

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

FORM 10-Q

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

For the Quarterly Period Ended December 31, 2018



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

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

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

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

The number of shares of common stock outstanding as of February 7, 2019: N/A

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

UNITED STATES POSTAL SERVICE STATEMENTS OF OPERATIONS (UNAUDITED)

<i>(in millions)</i>	Three Months Ended December 31,	
	2018	2017
Revenue:		
Operating revenue	\$ 19,711	\$ 19,152
Other revenue	6	12
Total revenue	19,717	19,164
Operating expenses:		
Compensation and benefits	13,585	12,928
Unfunded retirement benefits amortization	599	663
Retiree health benefits	1,275	1,179
Workers' compensation	887	266
Transportation	2,342	2,135
Other operating expenses	2,538	2,495
Total operating expenses	21,226	19,666
Loss from operations	(1,509)	(502)
Interest and investment income	34	22
Interest expense	(62)	(60)
Net loss	\$ (1,537)	\$ (540)

See accompanying notes to the unaudited financial statements.

**UNITED STATES POSTAL SERVICE
BALANCE SHEETS**

(in millions)

	December 31, 2018	September 30, 2018
	(Unaudited)	
Current Assets:		
Cash and cash equivalents	\$ 9,271	\$ 10,061
Restricted cash	358	275
Receivables, net	1,329	1,094
Supplies, advances and prepayments	233	153
Total current assets	11,191	11,583
Property and equipment, net	14,606	14,616
Other assets	494	489
Total assets	\$ 26,291	\$ 26,688
Current Liabilities:		
Compensation and benefits	\$ 1,766	\$ 2,234
Unfunded retirement benefits	6,151	5,551
Retiree health benefits	43,916	42,641
Workers' compensation	1,344	1,383
Payables and accrued expenses	2,315	2,217
Deferred revenue-prepaid postage	2,316	2,066
Customer deposit accounts	1,147	1,198
Other current liabilities	1,113	1,180
Current portion of debt	11,000	11,000
Total current liabilities	71,068	69,470
Workers' compensation costs, noncurrent	14,569	15,026
Employees' accumulated leave, noncurrent	2,012	1,906
Other noncurrent liabilities	698	723
Noncurrent portion of debt	2,200	2,200
Total liabilities	90,547	89,325
Net Deficiency:		
Capital contributions of the U.S. Government	3,132	3,132
Deficit since 1971 reorganization	(67,388)	(65,769)
Total net deficiency	(64,256)	(62,637)
Total liabilities and net deficiency	\$ 26,291	\$ 26,688

See accompanying notes to the unaudited financial statements.

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

For the three months ended December 31, 2017

<i>(in millions)</i>	Capital Contributions of U.S. Government	Accumulated Deficit Since Reorganization	Total Net Deficiency
Balance, September 30, 2017	\$ 3,132	\$ (61,856)	\$ (58,724)
Net loss	—	(540)	(540)
Balance, December 31, 2017	\$ 3,132	\$ (62,396)	\$ (59,264)

See accompanying notes to the unaudited financial statements.

For the three months ended December 31, 2018

<i>(in millions)</i>	Capital Contributions of U.S. Government	Accumulated Deficit Since Reorganization	Total Net Deficiency
Balance, September 30, 2018	\$ 3,132	\$ (65,769)	\$ (62,637)
Cumulative effect adjustments for adoption of ASC 606 and ASC 405-20	—	(82)	(82)
Net loss	—	(1,537)	(1,537)
Balance, December 31, 2018	\$ 3,132	\$ (67,388)	\$ (64,256)

See accompanying notes to the unaudited financial statements.

UNITED STATES POSTAL SERVICE
STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Three Months Ended December 31,	
	2018	2017
<i>(in millions)</i>		
Cash flows from operating activities:		
Net loss	\$ (1,537)	\$ (540)
Adjustments to reconcile net loss to cash provided by operations:		
Depreciation and amortization	417	417
Gain on disposals of property and equipment, net	(3)	(8)
Increase in other assets	(5)	(4)
Decrease in noncurrent workers' compensation	(457)	(1,070)
Increase (decrease) in noncurrent deferred appropriations and other revenue	6	(2)
Increase in other noncurrent liabilities	90	103
Changes in current assets and liabilities:		
Receivables, net	(235)	(216)
Other current assets	(80)	(51)
Unfunded retirement benefits	600	663
Retiree health benefits	1,275	1,179
Payables, accrued expenses and other	(451)	(241)
Deferred revenue-prepaid postage and other deferred revenue	73	(37)
Net cash (used in) provided by operating activities	(307)	193
Cash flows from investing activities:		
Purchases of property and equipment	(401)	(323)
Proceeds from sales of property and equipment	14	8
Net cash used in investing activities	(387)	(315)
Cash flows from financing activities:		
Issuance of notes payable	13,900	15,900
Payments on notes payable	(13,900)	(15,900)
Payments on capital lease obligations and other	(13)	(15)
Net cash used in financing activities	(13)	(15)
Net decrease in cash, cash equivalents and restricted cash	(707)	(137)
Cash, cash equivalents and restricted cash at beginning of period	10,336	10,804
Cash, cash equivalents and restricted cash at end of period	\$ 9,629	\$ 10,667
Supplemental cash flow disclosures:		
Cash paid for interest	\$ 60	\$ 67

See accompanying notes to the unaudited financial statements.

