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 DECEMBER 31, 2014
or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Transition Period from ________to________

Commission File Number: N/A

UNITED STATES POSTAL SERVICE

(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

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

The aggregate market value of shares of common stock held by non-affiliates as of December 31, 2014: N/A

The number of shares of common stock outstanding as of February 6, 2015: N/A

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

United States Postal Service
Statements of Operations
(Unaudited)

(in millions)	Three Months Ended December 31, 2014	Three Months Ended December 31, 2013
Revenue		
Operating revenue	$ 18,734	$ 17,957
Other revenue	27	37
Total revenue	**18,761**	**17,994**
Operating expenses		
Compensation and benefits	12,421	12,102
Retiree health benefits	2,184	2,153
Workers' compensation	786	—
Transportation	1,798	1,779
Other operating expenses	2,286	2,272
Total operating expenses	**19,475**	**18,306**
Loss from operations	**(714)**	**(312)**
Interest and investment income	6	6
Interest expense	(46)	(48)
Net loss	**$ (754)**	**$ (354)**

See accompanying notes to the unaudited financial statements.

United States Postal Service
Balance Sheets

(in millions)	December 31, 2014	September 30, 2014
	(Unaudited)	
Current Assets:		
Cash and cash equivalents	$ 7,080	$ 4,906
Restricted cash	250	246
Receivables, net	883	930
Supplies, advances and prepayments	164	122
Total current assets	**8,377**	**6,204**
Property and equipment, net	16,242	16,338
Other assets	425	420
Total assets	**$ 25,044**	**$ 22,962**
Current Liabilities:		
Compensation and benefits	$ 2,986	$ 1,506
Retiree health benefits	23,843	22,417
Workers' compensation costs	1,411	1,320
Payables and accrued expenses	2,319	2,023
Deferred revenue-prepaid postage	3,338	3,064
Customer deposit accounts	1,186	1,191
Other current liabilities	1,109	1,221
Current portion of debt	9,800	9,800
Total current liabilities	**45,992**	**42,542**
Workers' compensation costs, noncurrent	16,460	17,102
Employees' accumulated leave, noncurrent	2,005	1,982
Other noncurrent liabilities	1,472	1,467
Noncurrent portion of debt	5,200	5,200
Total liabilities	**71,129**	**68,293**
Net Deficiency:		
Capital contributions of the U.S. Government	3,132	3,132
Deficit since 1971 reorganization	(49,217)	(48,463)
Total net deficiency	**(46,085)**	**(45,331)**
Total liabilities and net deficiency	**$ 25,044**	**$ 22,962**

See accompanying notes to the unaudited financial statements.

United States Postal Service
Statements of Cash Flows
(Unaudited)

(in millions)	Three Months Ended December 31, 2014	Three Months Ended December 31, 2013
Cash flows from operating activities:		
Net loss	$ (754)	$ (354)
Adjustments to reconcile net loss to cash provided by operations:		
Depreciation and amortization	442	463
Loss on disposals of property and equipment, net	(20)	(29)
Increase in other assets	(5)	(18)
Decrease in noncurrent workers' compensation	(642)	(1,407)
Increase in noncurrent deferred appropriations and other revenue	10	20
Increase in other noncurrent liabilities	20	13
Changes in current assets and liabilities:		
Receivables, net	47	(33)
Other assets	(42)	(53)
Retiree health benefits	1,426	1,373
Payables, accrued expenses and other	1,837	1,416
Deferred revenue-prepaid postage, prepaid box rents and other	204	173
Net cash provided by operating activities	**2,523**	**1,564**
Cash flows from investing activities:		
Change in restricted cash	(4)	40
Purchases of property and equipment	(335)	(182)
Proceeds from sales of property and equipment	5	32
Net cash used in investing activities	**(334)**	**(110)**
Cash flows from financing activities:		
Issuance of notes payable	2,700	2,700
Payments on notes payable	(2,700)	(2,700)
Payments on capital lease obligations and other	(15)	(26)
Net cash used in financing activities	**(15)**	**(26)**
Net increase in cash and cash equivalents	2,174	1,428
Cash and cash equivalents at beginning of period	4,906	2,326
Cash and cash equivalents at end of period	**$ 7,080**	**$ 3,754**
Supplemental cash flow disclosures:		
Cash paid for interest	$ 49	$ 49

See accompanying notes to the unaudited financial statements.

Note 1- Basis of Presentation

The United States Postal Service (the "Postal Service") began operations on July 1, 1971 in accordance with the provisions of the *Postal Reorganization Act,* which established it as an "independent establishment of the executive branch of the Government of the United States." The *Postal Accountability and Enhancement Act*, Public Law 109-435 ("PAEA"), classifies Postal Service "products" into two broad categories: Market-Dominant and Competitive "products." However, the term "services" is often used in this document for consistency with other descriptions of "services" offered by the Postal Service. These products and services are sold through approximately 32,000 post offices, stations and branches, plus a large network of contract postal units, community post offices, Village Post Offices, commercial outlets which sell stamps on the Postal Service's behalf and on its website http://www.usps.com.

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of the U.S. Securities and Exchange Commission ("SEC") Regulation S-X. These financial statements should be read in conjunction with the Postal Service's financial statements for the year ended September 30, 2014 included in its Annual Report on Form 10-K filed with the Postal Regulatory Commission ("PRC") on December 5, 2014, and do not include all information and footnotes which are normally included in the Annual Report on Form 10-K. Except as otherwise specified, all references to years are to the fiscal year beginning October 1 and ending September 30, and quarters are quarters within fiscal years 2015 and 2014.

In the opinion of management, the accompanying unaudited interim financial statements reflect all material adjustments, including recurring adjustments, necessary to fairly present the financial position as of December 31, 2014 and the results of operations and cash flows for the three months ended December 31, 2014 and 2013. Operating results for the three months ended December 31, 2014 are not necessarily indicative of the results that may be expected for all of 2015.

The Postal Service has significant transactions with other U.S. government agencies. These are more fully discussed in *Note 3-Related Parties*.

Recent Accounting Standards

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update 2014-09 *Revenue from Contracts with Customers* ("ASU 2014-09"). The new standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. ASU 2014-09 is effective for fiscal years and interim periods within those years, beginning after December 15, 2016. Early adoption is not permitted. The Postal Service is currently evaluating the impact of adopting this standard on its financial statements, which is not known or reasonably estimable at this time.

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

Note 2- Liquidity

The Postal Service held cash and cash equivalents of $7.1 billion and $4.9 billion as of December 31, 2014 and September 30, 2014, respectively. Although liquidity appeared to improve during the quarter, the increase in cash and cash equivalents was largely attributable to the timing of payroll and accounts payable disbursements that occurred on January 2, 2015, when cash balances declined to $5.5 billion. The seasonal impact of holiday mailings, particularly packages, favorably affected cash balances during the quarter.

Liquidity Concerns

The Postal Service continues to suffer from a lack of liquidity. Cash balances remain insufficient to support an organization with approximately $73 billion in annual operating expenses. The Postal Service's average daily cash and cash equivalents balances during the three months ended December 31, 2014 were $5.7 billion, which represents only 21 days of operating cash. The Postal Service does not have the ability to borrow additional funds under its existing borrowing arrangements, and this level of cash balances could be insufficient to support operations in the event of another significant downturn in the U.S. economy.

The Postal Service incurred a net loss of $754 million for the three months ended December 31, 2014. The loss included $1.4 billion of expense accrued for the prefunding payment for the Postal Service Retiree Health Benefits Fund ("PSRHBF") mandated by the PAEA. This requirement to prefund retiree health benefit obligations is not imposed on most other federal agencies or private sector businesses. In addition to the requirement to prefund $5.7 billion of retiree health benefits in 2015, the Postal Service continues to pay its employer share of health insurance premiums for its retirees, which was $759 million during the three months ended December 31, 2014.

Since 2007, the Postal Service has incurred cumulative financial losses of $52.5 billion. As a result of these ongoing financial losses, the Postal Service does not have sufficient cash balances to meet all of its existing legal obligations, which include $22.4 billion of cumulative PSRHBF payments that were due but not paid in 2012, 2013 and 2014, make reductions in its debt and make all of the critical investments in its infrastructure that were deferred in recent years. As of the date of this report, the Postal Service has not incurred any penalties or negative consequences resulting from its inability to make the PSRHBF payments.

In December 2013, the PRC ruled that the Postal Service could collect an exigent surcharge on Market-Dominant products beginning in January 2014 until such time as it recovers $3.2 billion in incremental revenue. As of September 30, 2014, the last date reported to the PRC, the Postal Service had collected approximately $1.4 billion in incremental revenue, and the Postal Service currently estimates that the recovery of the $3.2 billion in incremental revenue will occur during 2015. The exigent surcharge was in addition to a 1.7% price increase based on the Consumer Price Index for All Urban Consumers ("CPI-U"). Also in January 2014, the Postal Service increased prices an average of 2.4% for Competitive services.

