall not execute, prior to FY 2014, any decisions pertaining to the closure or consolidation of specific mail processing facilities. This includes facilities that were not closed or consolidated before May 15, and facilities for which the Postal Service conducted an Area Mail Processing (AMP) study after January 1, 2006. This includes AMP studies that were either terminated or concluded that no significant cost savings or efficiencies would result. The measure was ordered reported favorably by a vote of 16-14. It now awaits consideration by the full Senate.

BOARD OF GOVERNORS NOMINATIONS HEARINGS

On June 21, 2012, the Senate Homeland Security and Governmental Affairs Committee held a hearing to examine the nominations of James C. Miller III, and Dr. Katherine C. Tobin, to the Board of Governors of the United States Postal Service. Dr. Tobin was nominated to serve for a term expiring December 8, 2016. Mr. Miller was nominated to serve for a term expiring December 8, 2017. The nominations now await consideration by the full Committee.

On July 12, 2012, the Senate Homeland Security and Governmental Affairs Committee held a hearing to examine the nomination of Stephen Crawford, to the Board of Governors of the United States Postal Service. Mr. Crawford was nominated to serve for a term expiring December 8, 2015. The nomination now awaits consideration by the full Committee.

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 rate fluctuations 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.

See our 2011 10-K, Financial Section Part II, Item 7A-*Quantitative and Qualitative Disclosures about Market Risk*.

Item 4 – Controls and Procedures

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

Disclosure Controls

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in quarterly and annual reports is recorded, processed, summarized, and reported within the time frames specified by P.L. 109-435, and that this information is accumulated and communicated to our management, including the Postmaster General and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

We carried out an evaluation under the supervision and with the participation of management, including the Postmaster General and Chief Financial Officer, of the effectiveness of the design and operation of disclosure controls and procedures as of June 30, 2012. Based upon, and as of the date of, the evaluation, the Postmaster General and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

Internal Controls

There have been no changes in the Postal Service's internal controls over financial reporting during the quarter ended June 30, 2012, that have materially affected, or are reasonably likely to materially affect, the Postal Service's internal control over financial reporting.

Part II

Item 1 – Legal Proceedings

For a discussion of legal proceedings affecting us, please also see the information under the caption “*Legal Matters and Contingent Liabilities*” within Item 2 - “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in this report.

Item 1A – Risk Factors

There have been no material changes in risk factors from those disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended September 30, 2011.

Item 6 – Exhibits

Exhibit Number	Description of Exhibit
10.1	Amendment to employment/compensation contract with Paul Vogel, President, Digital Solutions, dated June 14, 2012.
31.1	Certification of Principal Executive Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities and Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities and Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

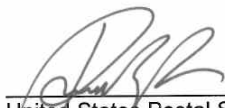
Amendment to Employment/Compensation Contract
Paul Vogel, President, Digital Solutions,
Dated June 14, 2012.

SECOND AMENDMENT OF EMPLOYMENT AGREEMENT


1. This document sets forth an amendment of the contract of employment between the United States Postal Service ("Postal Service") and Paul E. Vogel ("Mr. Vogel") as executed by the Postal Service and Mr. Vogel on July 27, 2010 and previously amended on November 14, 2011. The original contract of employment, and the first amendment, are collectively referred to as the "prior agreement" in this second amendment.
2. Paragraph 2 of the prior agreement is stricken and replaced by the following, which shall be deemed to be paragraph 2 of the presently-constituted Employment Agreement:

The Postal Service agrees to employ Mr. Vogel in the position of President, Digital Solutions, at the Postal Service's Headquarters located at 475 L'Enfant Plaza, S.W., Washington, DC. Mr. Vogel's employment in this position commenced on May 19, 2012.

3. All terms and conditions of the prior agreement, to the extent they concern events that may occur subsequent to the parties' execution of this second amendment of the employment agreement, shall remain in full force and effect.



United States Postal Service
Date: 6/12/12



Paul E. Vogel
Date: 6/14/12

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/Patrick R. Donahoe
Patrick R. Donahoe
Postmaster General and Chief Executive Officer

Date: August 9, 2012

/s/Stephen J. Masse
Stephen J. Masse
Chief Financial Officer and Executive Vice President, Acting

Date: August 9, 2012

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, Patrick R. Donahoe, 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 auditors and the audit committee of the Postal Service's Board of Governors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Postal Service's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have significant role in the Postal Service's internal control over financial reporting.

Date: August 9, 2012

/s/ Patrick R. Donahoe
Patrick R. Donahoe
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, Stephen J. Masse, 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 auditors and the audit committee of the Postal Service's Board of Governors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Postal Service's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have significant role in the Postal Service's internal control over financial reporting.

Date: August 9, 2012

/s/Stephen J. Masse
Stephen J. Masse
Chief Financial Officer and Executive Vice President, Acting

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, 2012, (the "Report"), I, Patrick R. Donahoe, 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 9, 2012

/s/Patrick R. Donahoe
Patrick R. Donahoe
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, 2012 (the "Report"), I, Stephen J. Masse, 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 9, 2012

/s/Stephen J. Masse
Stephen J. Masse
Chief Financial Officer and Executive Vice President, Acting