NOTES TO UNAUDITED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

Interim Financial Statements

The accompanying unaudited interim financial statements of the United States Postal Service (the "Postal Service") have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of the U.S. Securities and Exchange Commission ("SEC") Regulation S-X. These financial statements should be read in conjunction with the Postal Service's financial statements for the year ended September 30, 2018, included in its Annual Report on Form 10-K ("Annual Report") filed with the Postal Regulatory Commission ("PRC") on November 14, 2018, and do not include all information and footnotes which are normally included in the Annual Report. Except as otherwise specified, all references to years are to the fiscal year beginning October 1 and ending September 30, and quarters are quarters within fiscal years 2019 and 2018.

On August 17, 2018, the SEC adopted amendments to certain disclosure requirements in Securities Act Release No. 33-10532, *Disclosure Update and Simplification*. The amendments became effective on November 5, 2018. Among the amendments is the requirement to present the changes in shareholders' equity in the interim financial statements (either in a separate statement or footnote) in quarterly reports on Form 10-Q. Based on this new requirement, the Postal Service has prepared its *Statements of Changes in Net Deficiency* for the three months ended December 31, 2018, and 2017, in a separate statement.

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, 2018, the results of operations for the three months ended December 31, 2018, and 2017, the changes in net deficiency for the three months ended December 31, 2018, and 2017, and cash flows for the three months ended December 31, 2018, and 2017. Operating results for the three months ended December 31, 2018, are not necessarily indicative of the results that may be expected for all of 2019. Mail volume and revenue are historically greatest in the first quarter of the fiscal year, which includes the holiday mailing season.

NOTE 2 - RECENT ACCOUNTING PRONOUNCEMENTS

Recently Adopted Accounting Pronouncements

Accounting Standards Update 2014-09 Revenue from Contracts with Customers

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update 2014-09 *Revenue from Contracts with Customers*, which has since been codified in Accounting Standards Codification ("ASC") 606, *Revenue from Contracts with Customers* ("ASC 606"). 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. The new standard may be adopted either retrospectively or on a modified retrospective basis whereby the standard would be applied to new and existing contracts with remaining performance obligations as of the effective date, with a cumulative catch-up adjustment recorded to beginning retained earnings or net deficiency at the effective date for existing contracts with remaining performance obligations. ASC 606 became effective for the Postal Service's 2019 fiscal year. The Postal Service adopted the standard and applied it to all contracts using the modified retrospective approach with a cumulative catch-up adjustment recorded to net deficiency as of the beginning of fiscal year 2019.

The Postal Service evaluated the impact of the standard utilizing a comprehensive approach. To assess the impact of the guidance on its contracts with customers, the Postal Service reviewed accounting policies and practices to identify potential differences that would result from applying the new requirements to its revenue contracts, including evaluation of transfer of control, multiple-element arrangements, free goods, "breakage" (i.e., the value of prepaid postage that is ultimately not redeemed by the customer) and variable consideration. The Postal Service completed its contract analysis based on the five-step model as outlined in the authoritative literature, and quantified the impact of adopting the new standard on its financial statements.

In adopting the new standard, the Postal Service determined that the October 1, 2018 opening balance of accumulated deficit should increase to account for changes in the recognition of the "breakage" and "Mail-in-Transit" components of deferred revenue associated with prepaid postage. The amount of this increase is considered immaterial to the financial statements taken as a whole. See *Note 4 - Revenue Recognition* for further disclosures pertaining to ASC 606.

Accounting Standards Update 2016-04 Liabilities - Extinguishments of Liabilities

In March 2016, the FASB issued Accounting Standards Update 2016-04 *Liabilities - Extinguishments of Liabilities*, which has since been codified in ASC Subtopic 405-20, *Liabilities - Extinguishments of Liabilities* ("ASC 405-20"). The new standard requires entities that sell prepaid stored-value products redeemable for goods, services or cash at third-party merchants to recognize "breakage" as revenue on a pro-rata basis using an estimate based on past redemption patterns, consistent with how breakage is now recognized under ASC 606, discussed above. ASC 405-20 has become effective for the Postal Service's 2019 fiscal year. The Postal Service adopted the standard using the modified retrospective approach with a cumulative catch-up adjustment recorded to net deficiency as of the beginning of fiscal year 2019. The standard is applicable to the Postal Service's determinations of revenue from outstanding money orders and related breakage, which are recorded in *Other current liabilities*.

The Postal Service finalized its quantification of the impact of adopting ASC 405-20. In adopting the new standard, the Postal Service determined that the October 1, 2018 opening balance of accumulated deficit should decrease to account for the changes in the recognition of breakage revenue related to money orders. The amount of this decrease is considered immaterial to the financial statements taken as a whole. The opening balance of *Other current liabilities* decreased by the same amount.

Cumulative Adjustments

The Postal Service adopted ASC 606 and ASC 405-20 on October 1, 2018. The cumulative effects of changes to its accompanying unaudited *Balance Sheet* as of October 1, 2018, resulting from the adoption were as follows:

(in millions)	Balance as previously reported on September 30, 2018	Adjustments due to adoption of		Balance on October 1, 2018
		ASC 606	ASC 405-20	
Total assets	\$ 26,688	\$ —	\$ —	26,688
Current liabilities:				
Compensation and benefits	\$ 2,234	\$ —	\$ —	2,234
Unfunded retirement benefits	5,551	—	—	5,551
Retiree health benefits	42,641	—	—	42,641
Workers' compensation	1,383	—	—	1,383
Payables and accrued expenses	2,217	—	—	2,217
Deferred revenue-prepaid postage	2,066	164	—	2,230
Customer deposit accounts	1,198	—	—	1,198
Other current liabilities	1,180	—	(82)	1,098
Current portion of debt	11,000	—	—	11,000
Total current liabilities	69,470	164	(82)	69,552
Total noncurrent liabilities	19,855	—	—	19,855
Total liabilities	89,325	164	(82)	89,407
Net deficiency:				
Capital contributions of the U.S. government	3,132	—	—	3,132
Deficit since 1971 reorganization	(65,769)	(164)	82	(65,851)
Total net deficiency	(62,637)	(164)	82	(62,719)
Total liabilities and net deficiency	\$ 26,688	\$ —	\$ —	\$ 26,688