The Postal Service has appealed the PRC's ruling on the exigent price increase with the U.S. Court of Appeals for the District of Columbia, arguing that the PRC erred in its decision to limit the duration of the exigent surcharge. Some mailers have also filed an appeal seeking relief from the PRC's decision to allow any exigent price increase. The Postal Service's liquidity will be adversely impacted if the exigent price increase expires.

The ongoing decline in First-Class Mail volume has also been a major factor contributing to Postal Service losses. This decline is the result of lingering effects of the Great Recession and changes in consumers' and businesses' uses of mail resulting from the continuing migration toward electronic communication and transactional alternatives. The Postal Service anticipates that diversion of hard copy mail will continue to reduce First-Class Mail volumes and revenues for the foreseeable future.

With the exception of the exigent price increase discussed above, Market-Dominant services, which account for approximately 78% of the Postal Service's annual operating revenues, are subject to a price cap based on the CPI-U. While the vast majority of revenues are constrained by the price cap, costs are not statutorily constrained. Contractual obligations granting cost-of-living adjustments ("COLA") and general wage increases, along with increases in costs for mandatory federal benefits programs, such as retiree health benefits and the Federal Employees Retirement System ("FERS"), are exerting upward pressure on expenses in 2015 and beyond. Health benefits and FERS cost increases alone are expected to add approximately $700 million to 2015 expenses. Although the annual PSRHBF prefunding mandate ends in 2016, the PAEA requires the Postal Service to begin funding the normal costs and amortization of the unfunded liabilities of the PSRHBF and the Civil Service Retirement System ("CSRS") in 2017.

Postal Service Actions Taken to Improve Liquidity

To conserve cash, the Postal Service reduced its average annual capital expenditures from approximately $1.5 billion in years 2009 through 2011 to $718 million in years 2012 through 2014, and this decline in capital expenditures is unsustainable. The Postal Service's delivery fleet includes approximately 140,000 vehicles that are at least 20 years old and at or near the end of their useful lives. Repair and maintenance costs for these vehicles have risen significantly in recent years. Facilities maintenance, other than for health and safety reasons, has been deferred in recent years to save cash. Investments in package sorting and handling equipment are needed to fully capitalize on business opportunities in the growing package delivery market and letter sorting equipment that is at or near the end of its useful life must also be updated.

To address some of the critical vehicle, facility and package handling requirements that have been deferred in recent years, the Postal Service must increase its capital investments during the years 2015 through 2020. Management currently estimates that cash outlays for capital assets will amount to approximately $2.0 billion in 2015 and as much as an additional $8.0 billion in years 2016 through 2020. For the three months ended December 31, 2014, the Postal Service made capital investments of $335 million.

In 2013, the Postal Service implemented a realignment of its operations to further reduce costs and strengthen its finances. These operational realignments included reductions in the number of mail processing operations, realignment of retail office hours to match demand, reductions in the number of delivery routes and consolidations of delivery offices. In January 2015, the Postal Service revised its service standards for First-Class Mail and implemented a second phase of mail processing realignments which will result in a consolidation impacting up to 82 processing operations.

The Postal Service continues to leverage employee attrition, Voluntary Early Retirement ("VER") and utilization of non-career employees to the maximum extent permitted by its labor contracts. In July 2014, the Postal Service offered a VER to approximately three thousand postmasters who were impacted by reductions in retail hours at certain postal facilities. As of the September 30, 2014 deadline, this offer had been accepted by approximately 1,380 postmasters.

On January 15, 2015 the Postal Service filed a notice with the PRC of its intent to increase certain Market-Dominant prices by an average of 1.966% in accordance with the CPI-U price cap. The Postal Service estimates that this plan, if approved, would generate an additional $900 million in revenue per year. Since the plan would not take effect until April 26, 2015, the price increase would only generate additional estimated revenue of $400 million for 2015. On January 26, 2015 the Postal Service announced it had proposed price increases for Priority Mail International and Priority Mail Express International of 6.8% and 6.7%, respectively. If approved by the PRC, these price increases would also take effect on April 26, 2015.

The Postal Service continues to pursue legislation to reform its obsolete business model and streamline its burdensome regulatory structure, which can only be achieved through legislative changes. Such changes could include a transition to a new Monday-through-Friday mail delivery while maintaining a package delivery schedule from Monday through Saturday (and on Sundays in some instances). Additionally, reform is needed to establish a set of healthcare plans within the Federal Employees' Health Benefits Program ("FEHBP") that would fully integrate with Medicare for current and future Postal Service retirees. Such reform would eliminate the necessity for the PSRHBF prefunding requirement and virtually eliminate the unfunded liability of $22.4 billion referenced above.

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

Mitigating Circumstances

The Postal Service's status as an independent establishment of the executive branch that does not receive tax dollars for its operations presents unique requirements and restrictions, but also potentially mitigates some of the financial risk that would otherwise be associated with a cash shortfall. With annual revenue of approximately $68 billion, generated almost entirely through the sale of postal products and services, a financially-sound Postal Service would continue to be vital to American commerce. The U.S. economy benefits greatly from the Postal Service and the many businesses that provide the printing and mailing services that it supports.

Millions of check payments, letters and packages upon which people depend are mailed through the Postal Service network on a daily basis. Disruption of the mail would cause undue hardship to businesses and consumers, and in the event of a cash shortfall, the U.S. government would likely prevent the Postal Service from significantly curtailing or ceasing operations. The Postal Service continues to inform the Administration, Congress, the PRC and other stakeholders of the immediate and long-term financial challenges it faces and the legislative changes that are required to restore financial stability. However, there can be no assurances that a restructuring of the pension and benefit payment schedules or any other legislative changes will occur in the foreseeable future.

Debt

The Postal Service's debt consists of various fixed and floating-rate notes with various maturities and an aggregate principal balance outstanding of $15.0 billion as of December 31, 2014, the same outstanding balance that the Postal Service reported as of September 30, 2014. This is the maximum borrowing amount allowed under the Postal Service's legally-mandated debt ceiling. All debt is borrowed from the Federal Financing Bank ("FFB"), a government-owned corporation under the general supervision of the Secretary of the Treasury. Included in the current portion of debt are two revolving credit line facilities, renewable annually with the FFB, both of which are available through April 2015. These facilities, which have interest rates determined by the Treasury each business day, enable the Postal Service to draw up to $4.0 billion. As of December 31, 2014 and September 30, 2014, these facilities were fully drawn.

Note 3- Related Parties

As disclosed throughout this report, the Postal Service has significant transactions with other U.S. government agencies. Receivables and advances were $86 million and $90 million as of December 31, 2014 and September 30, 2014, respectively. As discussed in *Note 9- Fair Value Measurement*, the carrying amount of Revenue Forgone was $425 million and $420 million at December 31, 2014 and September 30, 2014, respectively, and is included in "*Other assets*" in the accompanying Balance Sheets.

Current liabilities, excluding $9.8 billion in debt, were $25.9 billion and $23.9 billion as of December 31, 2014 and September 30, 2014, respectively. Noncurrent liabilities, excluding $5.2 billion in debt, consisting primarily of workers' compensation and other noncurrent liabilities, were $16.5 billion and $17.2 billion as of December 31, 2014 and September 30, 2014, respectively. As discussed in *Note 2- Liquidity*, the Postal Service's debt, borrowed from the FFB, was $15.0 billion as of December 31, 2014 and September 30, 2014.

Operating revenue from other U.S. government agencies was $254 million and $204 million for three months ended December 31, 2014 and 2013, respectively, and is included in "*Operating revenue*" in the accompanying Statements of Operations. Operating expenses were $4.4 billion and $4.3 billion for the three months ended December 31, 2014 and 2013 respectively, consisting primarily of benefits, retiree health benefits and workers' compensation, and is included in "*Operating expenses*" in the accompanying Statement of Operations.

Interest income was $6 million for the three months ended December 31, 2014 and 2013 and interest expense was $45 million and $47 million for the three months ended December 31, 2014 and 2013, respectively.

In addition, the Postal Service held restricted cash, which is restricted by agreement with the U.S. Department of Justice, of $250 million and $246 million as of December 31, 2014 and September 30, 2014, respectively.

Note 4- Property and Equipment, net

Property and equipment, net, are recorded at cost, which includes the interest on borrowings used to pay for the construction of major capital additions, less allowances for depreciation and amortization. Interest capitalized during both the three months ended December 31, 2014 and 2013 was not significant. Property and equipment, net, are depreciated over estimated useful lives that range from 3 to 40 years using the straight-line method.

Assets classified as held for sale were approximately $113 million and $97 million as of December 31, 2014 and September 30, 2014, respectively, and included within "*Property and equipment, net*" in the accompanying Balance Sheets. Impairment charges were de minimis for the three months ended December 31, 2014 and 2013, respectively. Depreciation and amortization expense was $442 million and $463 million for the three months ended December 31, 2014 and 2013, respectively, and included within "*Other operating expenses*" in the accompanying Statement of Operations.

Deferred gains on sales of property are recognized in income, and the sold assets are removed from the accounting records when any lease-backs or other conditions requiring continued Postal Service involvement in the properties have expired. Deferred gains recognized in income were $21 million and $6 million for the three months ended December 31, 2014 and 2013, respectively, and included within "*Other revenue*" in the accompanying Statement of Operations.

Note 5- Contingencies

Contingent liabilities of the Postal Service consist primarily of claims and lawsuits resulting from labor, employment, environmental matters, property damage claims and injuries on Postal Service properties, and issues arising from Postal Service contracts, personal claims and traffic accidents. 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. Any pre-existing claims and litigation are reviewed and adjusted for resolutions or revisions to prior estimates.

Based on available information, adequate provision has been made for probable losses arising from all claims and lawsuits. The current portion of the contingent liability was $159 million and $158 million at December 31, 2014 and September 30, 2014, respectively, and is included in "*Payables and accrued expenses*" in the accompanying Balance Sheets. The noncurrent portion of this liability was $774 million and $776 million at December 31, 2014 and September 30, 2014, respectively, and is included in "*Other noncurrent liabilities*" in the accompanying Balance Sheets. As of December 31, 2014, contingent liabilities consisted of $844 million associated with labor and employment matters, $43 million with asset retirement obligations, $44 million with tort matters and $2 million with contractual matters, for a total of $933 million. As of September 30, 2014, contingent liabilities consisted of $839 million associated with labor and employment matters, $48 million with asset retirement obligations, $45 million with tort matters and $2 million with contractual matters, for a total of $934 million.

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 ranged from $350 million to $925 million at December 31, 2014, and $325 million to $925 million at September 30, 2014. No accruals for these reasonably possible losses have been recorded in the financial statements.

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

Note 6- Retirement Benefit Plans

Pension Programs

The majority of employees participate in one of two U.S. government pension programs based on the starting date of their employment with the U.S. Postal Service or other government agencies. Employee and employer contributions are made to the CSRS or the FERS, both of which are administered by the Office of Personnel Management ("OPM"). As government-sponsored benefit plans, the CSRS and FERS are not subject to the provisions of the *Employee Retirement Income Security Act of 1974*, as amended. Employees may also participate in the Thrift Savings Plan ("TSP"), a defined contribution retirement savings and investment plan, administered by the Federal Retirement Thrift Investment Board. The Postal Service cannot direct the costs, benefits or funding requirements of the plans. Accordingly, the Postal Service's participation in the U.S. government retirement plans is accounted for under the multiemployer plan accounting rules.

The Postal Service estimates that its annual retirement expense, which includes the costs of FERS, TSP and the employer's share of Social Security taxes, is approximately $6.4 billion. For the three months ended December 31, 2014 and 2013, retirement expense was $1.6 billion and $1.5 billion, respectively. Retirement expense is included in *"Compensation and benefits"* in the accompanying Statements of Operations.

Employer Contributions

PAEA suspended the employer contributions to CSRS until 2017 that would otherwise have been required under Title 5, Section 8334(a)(1) of the United States Code. At that time, OPM will determine whether additional funding is required for the benefit of the Postal Services' CSRS retirees. As a result, the Postal Service contribution rate for CSRS was zero for the three months ended December 31, 2014 and 2013.

As required by law, the Postal Service contribution rate was 13.2% and 11.9% of base salary for most current FERS employees for the three months ended December 31, 2014 and 2013, respectively. The Postal Service is also required to contribute to the TSP for FERS employees by contributing 1% of basic pay and to match voluntary employee contributions by up to an additional 4% of basic pay.

Note 7- Health Benefit Plans

Current Employees

Nearly all career employees are covered by the FEHBP, which covers both active and retired employees. Healthcare benefits are available to all participants who meet certain eligibility requirements. In addition to administering the program, OPM allocates the cost of FEHBP to the various participating government agency employers. The Postal Service cannot direct the costs, benefits or funding requirements of the plan, and therefore, the Postal Service accounts for program expenses using multiemployer plan accounting rules. Contributions to the plan are recorded as an expense in the period in which the contribution is due. The portion of the premium cost paid by the Postal Service for most active employees is determined through agreements with its unions.

The Postal Service paid approximately 76% and 77% of the premium costs during the three months ended December 31, 2014 and 2013, respectively. Postal Service employee healthcare expense was $1.2 billion during each of the three months ended December 31, 2014 and 2013 periods. These expenses are included in "*Compensation and benefits*" in the accompanying Statements of Operations.

Retirees

Employees who participate in the FEHBP for the five years immediately preceding their retirement may participate in the FEHBP during their retirement. The Postal Service is required to pay a portion of the health insurance premiums, based on the length of federal civilian service occurring after July 1, 1971, for all retired employees who participate in the FEHBP and who retired on or after that date, and their survivors. The employer's share of premium costs for retirees and their survivors is set by law and is not subject to negotiation with the unions.

Since 2007, the Postal Service has been required to prefund retiree health benefits by depositing funds into the PSRHBF. Payments are mandated to be made each year through 2016. This prefunding requirement is not imposed on most federal agencies or private sector businesses. The Postal Service has recorded $23.8 billion for the PSRHBF prefunding requirements as a current liability in "*Retiree health benefits*" in the accompanying Balance Sheets as of December 31, 2014. This includes payment defaults of $22.4 billion from 2012 through 2014 and a $1.4 billion accrual during the three months ended December 31, 2014 related to the $5.7 billion payment due by September 30, 2015. Current law also obligates the Postal Service to make an additional annual payment of $5.8 billion by September 30, 2016.

Although PAEA dictates the annual prefunding requirements through 2016, these amounts and the timing of funding could be changed at any time with enactment of a new law or an amendment of existing law. However, given its liquidity concerns, the Postal Service has and will likely continue to default on these prepayments in order to fulfill its other statutory obligations, including the obligation to provide universal mail service to the nation (as discussed in *Note 2- Liquidity*). PAEA contains no provisions addressing a payment default.

These annual prefunding payments are in addition to the approximately $3.2 billion per year in regularly-allocated cost of premiums for current retirees, which continue to be payable through 2016. The total unfunded PSRHBF commitment including past defaulted amounts and future obligations is $33.9 billion. Beginning in 2017, the Postal Service's share of the health insurance premiums for current and future Postal Service retirees will be paid from the PSRHBF. Although 2016 is the final year the Postal Service is mandated to make its prefunding payment, the statute requires that OPM perform an actuarial valuation no later than 2017 to determine if additional payments into the PSRHBF are required, and if so, OPM will design an amortization schedule to fully fund any remaining liability by 2056.

Note 8- Workers' Compensation

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

The liability for estimated future workers' compensation payments is recorded at its present value. To record the liability and annual expense, the Postal Service estimates 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 interest rates are updated as of the date of the financial statements to determine the present value of the workers' compensation liability at the Balance Sheets date, in accordance with GAAP. The impact of changes in the interest and inflation rates is included in operating expenses.

An estimation model that combines four generally-accepted actuarial valuation techniques is used to forecast future claim payments based upon past claim-payment experience, and exposure to claims as measured by total hours worked by Postal Service employees. A liability is recorded for the present value of estimated future payments to Postal Service employees, or their qualified survivors, for Postal Service employees who have been injured and are eligible for benefits through the end of the reporting period. The estimated total cost of claims is based on the date of the injury, the pattern of historical payments, frequency or severity of the claim-related injuries and the expected trend in future costs.

The estimation of the liability is highly sensitive to changes in interest rates used to calculate the present value of the future obligation. A 1% increase in the interest rate would decrease the December 31, 2014 liability and related expense by approximately $2.0 billion. A 1% decrease in the interest rate would increase the December 31, 2014 liability and related expense by approximately $2.4 billion.

Interest rates and inflation rates, for the estimated compensation claims portion of workers' compensation liability, were 2.4% and 2.8%, respectively, at December 31, 2014. Interest rates and inflation rates, for the estimated medical claims portion of workers' compensation liability, were 2.4% and 6.9%, respectively, at December 31, 2014.

Interest rates and inflation rates, for the estimated compensation claims portion of workers' compensation liability, were 2.8% and 2.9%, respectively, at September 30, 2014. Interest rates and inflation rates, for the estimated medical claims portion of workers' compensation liability, were 2.7% and 9.0%, respectively, at September 30, 2014.

Changes in the workers' compensation liability are attributable to the combined impact of changes in the interest and inflation rates, routine changes in actuarial estimation, new compensation and medical cases and the progression of existing cases. The present value of the total liability for future workers' compensation payments was $17.9 billion and $18.4 billion at December 31, 2014 and September 30, 2014, respectively. The current portion of the liability was $1.4 billion and $1.3 billion at December 31, 2014 and September 30, 2014, respectively. On October 15, 2014, the Postal Service made its annual payment to the DOL of $1.4 billion.

The following table presents the components of workers' compensation expense for the three months ended December 31, 2014 and 2013:

(in millions)	2014	2013
Impact of interest rate changes	$ 816	$ (541)
Actuarial valuation of new cases and revaluation of existing cases	(47)	524
Administrative fee	17	17
Total workers' compensation expense	**$ 786**	**$ —**

Change in Estimate

During the three months ended December 31, 2014, the Postal Service revised its calculation used in the valuation model to determine the fair value of workers' compensation liability. The impact of the change in estimate decreased the workers' compensation liability at December 31, 2014, and also decreased operating expenses by $353 million for the three months ended December 31, 2014. This change was considered a change in accounting estimate under GAAP. Management believes this change allows greater flexibility to select factors that reflect the best and most current injury trends and provides the best estimate of workers' compensation liability.