Accounting Pronouncements Issued but not Adopted

Accounting Standards Update 2016-02 Leases

In February 2016, the FASB issued Accounting Standards Update 2016-02 *Leases*, which has since been codified in ASC 842, *Leases* ("ASC 842"). The new standard requires an entity to record most leases on its balance sheets but continue to recognize expenses in the statements of operations in a manner similar to current accounting practices. The new standard states that a lessee will recognize a lease liability for the obligation to make lease payments and a right-of-use asset for the right to use the underlying asset for the lease term. Expenses related to leases determined to be operating leases will be recognized on a straight-line basis, while those determined to be finance leases will generally have higher expense in the earlier periods of the lease and both interest and amortization will be presented separately in the statements of operations.

ASC 842 will become effective for the Postal Service's 2020 fiscal year (beginning October 1, 2019) and the quarters therein, with early adoption permitted but not elected by the Postal Service. Entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. In July 2018, the FASB approved an additional and optional transition method that would allow adoption of the standard as of the effective date without restating prior periods, and the Postal Service has elected this transition method.

The Postal Service has completed its initial scoping exercise and continues to evaluate whether embedded leases exist in its service contracts. In addition, the Postal Service has substantially completed abstracting all of the necessary information to properly account for the over 23,000 facilities property leases portfolio under the new standard. The Postal Service has also begun abstracting all of the necessary information to properly account for other smaller lease portfolios. The Postal Service continues to evaluate the full impact of adopting this standard on its financial statements and disclosures, as well as its impact on Postal Service policies, practices and systems. As of December 31, 2018, the Postal Service had \$2.8 billion of future minimum operating lease commitments that are not recognized on its balance sheet. Therefore, the Postal Service expects that the adoption will have a material effect on its balance sheet and disclosures, but an immaterial effect on its statement of operations and statement of cash flows.

Accounting Standards Update 2016-13 Financial Instruments - Credit Losses

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

ASC 326 will become effective for the Postal Service's 2020 fiscal year (beginning October 1, 2019) and the quarters therein, with early adoption permitted. The standard is applicable to the Postal Service's valuation of trade accounts receivable and its revenue forgone receivable. The Postal Service is currently evaluating the impact of adopting this standard on its financial statements and disclosures.

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

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

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

ASU 2018-15 will become effective for the Postal Service's 2021 fiscal year (beginning October 1, 2020) and the quarters therein, with early adoption permitted, including adoption in any interim period. The Postal Service is currently evaluating the impact of adopting this standard on its financial statements and disclosures.

NOTE 3 - LIQUIDITY

The Postal Service generates its cash almost entirely through the sale of postal products and services. The Postal Service holds its cash with the Federal Reserve Bank of New York and invests its excess cash, when available, in highly-liquid, short-term investments issued by the U.S. Department of the Treasury. As of December 31, 2018, and September 30, 2018, the Postal Service held unrestricted cash and cash equivalents of \$9.3 billion and \$10.1 billion, respectively.

Debt

The Federal Financing Bank ("FFB"), a government-owned corporation under the general supervision of the Secretary of the Treasury, holds all of the Postal Service's debt, which consists of fixed-rate notes with various maturities of \$9.2 billion and two revolving credit facilities totaling up to \$4.0 billion with interest rates determined by the U.S. Department of the Treasury each business day. As of December 31, 2018, and September 30, 2018, these revolving facilities were fully drawn and were included in the current portion of debt. These annually-renewable facilities were renewed on April 20, 2018, and are scheduled to expire in April 2019.

As of both December 31, 2018, and September 30, 2018, the aggregate principal balance of all debt outstanding was \$13.2 billion, which is \$1.8 billion below the \$15.0 billion maximum borrowing amount allowed under the Postal Service's statutory debt ceiling.

Under the *Postal Reorganization Act*, as amended by Public Laws 101-227 and 109-435 (the "PRA"), the Postal Service can issue debt obligations. In 1974, the Postal Service began issuing debt through individual debt agreements to the FFB. The Postal Service is limited by statute to net annual debt increases of \$3.0 billion, and total debt may not exceed \$15.0 billion.

In 1999, the Postal Service entered into a Note Purchase Agreement ("NPA") with the FFB to establish standardized procedures for the Postal Service to issue its debt. Under the NPA, the Postal Service can issue a series of notes with established terms and conditions by providing two days prior notice. Also under the NPA, the Postal Service can make borrowings against two annually-renewable revolving credit line facilities.

On September 28, 2018, under a recent amendment to the NPA, the FFB extended the NPA for one quarter, until December 31, 2018. On December 28, 2018, the FFB amended the NPA again and extended it for 60 days, until February 28, 2019. These recent amendments represent a change in the FFB's previous practice of annually extending the NPA for a full fiscal year. These changes did not affect the terms of any of the Postal Service's outstanding debt as of September 30, 2018, and December 31, 2018.

If the Postal Service is unable to extend the NPA beyond February 28, 2019, it has no assurance that it could obtain alternative debt financing after that date on comparable terms. However, the Postal Service believes that should the NPA not be renewed, the Postal Service would be able to maintain adequate liquidity through existing and new financing arrangements, as necessary and allowed by statute, to fund its operations for the foreseeable future.