Note 9- Fair Value Measurement

The Postal Service defines fair value based on the price that would be received upon sale of an asset or the price that would be paid to transfer a liability between unrelated parties. The carrying amounts of the short-term financial instruments of the Postal Service, including cash, accounts receivable, accounts payable and accrued expenses**,** approximate fair value due to their short-term maturities. Noncurrent receivables and noncurrent debt are measured using inputs of the fair value hierarchy model. Property and equipment are stated at cost and measured at fair value on a nonrecurring basis if it is determined to be impaired.

Considerable judgment is involved in developing these estimates and, accordingly, they may not necessarily be indicative of amounts that would be realized upon disposition of a specific asset or liability. As a result of these valuation measurements, the Postal Service has recognized losses in its financial statements, while unrecognized gains and losses are not considered to have a significant impact on results of operations. The Postal Service has not recognized gains as a result of these valuation measurements.

Measurement of assets and liabilities at fair value is performed using inputs from a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value. The fair value hierarchy described below consists of three broad levels, 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 observable data, such as 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.

The fair values of Revenue Forgone and debt, which qualify as financial instruments in accordance with the accounting literature, are calculated using *Level 2* and *Level 3* inputs, respectively.

Under the *Revenue Forgone Reform Act of 1993*, Congress agreed to reimburse the Postal Service $1.2 billion in 42 annual installments of $29 million each through 2035 for services the Postal Service performed for other U.S. government agencies during years 1991 through 1998. The Postal Service recognizes the imputed interest it is owed as interest and investment income and estimates the value of revenue foregone using the income approach, which converts future cash flows to a single discounted amount using an interest rate for similar assets, a *Level 2* input. To determine the fair value of this noncurrent asset, the Postal Service calculates a net present value of anticipated annual payments received, discounted by the 20-year Treasury Constant Maturity Rate, which was 2.47% as of December 31, 2014.

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

For the periods ended December 31, 2014 and September 30, 2014, there were no significant transfers between *Level 1* and *Level 2* assets or liabilities. The carrying values and fair values of Revenue Forgone and debt are summarized in the following table, presented for disclosure purposes only:

(in millions)	**December 31, 2014**		**September 30, 2014**	
	Carrying Amount	**Fair Value**	**Carrying Amount**	**Fair Value**
Revenue forgone	$ 425	$ 551	$ 420	$ 505
Total noncurrent financial assets	**$ 425**	**$ 551**	**$ 420**	**$ 505**
Debt	$ 5,200	$ 5,697	$ 5,200	$ 5,565
Total noncurrent financial liabilities	**$ 5,200**	**$ 5,697**	**$ 5,200**	**$ 5,565**

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. We have no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Management's Discussion and Analysis of Financial Condition and Results of Operations and other parts of this report describe the principal factors affecting the results of operations, liquidity, capital resources and critical accounting estimates of our business and financial results. These may be impacted by risks and uncertainties discussed here and in the Annual Report on Form 10-K for the year ended September 30, 2014. Such factors, many of which we cannot control or influence, may cause actual results to differ materially from those currently contemplated.

Operating results for the three months ended December 31, 2014 are not necessarily indicative of the results to be expected for the year ended September 30, 2015. This report should be read in conjunction with our Annual Report on Form 10-K for the year ended September 30, 2014. As in that report, except as otherwise indicated by the context, the terms "Postal Service," "USPS," "we," "our" and "us" are used to refer to the United States Postal Service. All references to years in this report, unless otherwise stated, refer to fiscal years beginning October 1 and ending September 30. All references to quarters, unless otherwise stated, refer to quarters within fiscal years 2015 and 2014.

Introduction

The United States Postal Service commenced operations on July 1, 1971 as an "independent establishment of the executive branch of the Government of the United States" responsible for providing postal service to the nation. 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 United States 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 Governors and the Postmaster General.

The statute requires the Board to have a quorum of six members in order to take action. In December 2014, due to the term expiration of one Governor and Senate inaction on pending nominees, the number of sitting Board members dropped to five, thereby rendering the Board unable to assemble a quorum. In November 2014, prior to losing a quorum, the Board issued a resolution that established a Temporary Emergency Committee of the Board ("TEC") to exercise certain powers reserved to the Board during a period in which it is unable to assemble a quorum. The TEC consists of the remaining members of the Board, and exercises those Board powers necessary for operational continuity. The TEC will continue in existence until the Board is again able to assemble a quorum. The establishment of the TEC was publicly announced in a Federal Register notice on December 16, 2014.

The Federal Register notice also announced a resolution issued by the Governors in November 2014 regarding the exercise of those powers conferred by the statute solely on the Governors, as distinguished from the full Board. Powers conferred solely upon the Governors include the appointment and removal of the Postmaster General and the establishment of prices and classifications for postal products. The Governors announced that the inability of the Board to assemble a quorum does not inhibit the Governors' authority to continue exercising their independent powers.

Under the *Postal Reorganization Act*, and its successor, the *Postal Accountability and Enhancement Act*, Public Law 109-435 ("PAEA"), we have a legal mandate to offer a "fundamental service" to the American people "at fair and reasonable rates." We serve individual and commercial customers in the communications, distribution and delivery, advertising and retail markets throughout the nation and internationally. As a result, we 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 4.3% of operating revenue.

We fulfill our legal mandate to provide universal service at a fair price by offering a variety of classes of mail services without undue discrimination among our customers. Within each class of mail service, prices do not vary unreasonably by customer for the level of service provided. Prices and fees are subject to a review process by the Governors and by the Postal Regulatory Commission ("PRC"). PAEA provides greater flexibility in the pricing of Competitive services, as discussed below.

PAEA classifies postal services into two broad categories: Market-Dominant and Competitive "products." However, the term "services" is often used in this document for consistency with other descriptions of "services" we offer. Price increases for those services classified as Market-Dominant are subject to a price cap based on the Consumer Price Index - All Urban Consumers ("CPI-U"). The regulations for Competitive services place no upper limit on price changes, but do set a price floor.

Throughout this document and in the day-to-day operations of the organization, we refer to our major service categories as the following: First-Class Mail, Standard Mail, Shipping and Packages, International, Periodicals and Other. Most services in the First-Class Mail, Standard Mail and Periodicals categories are considered Market-Dominant services. Shipping and Package Services and International Mail, which are predominantly Competitive services, include, but are not limited to, First-Class and Standard Mail Parcels, Priority Mail, Priority Mail Express, Parcel Select and Parcel Return Service, Bulk Standard Post and Bulk International Mail.

Products and services are sold through a network of approximately 32,000 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 through our website at *http://www.usps.com*. Mail deliveries are made to approximately 154 million city, rural, Post Office box and highway delivery points. Operations are conducted primarily in the domestic market, with international sales representing approximately 4.6% of operating revenue.

We operate and manage a very extensive and integrated retail, distribution, transportation and delivery network. As such, with limited exceptions, our physical infrastructure and labor force are not 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.

Our 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"). Approximately 88% of career employees are covered by collective bargaining agreements. We are 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 are not a reporting company under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and are not subject to regulation by the Securities and Exchange Commission ("SEC"). However, we are required under PAEA to file with the PRC certain financial reports containing information prescribed by the SEC under Sections 13 and 15(d) of the Exchange Act. 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*.

We are 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.

Cyber Intrusion Incident

As we disclosed in our Annual Report on Form 10-K for the year ended September 30, 2014, during the fourth quarter of 2014 we learned of a cyber intrusion into some of our information systems. We have been working closely with the U.S. Computer Emergency Readiness Team, the Federal Bureau of Investigation, the USPS Office of Inspector General ("OIG"), the Postal Inspection Service, Carnegie Mellon's Computer Emergency Response Team and private-sector forensic specialists to investigate the matter and to strengthen the security of our systems against future cyber intrusions. For the three months ended December 31, 2014, we incurred approximately $8 million in expenses related to remediation efforts.

Critical Accounting Policies and Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States ("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, 2014. Management discusses the development and selection of accounting policies and estimates with the Audit and Finance Committee of the Board.

During the three months ended December 31, 2014, we revised the calculation used to estimate our workers' compensation liability (See *Item 1. Financial Statements, Note 8- Workers' Compensation*). Other than this, there have been no significant changes or updates to our critical accounting policies and estimates since our last report.

Recent Accounting Standards

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update 2014-09 *Revenue from Contracts with Customers* ("ASU 2014-09"). The new standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. ASU 2014-09 is effective for fiscal years and interim periods within those years, beginning after December 15, 2016. Early adoption is not permitted. We are currently evaluating the impact of adoption of this standard on our financial statements which is not known or reasonably estimable at this time.

In August 2014, the FASB issued Accounting Standards Update 2014-15 *Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern* ("ASU 2014-15"). The new standard requires management to perform interim and annual assessments of an entity's ability to continue to meet its obligations as they become due within one year after the date that the financial statements are issued. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and interim periods thereafter, with early adoption permitted. At this time, we are planning for the implementation of the new standard prior to the effective date deemed by FASB. However, upon reviewing the new pronouncement, we do not believe the adoption of the new standard will have a significant impact on results of operations.