Liquidity Concerns

The Postal Service is constrained by laws and regulations, including the *Postal Accountability and Enhancement Act*, Public Law 109-435 ("PAEA"), which restrict revenue sources and mandates certain expenses. These expenses include prefunding requirements for retiree health benefits, and amortization schedules to provide full funding of retiree health and pension benefits that are unlike those imposed on most other U.S. government entities or private sector businesses.

PAEA-mandated expenses include amortization payments to provide full funding of retirement benefits under the Civil Service Retirement System ("CSRS") and the Federal Employee Retirement System ("FERS"), described in greater detail below and in *Note 9 - Retirement Plans*. Additionally, the PAEA established the Postal Service Retiree Health Benefits Fund ("PSRHBF") and mandated certain obligations for paying the normal costs and amortization payments for full prefunding of retiree health benefits. Normal costs are the present value of the estimated retiree health benefits attributable to active employees' current year of service. These prefunding obligations are described in greater detail below and in *Note 10 - Health Benefits Plans*.

The Postal Service reported operating expenses of approximately \$74 billion in 2018 and has incurred cumulative net losses of \$70.5 billion from 2007 through December 31, 2018. The Postal Service defaulted on \$33.9 billion in PSRHBF prefunding payments to the U.S. Office of Personnel Management ("OPM") for the years 2012 through 2016. The Postal Service also did not make payments totaling \$13.8 billion to OPM over the last two fiscal years (approximately \$6.9 billion in payments were each due September 30, 2018, and September 30, 2017), for normal cost of retiree health benefits and amortization payments for PSRHBF, CSRS and FERS unfunded liabilities, in order to preserve liquidity and to ensure that the Postal Service's ability to fulfill its primary universal service mission was not placed at undue risk.

The following table presents the total expenses related to past due obligations related to retiree health benefits, CSRS and FERS by the Postal Service and the fiscal years in which the accruals were recorded:

<i>(in millions)</i>	2018	2017	2012 to 2016	Total as of September 30, 2018
PSRHBF prefunding fixed amount ¹	\$ —	\$ —	\$ 33,900	\$ 33,900
PSRHBF unfunded benefits amortization	815	955	—	1,770
Normal cost of retiree health benefits	3,666	3,305	—	6,971
CSRS unfunded retirement benefits amortization	1,440	1,741	—	3,181
FERS unfunded retirement benefits amortization ²	958	917	495	2,370
Total expenses related to past due obligations	\$ 6,879	\$ 6,918	\$ 34,395	\$ 48,192

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

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

Absent legislative and regulatory change, the Postal Service projects continuing annual net losses in the future. As a result of these losses and its liquidity concerns, the Postal Service will be unlikely to have sufficient liquidity to meet all of its existing legal obligations when due, to pay down its debt and to make the critical infrastructure investments that have been deferred in recent years.

In the event that circumstances leave the Postal Service with insufficient liquidity, it would likely be required to implement additional contingency plans to ensure that mail deliveries continue. These measures may require the Postal Service to prioritize payments to the FFB, employees and suppliers ahead of some payments to other U.S. government entities, as has been done in the past.

Business Model Challenges/Constraints

Market-Dominant services, which account for approximately 67% of the Postal Service's annual operating revenues, are currently subject to a price cap as measured by the Consumer Price Index for All Urban Consumers ("CPI-U"). However, the Postal Service's costs are not similarly constrained. A large portion of its cost structure cannot be altered expeditiously due to the Postal Service's universal service obligation, which currently includes a legal requirement to deliver mail six days per week, while the number of delivery points continues to grow by approximately one million per year, further driving up delivery costs. As described above, certain employee and retiree benefit costs are mandated by law and cannot be altered without legislative change. Under current law, the Postal Service is generally unable to increase prices sufficiently to offset increased costs, and is likewise constrained by law from reducing many of its costs or from pursuing many alternate sources of revenue.

Aside from its universal service obligation, a significant factor contributing to Postal Service losses is the ongoing decline in the volume of Market-Dominant products and services. Specifically, secular declines in *First-Class Mail* are largely the result of changes in consumers' and businesses' use of mail resulting from the continuing migration to electronic communication and transactional alternatives, which has taken place over the last decade and is expected to continue. After experiencing relatively flat volume between 2009 and 2016, beginning in 2017, *Marketing Mail* volume has been challenged by commercial mailers' increasing use of digital advertising, although it has been boosted by strong political and election mail volumes, particularly in the first quarter of 2019. Further exacerbating losses is the increasing number of delivery points, which, when combined with the reduction in mail volume, has resulted in a drop in the average number of pieces delivered per delivery point per day from approximately 5.5 pieces in 2007 to 3.5 pieces in 2018, a decline of approximately 37%.

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

Mitigating Circumstances

The Postal Service continues to pursue strategies within its control to increase operational efficiency and improve liquidity. The Postal Service has conserved capital in recent years by spending only what it believed was essential to maintain its existing facilities and service levels and to increase efficiencies. However, an increase in capital investment is necessary to upgrade its facilities, fleet of vehicles and processing equipment in order to remain operationally viable.

The Postal Service also supports legislative reforms that will enable it to increase revenue and reduce costs. Aggressive management of the business, as well as legislative and regulatory reforms, will all be necessary to restore the Postal Service to financial health.

The Postal Service's status as an independent establishment of the executive branch that does not receive tax dollars for its operations presents unique requirements and restrictions, but also potentially mitigates some of the financial risk that would otherwise be associated with a cash shortfall. With annual total revenue in 2018 of approximately \$71 billion, a financially-sound Postal Service continues to be vital to U.S. commerce.

The U.S. economy benefits greatly from the Postal Service and the many businesses that provide the printing and mailing services that it supports. Disruption of the mail would cause undue hardship to businesses and consumers as it would significantly inhibit the remittance of payments through the mail, 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 Executive Branch, Congress, the PRC and other stakeholders of the immediate and long-term financial challenges it faces and the legislative and regulatory changes that are required to restore its financial stability.