Related Party Transactions

As disclosed throughout this report, we have significant transactions with other U.S. government agencies. Receivables and advances were $86 million and $90 million as of December 31, 2014 and September 30, 2014, respectively. As discussed in *Item 1. Financial Statements, Note 9- Fair Value Measurement*, the carrying amount of Revenue Forgone was $425 million and $420 million at December 31, 2014 and September 30, 2014, respectively, and is included in "*Other assets*" in the accompanying Balance Sheets.

Current liabilities, excluding $9.8 billion in debt, were $25.9 billion and $23.9 billion as of December 31, 2014 and September 30, 2014, respectively. Noncurrent liabilities, excluding $5.2 billion in debt, consisting primarily of workers' compensation and other noncurrent liabilities were $16.5 billion and $17.2 billion as of December 31, 2014 and September 30, 2014, respectively. As discussed in *Item 1. Financial Statements, Note 2- Liquidity*, our debt, borrowed from the FFB, was $15.0 billion as of December 31, 2014 and September 30, 2014.

Operating revenue from other U.S. government agencies was $254 million and $204 million for three months ended December 31, 2014 and 2013, respectively, and is included in "*Operating revenue*" in the accompanying Statements of Operations. Operating expenses were $4.4 billion and $4.3 billion for the three months ended December 31, 2014 and 2013 respectively, consisting primarily of benefits, retiree health benefits and workers' compensation, and is included in "*Operating expenses*" in the accompanying Statement of Operations.

Interest income was $6 million for the three months ended December 31, 2014 and 2013 and interest expense was $45 million and $47 million for the three months ended December 31, 2014 and 2013, respectively.

In addition, we held restricted cash, which is restricted by agreement with the U.S. Department of Justice, of $250 million and $246 million as of December 31, 2014 and September 30, 2014, respectively.

Three Months Ended December 31, 2014 and December 31, 2013

Results of Operations

Our net loss was $754 million for the three months ended December 31, 2014, compared to a net loss of $354 million for the same period last year, an increase of $400 million. Operating revenue increased $777 million, or 4.3%, compared to the same period last year. This increase in operating revenue was primarily due to an increase in our Shipping and Packages volume and the approved price increase that was implemented in January 2014. Operating expenses increased $1.2 billion, or 6.4%, compared to the same period last year. This increase in operating expenses was primarily due to the increase in workers' compensation expense of $786 million caused by a change in the fair value adjustment due primarily to interest rate changes, and an increase in compensation and benefits of $319 million caused primarily by an increase in the amount of labor hours caused by the increase in Shipping and Packaging volume during the seasonal holiday period.

The major factors that impact operating results include overall customer demand and the mix of postal services, profit margins associated with those services, volume of mail and packages processed through our network and our ability to manage our cost structure in line with declining levels of mail volume. In the day-to-day operation of our business, we focus our attention on those costs that are controllable by us which include wages, transportation and certain other cost to match declining volume levels. We exclude the non-controllable factors from our internal financial analyses in order to focus our attention on relevant expenses that management can control. Non-controllable expenses, which greatly impact our financial results, are comprised of the annual legally-mandated Postal Service Retirement Health Benefit Fund ("PSRHBF") prefunding expense and non-cash items such as the fluctuations in workers' compensation expense due to changes in interest rates and changes resulting from the revaluation of the related liability.

We determine our controllable income by adjusting our GAAP net loss for the impact of these non-controllable factors noted above. For the three months ended December 31, 2014 and 2013, our controllable income was $1.1 billion and $765 million, respectively, an increase of $359 million, or 46.9%, compared to the same period last year.

The following table illustrates the income from ongoing business activities without the impact of non-controllable items. This table better reflects the aspects of our financial results that are controllable by management, and reconciles controllable income back to our GAAP net loss. Net financial results for the three months ended December 31, 2014 and 2013 would have been as follows:

(in millions)	2014	2013
Net loss	**$ (754)**	**$ (354)**
Impact of:		
Interest rate changes related to workers' compensation liability	816	(541)
Other non-cash workers' compensation expense	(363)	235
PSRHBF prefunding expense	1,425	1,425
Controllable income*	**$ 1,124**	**$ 765**

* Controllable income excludes the impact of certain noncash workers' compensation adjustments and PSRHBF prefunding expense.

Operating Revenue and Volume

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

As described above, we implemented a price increase on our Market-Dominant and Competitive products, effective January 2014. Market-Dominant prices included a 1.7% increase based on the CPI-U plus a 4.3% exigent price increase. The PRC approved this exigent price increase as a surcharge to be collected only until we recover $3.2 billion of incremental revenue above what it would otherwise have recovered through a CPI-U increase alone. Additionally, prices increased an average of 2.4% for Competitive service products. As of September 30, 2014, the latest date we have reported to the PRC, we had collected approximately $1.4 billion in incremental revenue from the exigent price increase.

While we continue to experience strong results in our Shipping and Package business, it represents only 23% of our three months ended December 31, 2014 revenues, compared to First-Class Mail, which represents 40%. Furthermore, Shipping and Packages costs to process and deliver is substantially higher than for First-Class Mail. As a result, revenues from Shipping and Packages would have to grow at a higher rate than the decline in First-Class Mail revenues in order to replace the lost profit margin of First-Class Mail.

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

Summary of Revenue and Volume Results

For the three months ended December 31, 2014, operating revenue was $18.7 billion, an increase of $777 million or 4.3%, compared to the same period last year. Shipping and Packages revenue was $4.3 billion for the three months ended December 31, 2014, an increase of $404 million, or 10.5%, compared to the same period last year, aided by the record number of holiday seasonal packages delivered. Shipping and Packages volume was 1.3 billion pieces for the three months ended December 31, 2014, an increase of 143 million pieces, or 12.8%, compared to the same period last year.

The following table summarizes our operating revenue and volume for the three months ended December 31, 2014 and 2013, by each service line:

	2014		2013	
(in millions)	**Revenue**	**Volume**	**Revenue**	**Volume**
First-Class Mail [1]	$ 7,569	16,679	$ 7,301	16,868
Standard Mail [2]	4,979	22,767	4,628	21,993
Shipping and Packages [3]	4,269	1,256	3,865	1,113
International	860	271	871	272
Periodicals	414	1,490	409	1,564
Other [4, 5]	643	160	883	218
Total revenue and volume	**$ 18,734**	**42,623**	**$ 17,957**	**42,028**

Note: The totals for certain mail categories for the prior year have been reclassified to conform with classifications used in the current year. Non-operating revenue is no longer included in this schedule.

[1] Excludes First-Class Mail Parcels.

[2] Excludes Standard Mail Parcels.

[3] Includes Priority Mail, Standard Post, Parcel Select Mail, Parcel Return Service Mail, Standard Parcels, Package Service Mail, First-Class Mail Parcels, First-Class Package Service and Express Mail.

[4] Includes PO Box Services, Certified Mail, Return Receipts, Insurance, Other Ancillary Fees, Shipping and Mailing Supplies and Other services.

[5] Includes the U.S. Postal Service's mail and free mail provided to certain groups.

First-Class Mail and Standard Mail continue to provide the majority of our revenue for the three months ended December 31, 2014, despite trends away from hard copy to electronic media. First-Class Mail represents 40% of our revenue and accounts for 39% of the mail volume while Standard Mail generates 27% of revenue, but 53% of volume. Shipping and Packages generated approximately 23% of our revenue despite representing only 3% of our volume.

First-Class Mail
First-Class Mail volume, our most profitable service category, declined 189 million pieces, or 1.1%, for the three months ended December 31, 2014 compared to the same period last year. The most significant factor contributing to this decline in volume was the continuing migration toward electronic communication and electronic transaction alternatives. First-Class Mail revenue increased $268 million, or 3.7%, compared to the same period last year. The increase in revenue was primarily due to the price increase that was implemented in January 2014, which included the exigent price increase, offset by the decline in volume as noted above. Price increases for all services in the First-Class Mail category are generally capped at the rate of inflation because these services are classified by law as Market-Dominant.

Standard Mail
Standard Mail revenue increased $351 million, or 7.6%, for the three months ended December 31, 2014 compared to the same period last year. Standard Mail revenues benefited from the price increase that was implemented in January 2014. Increases in volume is reflective of the cyclical nature of Standard Mail, targeted sales advertising campaigns and an improving economy, which stimulate demand for standard mail. Volume was also favorably impacted in the quarter by the mailing associated with the November 2014 mid-term elections, which generated approximately $204 million in revenues. Price increases for all services in the Standard Mail category are generally capped at the rate of inflation because they are classified by law as Market-Dominant.

Shipping and Packages
The following table summarizes our operating revenue and volume for Shipping and Packages for the three months ended December 31, 2014 and 2013, by each service:

(in millions)	2014		2013	
	Revenue	Volume	Revenue	Volume
Priority Mail[1]	$ 2,294	295	$ 2,171	272
Parcel Select, Parcel Return, Standard Parcels	964	548	758	447
First-Class Packages[2]	597	246	529	233
Package Services	219	158	212	152
Priority Mail Express	195	9	195	9
Total Shipping and Packages	**$ 4,269**	**1,256**	**$ 3,865**	**1,113**

*Note: The totals for certain mail categories for the prior year have been reclassified to conform with classifications used in the current year.
[1] Includes Standard Post which is a retail-only product classified as Market-Dominant. Standard Post is priced identically to Priority Mail for Zones 1-4 and is functionally equivalent to Priority for those Zones.
[2] Includes First-Class Mail Parcels and First-Class Package Services.

Shipping and Packages revenue continued to show solid volume growth as a result of our successful efforts to compete in the ground shipping services and "last mile" e-commerce fulfillment markets which include Sunday delivery growth. Volume also experienced strong end-to-end growth and we took advantage of consumers' continued use of online shopping, which provided a surge in package volume with a record number of packages delivered during the 2014 holiday season. To accommodate this surge in volume and avoid service disruptions during the holiday season, we increased Sunday delivery service for some of our customers in limited U.S. markets.

Priority Mail
We continue to improve our Priority Mail service to better meet the needs of consumers and business mailers. Priority Mail represented approximately 53.7% of our total Shipping and Packages revenue for the three months ended December 31, 2014. The increase was primarily due to the holiday seasonal volume increase and the exigent price increase implemented in January 2014.

Parcel Services
Parcel Services revenue increased $206 million, or 27.2%, for the three months ended December 31, 2014, compared to the same period last year. This category includes Parcel Select revenue of $908 million, Parcel Returns revenue of $38 million and Standard Mail Parcels revenue of $18 million. These services continue to show strong volume growth of 22.6% for the three months ended December 31, 2014, compared to the same period last year. This growth was driven largely by the continuing growth of e-commerce. However, this category represents one of our lowest available priced services, and as a result, provides a relatively low level of contribution compared to many of our other services.

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

International Mail
International mail revenue decreased $11 million, or 1.3%, for the three months ended December 31, 2014, compared to the same period last year. A weaker global economy and increasing competition continue to be the primary factor contributing to the decline in international mail revenues and volumes.

Periodicals
Periodicals volume decreased by 74 million pieces, or 4.7%, for the three months ended December 31, 2014, compared to the same period last year. Periodicals revenue increased $5 million, or 1.2%, for the three months ended December 31, 2014, compared to the same period last year due to the January 2014 price increase.

Trends in hard-copy reading behavior and shifts of advertising away from print have been depressing this segment for years. Periodicals are not expected to rebound as e-readers and electronic content continue to grow in popularity with the public.

Other
Other revenue includes ancillary services such as Certified Mail, P.O. Box services, Return Receipts and Delivery Confirmation. Also included in this category are revenues generated from sales of money orders and passport services.

Operating Expenses

Compensation and Benefits
Compensation and benefits expenses consist of costs related to our active career and non-career employees including compensation expense, retirement expense, health benefits expense and other miscellaneous expenses more fully described below. The following table presents the compensation and benefits expense for the three months ended December 31, 2014 and 2013:

(in millions)	2014	2013	% Change
Compensation	$ 9,560	$ 9,320	2.6 %
Retirement	1,580	1,462	8.1 %
Health benefits	1,200	1,222	(1.8)%
Other	81	98	(17.3)%
Total compensation and benefits	**$ 12,421**	**$ 12,102**	**2.6 %**

Compensation Expense
The increase in compensation expense was primarily due to an increase of approximately six million work hours, or 2.2%, compared to the same period last year, due to higher package volumes and an increased number of Sunday deliveries. Many of the additional work hours were attributable to the increased utilization of non-career employees, which increased by approximately six thousand, or 4.6%, since December 31, 2013. This six thousand non-career employee increase was largely due to a temporary increase in the number of city carrier associates, an increase that was negotiated with the NALC, in order to handle the growth in Sunday package deliveries.

Additionally, the number of career employees increased by approximately one thousand, or 0.2%, compared to the same period last year and was accomplished primarily by converting non-career employees to career status.

Retirement Expense

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

Retirement expense increased $118 million, or 8.1%, for the three months ended December 31, 2014 compared to the same period last year. This increase was primarily due to the increase in our employer contribution rate from 11.9% to 13.2% of basic pay for most current Federal Employees' Retirement System ("FERS") employees, which was effective October 1, 2014. This government-wide increase, determined by the Office of Personnel Management ("OPM"), which further underscores the need for USPS-specific calculations of our retirement costs. This contribution increase is expected to result in an annual increase in our retirement expense of approximately $300 million.

Health Benefits Expense

Health benefits expense decreased $22 million, or 1.8%, for the three months ended December 31, 2014 as compared to the same period last year. Our share of healthcare premiums for our employees represents 76% and 77% of the total healthcare premium cost for the three months ended December 31, 2014 and 2013, respectively. The decrease in health benefits expense was primarily due to lower employer healthcare contribution percentages that we implemented during the period for certain categories of employees, consistent with our contractual agreements.

Retiree Health Benefit Premiums and PSRHBF Prefunding

We participate in federal employee benefit programs for retirement, health and workers' compensation benefits. Under PAEA, we are obligated to fully fund the employer's portion of the established health and retirement benefits of retirees and current postal employees (as discussed in *Item 1. Financial Statements, Note 7- Health Benefit Plans and Note 2- Liquidity)*.

The components of retiree health benefits expense for the three months ended December 31, 2014 and 2013 were as follows:

(in millions)	2014	2013
Employer premium expense	$ 759	$ 728
Accrual for prefunding payment to PSRHBF	1,425	1,425
Total retiree health benefits expense	**$ 2,184**	**$ 2,153**

Retiree health benefits expense increased $31 million, or 1.4%, for the three months ended December 31, 2014, compared to the same period last year. The increase is due to the increased employer health benefit premium expense for the period.

Under PAEA, we continue to pay the premiums for postal retirees participating in the Federal Employees Health Benefits Program ("FEHBP") until September 30, 2016, and we continue to expense these payments during the year they become due. Retiree health benefits premium costs are primarily impacted by the number of retirees and survivors receiving health benefits, the mix of plans selected by retirees, the premium costs of those plans, and the portion of premium costs allocated to the U.S. government for retiree service prior to 1971. As of December 31, 2014, there were approximately 490,000 participants, which remained unchanged compared to the same period last year. In addition, retiree health benefit premium expense also increased due to an increase in the cost of premiums by 4.5% compared to December 31, 2013.

These costs are reflected as *"Retiree health benefits"* in the accompanying Statements of Operations, and consist of payments to OPM for the Postal Service's share of FEHBP retiree premiums currently paid, plus accrued prefunding payments to the PSRHBF. Because the amounts scheduled to be paid into the PSRHBF are set by legislation, the Postal Service retiree health expense may represent more than the full normal cost of the benefits earned by Postal Service employees.

Workers' Compensation

Our employees injured on the job are covered by the Federal Employees' Compensation Act ("FECA"), administered by Department of Labor's ("DOL") Office of Workers' Compensation Programs ("OWCP"), which makes all decisions regarding injured workers' eligibility for benefits. Annually, we reimburse the DOL for all workers' compensation benefits paid to or on behalf of our employees, plus an administrative fee (as discussed in *Item 1. Financial Statements, Note 8- Workers' Compensation*).

During the three months ended December 31, 2014 we revised the calculation we use to determine the fair value of the workers' compensation liability. Management believes this change allows greater flexibility to select loss development factors that reflect the best and most current injury trends and provides the best estimate of workers' compensation liability. The impact of the change in estimate decreased workers' compensation liability and operating expenses by $353 million for the three months ended December 31, 2014. Excluding the change in estimate for the period, workers' compensation expense would have been $1.1 billion. This change was considered a change in accounting estimate under GAAP.

Changes in the workers' compensation liability are attributable to the combined impact of changes in interest and inflation rates, routine changes in actuarial estimates, new compensation and medical cases and the progression of existing cases. 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. Payments on claims fluctuate significantly from quarter to quarter, so the change in the number of claims for any quarter compared to the same period in the prior year are not necessarily representative of the results to be expected for the full year.

At December 31, 2014, the present value of the liability for future workers' compensation payments was $17.9 billion, after making the scheduled annual payment of $1.4 billion on October 15, 2014. The current portion of the liability was $1.4 billion and $1.3 billion at December 31, 2014 and September 30, 2014, respectively.

The following table presents the components of workers' compensation expense for the three months ended December 31, 2014 and 2013:

(in millions)	2014	2013
Impact of interest rate changes	$ 816	$ (541)
Actuarial valuation of new cases and revaluation of existing cases	(47)	524
Administrative fee	17	17
Total workers' compensation expense	**$ 786**	**$ —**

The impact of lower interest rate changes from the prior period increased workers' compensation expense $1.4 billion, or 250.8%, for the three months ended December 31, 2014 compared to the same period last year. In addition, actuarial valuation of new and existing cases decreased workers' compensation expense $571 million, or 109.0% for the three months ended December 31, 2014, compared to the same period last year. This decrease in actuarial valuation of new and existing cases is comprised of the $353 million change in estimate due to revising our valuation estimate and $218 million in actuarial valuation of new and existing cases.