NOTE 4 - REVENUE RECOGNITION

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

Practical Expedients

The Postal Service has elected to apply the *Incremental cost to obtain a contract* practical expedient. As such, the Postal Service recognizes the incremental costs to obtain a contract as expenses when incurred since the amortization period if capitalized would be less than one year due to the majority of the Postal Service's contract obligations being fulfilled in less than one year.

Disaggregation of Revenue

The following table summarizes the Postal Service's disaggregated operating revenue for the three months ended December 31, 2018, and 2017, by each service category:

(in millions)	Three Months Ended December 31,	
	2018	2017
Operating revenue:		
First-Class Mail	\$ 6,623	\$ 6,704
Marketing Mail	4,665	4,447
Shipping and Packages	6,461	5,945
International	724	771
Periodicals	311	336
Other	927	949
Total operating revenue	\$ 19,711	\$ 19,152

Satisfaction of Performance Obligations

ASC 606 defines a performance obligation as a promise in a contract to transfer a distinct good or service to the customer. A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied.

First-Class Mail, Marketing Mail, Shipping and Packages, International Mail and Periodicals are categorized as Mailing and Shipping services for purposes of satisfying performance obligations. Revenue for Mailing and Shipping Services is recognized over a relatively short period of time as the customer mail sender/recipient receives and consumes the benefits of these services as the Postal Service fulfills its obligation to deliver the mailpiece.

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

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

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

Variable Consideration

The Postal Service offers certain contracts to its customers that contain various types of customer incentives or other provisions that can either increase or decrease the transaction price. Customer incentives include discounts, money back guarantees, rebates, refunds or incentive payments. The other provisions include performance penalties. The Postal Service uses the expected value approach to estimate variable consideration to which it expects to be entitled.

Contract Modifications

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

Principal vs. Agent Consideration

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

Contract Liabilities

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

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

The following table provides details for *Deferred revenue-prepaid postage* and prepaid *PO Box* and Caller Service fees as of December 31, 2018, and September 30, 2018:

<i>(in millions)</i>	December 31, 2018	September 30, 2018
Deferred revenue-prepaid postage:		
Forever stamps	\$ 1,379	\$ 1,156
Mail-in-transit	578	478
Metered postage	233	302
Other prepaid postage	126	130
Total deferred revenue-prepaid postage	2,316	2,066
Prepaid PO Box and Caller Service fees	427	438
Total deferred revenue	\$ 2,743	\$ 2,504

The following table provides details of revenue recognized for the three months ended December 31, 2018, that existed in deferred revenue as of September 30, 2018:

<i>(in millions)</i>	Three Months Ended December 31, 2018
Revenue recognized in the period from deferred revenue:	
Forever stamps	\$ 496
Mail-in-transit	478
Metered postage	302
Other prepaid postage	55
PO Box and Caller Service fees	228

NOTE 5 - RELATED PARTIES

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

The following table presents related-party assets and liabilities as of December 31, 2018, and September 30, 2018:

(in millions)	December 31, 2018	September 30, 2018
Related-party assets:		
Receivables and advances ¹	\$ 82	\$ 61
Carrying amount of revenue forgone installment receivable ²	451	446
Related-party liabilities:		
Current portion of debt	\$ 11,000	\$ 11,000
Other current liabilities ³	51,671	50,312
Noncurrent portion of debt	2,200	2,200
Other noncurrent liabilities ⁴	14,599	15,047

¹ Current portion within *Receivables, net* and noncurrent portion within *Other assets* in the accompanying *Balance Sheets*.
² Included within *Other assets* in the accompanying *Balance Sheets*. See further discussion in *Note 12 - Fair Value Measurement*.
³ Amounts include CSRS, FERS, PSRHB and current workers' compensation obligations as well as payables to other agencies.
⁴ Amounts include noncurrent workers' compensation obligations.

The following table presents related-party revenue and expenses for the three months ended December 31, 2018, and 2017:

(in millions)	Three Months Ended December 31, 2018	2017
Related-party operating revenue ¹	\$ 237	\$ 233
Related-party operating expenses ²	\$ 4,240	\$ 4,217
Related-party interest income ³	\$ 34	\$ 21
Related-party interest expenses ⁴	\$ 57	\$ 55

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

NOTE 6 - CASH, CASH EQUIVALENTS AND RESTRICTED CASH

The following table provides a reconciliation of cash, cash equivalents and restricted cash reported in the accompanying *Balance Sheets* as of December 31, 2018, and 2017, respectively, and as of September 30, 2018, and 2017, respectively (to disclose the opening balances), that sum to the totals of the same such amounts shown in the accompanying unaudited *Statements of Cash Flows* for the three months ended December 31, 2018, and 2017:

(in millions)	December 31, 2018	2017	September 30, 2018	2017
Cash and cash equivalents	\$ 9,271	\$ 10,389	\$ 10,061	\$ 10,513
Restricted cash	358	278	275	291
Total Cash, cash equivalents and restricted cash as shown in the accompanying unaudited Statements of Cash Flows	\$ 9,629	\$ 10,667	\$ 10,336	\$ 10,804

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

NOTE 7 - PROPERTY AND EQUIPMENT, NET

Assets within *Property and equipment, net* in the accompanying *Balance Sheets* are recorded at cost, which includes the interest on borrowings used to finance construction of major capital additions, less allowances for depreciation and amortization. Interest capitalized during both the three months ended December 31, 2018, and 2017, was not significant. Fixed assets are depreciated over estimated useful lives ranging from 3 to 40 years using the straight-line method.