As noted above, we are legally-mandated to participate in the federal workers' compensation program that is managed by the DOL OWCP and governed by FECA. Under FECA, workers' compensation claims for many types of injuries cannot be settled through lump-sum payments. Rather, compensation may be paid over many years. As we do not manage the FECA program, we have no ability to control the significant administrative costs. Federal law grants COLA adjustments to those claims, and this results in substantially higher costs to us than would likely be the case if we managed our own claims.

Transportation

Transportation expense consists primarily of highway, air, and international transportation costs. The components of transportation expense for the three months ended December 31, 2014 and 2013 are as follows:

(in millions)	2014	2013
Highway	$ 982	$ 939
Air	564	564
International	237	264
Other	15	12
Total transportation expenses*	**$ 1,798**	**$ 1,779**

* Transportation expense includes only the costs we incur to transport mail and other products between our facilities and does not include actual delivery costs, i.e., the "last mile."

Highway transportation increased primarily due to an increase in mileage for Highway Contract Routes of 3.9%, which was primarily due to the increase in Shipping and Packaging volume during the seasonal holiday period. This increase was offset by lower fuel prices of 0.5% as compared to the same period last year. International transportation decreased primarily to a decline in the International Express and International Priority volumes. Air transportation remained unchanged and Other transportation expenses increased $3 million from the same period last year.

Other Operating Expenses

Other operating expenses were $2.3 billion for the three months ended December 31, 2014, virtually unchanged from $2.3 billion for the same period last year.

Liquidity and Capital Resources

We held cash and cash equivalents of $7.1 billion and $4.9 billion as of December 31, 2014 and September 30, 2014, respectively. Although liquidity appeared to improve during the quarter, the increase in cash and cash equivalents was largely attributable to the timing of payroll and accounts payable disbursements that occurred on January 2, 2015, when cash balances declined to $5.5 billion. The seasonal impact of holiday mailings, particularly packages, favorably affected cash balances during the quarter.

Cash Flow Activity

Operating Activities: Cash provided by operating activities for the three months ended December 31, 2014 was $2.5 billion, compared to $1.6 billion for the same period last year. This increase resulted primarily from cash provided from changes in current assets and liabilities during the period, which was $3.5 billion compared to $2.9 billion for the same period last year. The increase in cash provided during the period was primarily offset by changes in noncurrent workers' compensation liability used in operating activities of $642 million during the three months ended December 31, 2014 compared to $1.4 billion for the same period last year.

Investing Activities: Purchases of property and equipment were $335 million for the three months ended December 31, 2014, consisting of $100 million for building improvements, $50 million in vehicles, $36 million in equipment, $114 million in IT software and $35 million in other construction-in-progress related activities. This amount compared to $182 million in the same period last year, an increase of $153 million, or 84.1%. Proceeds from the sale of property and equipment were $5 million and $32 million for the three months ended December 31, 2014, and 2013, 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 three months ended December 31, 2014 and 2013, we repaid and issued $2.7 billion in notes payable resulting in zero net issuance. There was no change in our overall $15.0 billion borrowing capital or in our $4.0 billion revolving credit line from September 30, 2014.

Liquidity Concerns

We continue to suffer from a lack of liquidity. Cash balances remain insufficient to support an organization with approximately $73 billion in annual operating expenses. Our average daily cash and cash equivalents balances during the three months ended December 31, 2014 were $5.7 billion, which represents only 21 days of operating cash. We do not have the ability to borrow additional funds under our existing borrowing arrangements, and this amount of cash balances could be insufficient to support operations in the event of another significant downturn in the U.S. economy.

We incurred a net loss of $754 million for the three months ended December 31, 2014. The loss included $1.4 billion of expense accrued for the prefunding payment for the PSRHBF. This requirement to prefund retiree health benefit obligations is not imposed on most other federal agencies or private sector businesses. In addition to the requirement to prefund $5.7 billion of retiree health benefits in 2015, we continue to pay our employer share of health insurance premiums for our retirees, which was $759 million during the three months ended December 31, 2014.

Since 2007, we have incurred cumulative financial losses of $52.5 billion. As a result of these ongoing financial losses, we do not have sufficient cash balances to meet all of our existing legal obligations, which include $22.4 billion of cumulative PSRHBF payments that were due but not paid in 2012, 2013 and 2014, make reductions in our debt and make all of the critical investments in our infrastructure that we deferred in recent years. As of the date of this report, we have not incurred any penalties or negative consequences resulting from our inability to make the PSRHBF payments.

In December 2013, the PRC ruled that we could collect an exigent surcharge on Market-Dominant products beginning in January 2014 until such time as we recover $3.2 billion in incremental revenue. As of September 30, 2014, the last date reported to the PRC, we had collected approximately $1.4 billion in incremental revenue, and we currently estimate that we will recover the $3.2 billion in incremental revenue during 2015. The exigent surcharge was in addition to a 1.7% price increase based on the Consumer Price Index for All Urban Consumers ("CPI-U"). Also in January 2014, we increased prices an average of 2.4% for Competitive services.

We have appealed the PRC's ruling on the exigent price increase with the U.S. Court of Appeals for the District of Columbia, arguing that the PRC erred in its decision to limit the duration of the exigent surcharge. Some mailers have also filed an appeal seeking relief from the PRC's decision to allow any exigent price increase. Our liquidity will be adversely impacted if the exigent price increase expires.

The ongoing decline in First-Class Mail volume has also been a major factor contributing to our losses. This decline is the result of lingering effects of the Great Recession and changes in consumers' and businesses' uses of mail resulting from the continuing migration toward electronic communication and transactional alternatives. We anticipate that diversion of hard copy mail will continue to reduce First-Class Mail volumes and revenues for the foreseeable future.

With the exception of the exigent price increase discussed above, Market-Dominant services, which account for approximately 78% of our annual operating revenues, are subject to a price cap based on the CPI-U. While the vast majority of revenues are constrained by the price cap, costs are not statutorily constrained. Contractual obligations granting cost-of-living adjustments ("COLA") and general wage increases, along with increases in costs for mandatory federal benefits programs, such as retiree health benefits and FERS, are exerting upward pressure on expenses in 2015 and beyond. Health benefits and FERS cost increases alone are expected to add approximately $700 million to 2015 expenses. Although the annual PSRHBF prefunding mandate ends in 2016, the PAEA requires us to begin funding the normal costs and amortization of the unfunded liabilities of the PSRHBF and the Civil Service Retirement System in 2017.

Postal Service Actions Taken to Improve Liquidity

In order to conserve cash, we reduced our average annual capital expenditures from approximately $1.5 billion in years 2009 through 2011 to $718 million in years 2012 through 2014, and this decline in capital expenditures is unsustainable. Our delivery fleet includes approximately 140,000 vehicles that are at least 20 years old and at or near the end of their useful lives. Repair and maintenance costs for these vehicles have risen significantly in recent years. Facilities maintenance, other than for health and safety reasons, has been deferred in recent years to save cash. Investments in package sorting and handling equipment are needed to fully capitalize on business opportunities in the growing package delivery market and letter sorting equipment that is at or near the end of its useful life must also be updated.

In order to address some of the critical vehicle, facility and package handling requirements that have been deferred in recent years, we must increase our capital investments during the years 2015 through 2020. For the three months ended December 31, 2014, we made capital investments of $335 million. We currently estimate that cash outlays for capital assets will amount to approximately $2.0 billion in 2015 and as much as an additional $8.0 billion in years 2016 through 2020.

In 2013, we implemented a realignment of our operations to further reduce costs and strengthen our finances. These operational realignments included reductions in the number of mail processing operations, realignment of retail office hours to match demand, reductions in the number of delivery routes and consolidations of delivery offices. In January 2015, we revised our service standards for First-Class Mail and implemented a second phase of mail processing realignments which will result in a consolidation impacting up to 82 processing operations.

We continue to leverage employee attrition, Voluntary Early Retirement ("VER") and utilization of non-career employees to the maximum extent permitted by our labor contracts. In July 2014, we offered a VER to approximately three thousand postmasters who were impacted by reductions in retail hours at certain of our facilities. As of the September 30, 2014 deadline, this offer had been accepted by approximately 1,380 postmasters.

On January 15, 2015 we filed a notice with the PRC of our intent to increase certain Market-Dominant prices by an average of 1.966% in accordance with the CPI-U price cap. We estimate that this plan, if approved, would generate an additional $900 million in revenue per year. Since the plan would not take effect until April 26, 2015, we estimate the price increase would only generate additional revenue of $400 million for 2015. On January 26, 2015 we announced that we had proposed price increases for Priority Mail International and Priority Mail Express International of 6.8% and 6.7%, respectively. If approved by the PRC, these price increases would also take effect on April 26, 2015.

We continue to pursue legislation to reform our obsolete business model and streamline our burdensome regulatory structure, which can only be achieved through legislative changes. Such changes could include a transition to a new Monday-through-Friday mail delivery while maintaining a package delivery schedule from Monday through Saturday (and on Sundays in some instances). Additionally, reform is needed to establish a set of healthcare plans within the FEHBP that would fully integrate with Medicare for current and future retirees. Such reform would eliminate the necessity for the PSRHBF prefunding requirement and virtually eliminate the unfunded liability of $22.4 billion referenced above.

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

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. With annual revenue of approximately $68 billion, generated almost entirely through the sale of postal products and services, a financially-sound Postal Service would continue to be vital to American commerce. The U.S. economy benefits greatly from the Postal Service and the many businesses that provide printing and mailing services that we support.

Millions of check payments, letters and packages upon which people depend are mailed through our network on a daily basis. Disruption of the mail would cause undue hardship to businesses and consumers, and in the event of a cash shortfall, the U.S. government would likely prevent us from significantly curtailing or ceasing operations. We continue to inform the Administration, Congress, the PRC and other stakeholders of the immediate and long-term financial challenges we face and the legislative changes that are required to restore financial stability. However, there can be no assurances that our requests to restructure the pension and benefit payment schedules, or any other legislative changes, will be made in the foreseeable future.

Debt

Our debt consists of various fixed and floating-rate notes with various maturities and an aggregate principal balance outstanding of $15.0 billion as of December 31, 2014, the same outstanding balance that we reported as of September 30, 2014. This is the maximum borrowing amount allowed under our legally-mandated debt ceiling. All debt is borrowed from the Federal Financing Bank ("FFB"), a government-owned corporation under the general supervision of the Secretary of the Treasury. Included in the current portion of debt are two revolving credit line facilities, renewable annually with the FFB, both of which are available through April 2015. These facilities, which have interest rates determined by the Treasury each business day, enable us to draw up to $4.0 billion. As of December 31, 2014 and September 30, 2014, these facilities were fully drawn.

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. The estimate of our liability for material claims was $933 million and $934 million as of December 31, 2014 and September 30, 2014, respectively, based upon our evaluation of new and existing claims.

Fair Value Measurements

As required by authoritative accounting literature, certain fair value disclosures for the three months ended December 31, 2014 are contained in the Notes to the Financial Statements. We did not recognize gains as a result of valuation measurements during the three months ended December 31, 2014. All recognized losses have been incorporated into our financial statements as of December 31, 2014. See *Item 1. Financial Statements, Note 9- Fair Value Measurements.*

Legislative Update

Our legislative update section provides ongoing insights into the legislative and policy processes that may affect us and our operations. Please also refer to the Legislative Update contained in our financial statements for the year ended September 30, 2014 filed as part of our Annual Report on Form 10-K filed with the PRC on December 5, 2014.

The 113th Congress adjourned without taking action on two major postal reform bills -- S. 1486, *Postal Reform Act of 2014* and H.R. 2748, *Postal Reform Act of 2013* -- both of which included provisions designed to help us achieve financial viability. As the debate on Postal Service reform legislation continues in the 114th Congress, reforms are urgently needed. We will work with Congress and all of our stakeholders to enact comprehensive legislation that will make us financially viable.

Appropriations

On December 16, 2014, the President signed into law H.R. 83 (Public Law 113-235), the *Consolidated and Further Continuing Appropriations Act, 2015*, funding the U.S. government for the fiscal year ending September 30, 2015. The bill includes a $70 million payment to the Postal Service Fund for Revenue Forgone on free mail for the blind and overseas voting, which funds will not be available until October 1, 2015. No funds were provided for provisions related to the Revenue Forgone Act of 1993, which authorizes us to receive $29 million annually through 2035 as reimbursement for services we provided to other U.S. government agencies from years 1991 through 1998. H.R. 83 also authorizes $14.7 million for the PRC and $243.8 million for the OIG, with both appropriations to be paid by transfer from the Postal Service Fund. The measure also requires continuation of six-day mail delivery and prohibits any of the appropriated funds from being used to consolidate or close small rural or other small post offices.

President's Fiscal Year 2016 Budget Proposal

On February 2, 2015, the President released his fiscal year 2016 Budget Proposal for the U.S. government (the "Budget"). The Budget proposes several recommendations to improve our efficiency and net revenue, along with financial relief measures, including:

- Requiring OPM to refund the FERS surplus to us over a period of two years and require that OPM calculate future costs using factors specific to the demographics and salary assumptions of our workforce.
- Codifying the defaulted PSRHBF prefunding payments from years 2011 through 2014, and deferring the 2015 and 2016 fixed payments, shifting to "normal cost" PSRHBF funding beginning in 2015 rather than 2017 as mandated by the PAEA.

In addition, the Budget proposes operational reforms to reduce our costs and improve our revenue, including:

- Authorizing us to adjust mail delivery frequency to five-day delivery if mail volume falls below 140 billion pieces for four consecutive quarters (the Budget assumes this will occur near the end of 2018),
- Allowing us to leverage our resources by increasing collaboration with state and local governments,
- Allowing us to begin shifting to centralized and curbside delivery where appropriate, and to codify our current administrative plan ("POStPlan") to avoid small and rural post office closures,
- Enhancing Postal Service governance to allow management and the Board of Governors to more quickly and effectively respond to market opportunities and challenges while retaining strong oversight from the PRC and Congress, and
- Permanently extending the exigent price increase.

The Budget also reflects reimbursement to us in the amount of approximately $67 million for free mail for the blind and overseas voting; however, it contains no provisions related to Revenue Forgone.

Board of Governors Nominations

After failing to act on the Board nominations of Mickey D. Barnett, David Michael Bennett, Stephen Crawford, Victoria Reggie Kennedy, James C. Miller III and David S. Shapira, the Senate returned the nominations to the President on December 17, 2014.

As described above in *Introduction*, in December 2014, due to one Governor departing office and Senate inaction on pending nominees, the number of sitting Board members dropped to five, thereby rendering the Board unable to assemble a quorum. Prior to losing its quorum, the Board issued a resolution that established the Temporary Emergency Committee to exercise certain powers reserved to the Board during a period in which it is unable to assemble a quorum.

On January 8, 2015, the President announced the re-nomination of David S. Shapira to serve on the Board for a term to expire on December 8, 2019. No other nominations have been announced for the six open Board seats.

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.

We also have provision in our debt agreements that allow us to prepay our $15 billion debt at any time at a priced determined by the Secretary of the Treasury, based on prevailing interest rates in the Treasury Security market at the time of repayment.

See our 2014 Annual Report on Form 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 PAEA, and that this information is accumulated and communicated to our management, including the Postmaster General and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

We carried out an evaluation under the supervision and with the participation of management, including the Postmaster General and Chief Financial Officer, of the effectiveness of the design and operation of disclosure controls and procedures as of December 31, 2014. 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 our internal controls over financial reporting during the quarter ended December 31, 2014, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

As we disclosed in a Periodic Report on Form 8-K filed with the PRC on November 14, 2014, the Governors announced the appointment of Megan J. Brennan as Postmaster General. Ms. Brennan became Postmaster General on February 1, 2015, succeeding Patrick R. Donahoe, whose retirement became effective on the same date.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

For a discussion of legal proceedings affecting us, please refer to our Annual Report on Form 10-K, filed on December 5, 2014, as well as 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, 2014.

Item 6. Exhibits

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

Signatures

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

United States Postal Service

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

Date: February 6, 2015

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

Date: February 6, 2015

Exhibit 31.1

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

I, Megan J. Brennan, certify that:

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

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

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

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

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

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

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

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

5. The Postal Service's other certifying officer and I have disclosed based on our most recent evaluation of internal control over financial reporting, to the Postal Service's 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: February 6, 2015

/s/Megan J. Brennan

Megan J. Brennan

Postmaster General and Chief Executive Officer

Exhibit 31.2

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

I, Joseph Corbett, certify that:

1. I have reviewed this quarterly report on Form 10-Q of the United States Postal Service (Postal Service);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Postal Service as of, and for, the periods presented in this report;
4. The Postal Service's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Postal Service and have:
    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Postal Service, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
    b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
    c. Evaluated the effectiveness of the Postal Service's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
    d. Disclosed in this report any change in the Postal Service's internal control over financial reporting that occurred during the Postal Service's most recent fiscal quarter (the Postal Service's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Postal Service's internal control over financial reporting; and
5. The Postal Service's other certifying officer and I have disclosed based on our most recent evaluation of internal control over financial reporting, to the Postal Service's 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: February 6, 2015

/s/Joseph Corbett

Joseph Corbett
Chief Financial Officer and Executive Vice President

Exhibit 32.1

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

In connection with the Quarterly Report of the United States Postal Service (Postal Service) on Form 10-Q for the period ended December 31, 2014, (the Report), I, Megan J. Brennan, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 that:

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

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

Dated: February 6, 2015

/s/Megan J. Brennan

Megan J. Brennan

Postmaster General and Chief Executive Officer

Exhibit 32.2

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

In connection with the Quarterly Report of the United States Postal Service (Postal Service) on Form 10-Q for the period ended December 31, 2014 (the Report),I, Joseph Corbett, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 that:

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

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

Dated: February 6, 2015

/s/Joseph Corbett

Joseph Corbett

Chief Financial Officer and Executive Vice President