The net book values of assets classified as held for sale were approximately \$11 million and \$13 million as of December 31, 2018, and September 30, 2018, respectively, and are included within *Property and equipment, net* in the accompanying *Balance Sheets*.

For each of the three months ended December 31, 2018, and 2017, depreciation and amortization expense was \$417 million and impairment charges were de minimis. These items are included within *Other operating expenses* in the accompanying unaudited *Statements of Operations*.

NOTE 8 - COMMITMENTS AND CONTINGENCIES

Commitments

In May 2018, the Postal Service agreed to extend contract negotiations relating to a new collective bargaining agreement with the National Rural Letter Carriers' Association ("NRLCA"). The contract with the NRLCA expired on May 20, 2018, and the respective parties mutually agreed to extend negotiations beyond the deadline. The respective parties will continue to follow the current agreement until a new contract is reached. No new agreement has been reached as of the date of this report.

In September 2018, the Postal Service agreed to extend contract negotiations relating to a new collective bargaining agreement with the American Postal Workers Union, AFL-CIO ("APWU"). The contract with the APWU expired on September 20, 2018, and the respective parties mutually agreed to extend negotiations beyond the deadline. On December 21, 2018, negotiations between the Postal Service and the APWU came to an impasse. The respective parties will continue to follow the current agreement until a new contract is reached through the dispute resolution process. No new agreement has been reached as of the date of this report.

Contingent Liabilities

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

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

Provision for Losses

The Postal Service has made adequate provision for probable losses arising from all claims. The following table presents contingent liabilities by current and noncurrent portions and by category, as of December 31, 2018, and September 30, 2018:

<i>(in millions)</i>	December 31, 2018	September 30, 2018
Current/noncurrent portions of contingent liabilities:		
Current portion ¹	\$ 258	\$ 244
Noncurrent portion ²	176	193
Total contingent liabilities	\$ 434	\$ 437
Contingent liabilities by category:		
Labor and employment matters	\$ 311	\$ 297
Asset retirement obligations	57	67
Tort matters	62	67
Contractual matters	4	6
Total contingent liabilities	\$ 434	\$ 437

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

Reasonably Possible Contingencies

The Postal Service does not accrue for contingencies which it deems reasonably possible of an unfavorable outcome. These ranged in amount from approximately \$225 million to \$1.1 billion at both December 31, 2018, and September 30, 2018.

Class Action Litigation

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

The *McConnell* case alleges violations of the Rehabilitation Act of 1973 resulting from the NRP's failure to provide a reasonable accommodation, the NRP's wrongful disclosure of medical information, the NRP's creation of a hostile work environment, and the NRP's adverse impact on disabled employees. The class is seeking injunctive relief and damages of an uncertain amount. If the plaintiffs are able to prove their allegations in this matter and to establish the damages they assert, an adverse ruling could have a material impact on the Postal Service.

In 2015, the Administrative Judge assigned to handle the *McConnell* case granted in-part both the Class Agent's and the Postal Service's motions for summary judgment. In her decision, the Administrative Judge found that the NRP violated the Rehabilitation Act. The Postal Service appealed this decision to the OFO, which was denied in 2018. The Postal Service implemented this order, and notified all class members of their right to file an individual claim for relief. Class members were allowed thirty days to submit claims to the Postal Service's National Equal Employment Opportunity Investigative Services Office. The claims submission deadline has now passed. Class Agent's counsel challenged the Postal Service's implementation of the decision and many issues remain unresolved.

In November 2018, the OFO in a procedural ruling, ordered the Postal Service to vacate all Final Agency Decisions on disputed claims within thirty (30) days and instead inform a newly designated EEO judge of the Postal Service's

intent to dispute any individual claims within sixty (60) days. The order was procedural and the ultimate outcome could still be greater or less than the amount accrued as of December 31, 2018.

NOTE 9 - RETIREMENT PLANS

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

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

Career 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's TSP expenses are related only to its contributions for FERS employees who participate in the TSP.

CSRS provides a basic annuity plan benefit to employees hired before January 1, 1984. Dual CSRS provides Social Security benefits in addition to its basic annuity plan for employees hired between January 1, 1984, and January 1, 1987. CSRS and Dual CSRS employees may also participate in the TSP, although the Postal Service does not match contributions for these participants.

The PAEA suspended the Postal Service's employer contributions to CSRS that would otherwise have been required under *Title 5, Section 8334(a)(1)* of the U.S. Code, although CSRS employees continue to contribute to the plan. By law, the Postal Service does not pay normal costs for CSRS retirement benefits; however, in 2017 the Postal Service was required to begin making annual payments to amortize the unfunded CSRS liability. Employee contributions for both 2018 and 2019, as a percentage of employee basic pay, are 7.0% for CSRS.

Effective January 1, 1987, FERS covers employees hired since December 31, 1983, and FERS employees are covered by an annuity, Social Security and TSP benefits. For FERS employees who participate in TSP, the Postal Service contributes 1% of basic pay and matches voluntary employee contributions up to an additional 4% of basic pay.

FERS employees are further categorized as either FERS, FERS - Revised Annuity Employees ("FERS-RAE"), or FERS - Further Revised Annuity Employees ("FERS-FRAE") depending on whether their date of hire was before, during, or after calendar year 2013, respectively. The following table presents the employee and employer contributions, as a percentage of employee basic pay, for both 2018 and 2019:

	Employee Contributions	Employer Contributions
FERS	0.8%	13.7%
FERS-RAE	3.1%	11.9%
FERS-FRAE	4.4%	10.7%

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

FERS Employees' Current Year Service Expense

The Postal Service records expenses for FERS employees' current year service consisting of FERS normal cost, Social Security and TSP contributions, each of which is included within *Compensation and benefits* in the accompanying unaudited *Statements of Operations*.

The following table presents these expenses for the three months ended December 31, 2018, and 2017:

(in millions)	Three Months Ended December 31,	
	2018	2017
FERS normal costs ¹	\$ 887	\$ 868
Social Security ²	\$ 579	\$ 544
TSP	\$ 281	\$ 271
¹ Represents the Postal Service's employer cash contributions, which excludes employee Social Security contributions and period-end unpaid employer amounts due, for FERS employees. ² Represents the Postal Service's Social Security contributions for FERS employees.		

CSRS and FERS Unfunded Retirement Benefits Amortization

OPM periodically notifies the Postal Service regarding its revaluation of unfunded CSRS and FERS liabilities. The Postal Service records these expenses as *Unfunded retirement benefits amortization* in the accompanying unaudited *Statements of Operations*. These amounts may be significantly impacted by changes in actuarial assumptions used to revalue the unfunded liabilities.

OPM historically calculated these obligations using government-wide economic and demographic data. In October 2017, OPM issued a new rule announcing its intent to calculate future unfunded CSRS and FERS obligations using Postal Service-specific demographic assumptions.

In October 2018, OPM provided the Postal Service with an actuarial report using these new rules indicating the projected annual amortization payments due September 30, 2019, would be \$1.4 billion for the CSRS obligation and \$958 million for the FERS obligation. The Postal Service expects to receive invoices from OPM for the actual amounts due September 30, 2019, during the fourth quarter of fiscal 2019, and these invoices may differ from OPM's original projections due to changes in discount rates, actuarial assumptions and experience as of the calculation date.

The following table presents the expense recorded for CSRS and FERS unfunded retirement benefits amortization for the three months ended December 31, 2018, and 2017:

(in millions)	Three Months Ended December 31,	
	2018	2017
CSRS unfunded retirement benefits amortization ¹	\$ 360	\$ 434
FERS unfunded retirement benefits amortization ²	239	229
Total CSRS and FERS unfunded retirement benefits amortization	\$ 599	\$ 663
¹ Expense for the accrual for the annual payment due to OPM by September 30 of the respective fiscal year, based on information provided by OPM, to amortize the unfunded CSRS retirement obligation. Payments are to be made through 2043 based on OPM invoices. ² Expense for the accrual for the annual payment due to OPM by September 30 of the respective fiscal year, based on information provided by OPM, to amortize the unfunded FERS retirement obligation. Payments are to be made through 2047 based on OPM invoices.		

The amounts the Postal Service has accrued for CSRS and FERS unfunded retirement benefits but has not yet paid are recorded as a current liability within *Unfunded retirement benefits* in the accompanying *Balance Sheets*.

Total expenses related to multiemployer retirement plans include CSRS and FERS unfunded liability amortization, and FERS normal costs. For the three months ended December 31, 2018, and 2017, these expenses totaled \$1.5 billion and \$1.5 billion, respectively.

NOTE 10 - HEALTH BENEFITS PLANS

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

Active Employees

The Postal Service paid 72.7% and 73.7% of FEHB premium costs during the three months ended December 31, 2018, and 2017, respectively. Postal Service employee healthcare expense was approximately \$1.3 billion for each of the three months ended December 31, 2018, and 2017. These expenses are included within *Compensation and benefits* in the accompanying unaudited *Statements of Operations*.

Retirees

Postal Service retirees who participated in FEHB for the five years immediately preceding their retirement may continue to participate in the plan during retirement. Qualifying survivors of retirees are also eligible to receive benefits. The Postal Service is required to contribute to the PSRHBf an amount estimated to be equal to the employer portion of FEHB insurance premiums for participating employees and their qualifying survivors, upon retirement, for each employee's current year of service (normal cost). The Postal Service is also required to contribute an amount sufficient to fully amortize the unfunded liability of the PSRHBf by 2056. These amounts are based, in part, on each current and prospective retiree's length of federal civilian service occurring on or after July 1, 1971. Each participant's share of premium costs is set by law and is not subject to negotiation with Postal Service labor unions. The Postal Service expenses what it is billed by OPM for both normal cost and amortization of the unfunded liability.

The PAEA required the Postal Service to prefund retiree health benefits during years 2007 through 2016 by paying annual amounts ranging from \$1.4 billion to \$5.8 billion, totaling \$54.8 billion, into the PSRHBf, which began paying the Postal Service's share of retiree health benefit premiums in 2017. The Postal Service remains obligated to fund the \$33.9 billion in PSRHBf prefunding payments that it defaulted on for the years 2012 through 2016, as well as the amortization and normal cost payments of \$955 million and \$3.3 billion, respectively, that it did not pay at the end of 2017, and the amortization and normal cost payments of \$815 million and \$3.7 billion, respectively, that it did not pay at the end of 2018. As of the date of this report, the Postal Service has not been assessed any penalties associated with these non-payments.

As required by PAEA, OPM annually performs an actuarial valuation for the purpose of developing a payment schedule for the Postal Service to fund the remaining unfunded PSRHBf obligation in annual payments through the year 2056. Based on preliminary calculations provided by OPM using updated discount rate assumptions, the Postal Service has estimated that the amortization payment due September 30, 2019, to be \$1.1 billion, and has therefore accrued an expense of \$275 million for the three months ended December 31, 2018. This amount is included within *Retiree health benefits* in the accompanying unaudited *Statements of Operations*. The Postal Service expects to receive the invoice from OPM for the actual amount due during the fourth quarter of fiscal 2019 and this may differ from the original projected amount due to changes in discount rates, actuarial assumptions and experience as of the calculation date.

Furthermore, the Postal Service is obligated to pay the estimated normal costs of retiree health benefits attributable to the service of its employees during the most recently ended fiscal year. Based on preliminary calculations provided by OPM using updated discount rate assumptions, the Postal Service has estimated the normal cost payment, also due by September 30, 2019, to be \$4.0 billion, and the Postal Service has recorded expenses of \$1.0 billion for the three months ended December 31, 2018. This amount is included within *Retiree health benefits* in the accompanying unaudited *Statements of Operations*. The Postal Service expects to receive the invoice from OPM for the actual amount due during the fourth quarter of fiscal 2019 and this may differ from the original projected amount due to changes in discount rates, actuarial assumptions and experience as of the calculation date.

The cumulative amount of PSRHBf statutorily-specified, normal cost and amortization payments the Postal Service has accrued is \$43.9 billion as of December 31, 2018, inclusive of the \$42.6 billion that was unpaid as of September 30, 2018. Given that OPM considers these amounts to be due and payable, the Postal Service reflects the cumulative unpaid amount as a current liability within *Retiree health benefits* in the accompanying *Balance Sheets*.

The following table details retiree health benefits expense for the three months ended December 31, 2018, and 2017:

(in millions)	Three Months Ended December 31,	
	2018	2017
PSRHBf unfunded liability expense ¹	\$ 275	\$ 297
Normal cost of retiree health benefits ²	1,000	882
Total retiree health benefits expense	\$ 1,275	\$ 1,179

¹ Expense for the accrual for the annual payment due to PSRHBf by September 30 of the respective fiscal year, for the amortization of the unfunded liability based on Postal Service estimates to OPM's preliminary calculations with updated discount rate assumptions.

² Expense for the accrual for the annual payment due to the PSRHBf by September 30 of the respective fiscal year, based on OPM projections with updated discount rate assumptions, for actuarially determined normal cost of retiree health benefits for current employees.

NOTE 11 - WORKERS' COMPENSATION

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

Workers' Compensation Liability

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

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

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

This liability calculation is highly sensitive to changes in discount rates. For example, a 1% increase in the discount rate would decrease the December 31, 2018, liability and related expense by approximately \$1.7 billion. Likewise, a 1% decrease in the discount rate would increase the December 31, 2018, liability and related expense by approximately \$2.1 billion.

The following table details the applicable inflation and discount rates for compensation and medical claims used to estimate the workers' compensation liability as of December 31, 2018, and September 30, 2018:

	December 31, 2018	September 30, 2018
Compensation claims liability:		
Discount rate	2.82%	3.10%
Long-term wage inflation rate	2.60%	2.60%
Medical claims liability:		
Discount rate	2.83%	3.10%
Historical medical inflation rate	3.00%	3.00%

As of December 31, 2018, and September 30, 2018, the Postal Service's total liability for workers' compensation was approximately \$15.9 billion and \$16.4 billion, respectively. As of December 31, 2018, and September 30, 2018, the current portion of the liability was approximately \$1.3 billion and \$1.4 billion, respectively, and the noncurrent portion of the liability was approximately \$14.6 billion and \$15.0 billion, respectively, as reflected in the accompanying *Balance Sheets*.

Workers' Compensation Expense

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

The following table presents the components of workers' compensation expense for the three months ended December 31, 2018, and 2017:

	Three Months Ended December 31,	
(in millions)	2018	2017
Impact of discount rate changes	\$ 505	\$ —
Actuarial revaluation of existing cases	68	(79)
Cost of new cases	290	326
Administrative fee	24	19
Total workers' compensation expense	\$ 887	\$ 266

NOTE 12 - FAIR VALUE MEASUREMENT

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

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

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

For the three months ended December 31, 2018, and the year ended September 30, 2018, no significant transfers between *Level 1* and *Level 2* assets or liabilities transpired. The carrying amount and fair value of the revenue forgone installment receivable and the noncurrent portion of debt are presented for disclosure purposes only in the following table:

(in millions)	December 31, 2018		September 30, 2018	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Revenue forgone installment receivable *	\$ 451	\$ 472	\$ 446	\$ 475
Noncurrent portion of debt	\$ 2,200	\$ 2,358	\$ 2,200	\$ 2,295

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

The revenue forgone installment receivable qualifies as a financial instrument in accordance with authoritative literature. To calculate its fair value, the Postal Service recognizes the imputed interest it is owed as interest income and estimates the value of this receivable using the interest method, which converts future cash flows to a single discounted amount using interest rates for similar assets, which are considered *Level 2* inputs. The Postal Service then calculates the net present value of anticipated annual installment payments to be received, discounted by the 20-year U.S. Treasury Constant Maturity Rate, which was 2.87% and 3.13% as of December 31, 2018, and September 30, 2018, respectively.

The noncurrent portion of debt also qualifies as a financial instrument. Because no active market exists for its debt with the FFB, the Postal Service estimates the fair value of the noncurrent portion of this liability using expected future payments at discount rates provided by the FFB, considered *Level 3* inputs. The weighted averages of the FFB discount rates, based on U.S. Treasury Yield Curve Rates, were 2.68% and 3.02% as of December 31, 2018, and September 30, 2018, respectively.

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

CAUTIONARY STATEMENTS

The following *Management's Discussion and Analysis of Financial Condition and Results of Operations* and other parts of this report describe the principal factors affecting the financial results, liquidity, capital resources and critical accounting estimates of the United States Postal Service ("Postal Service," "USPS," "we," "our" and "us"). Our results of operations may be impacted by risks and uncertainties discussed here and in our Annual Report on Form 10-K for the year ended September 30, 2018 ("Annual Report") filed with the Postal Regulatory Commission ("PRC") on November 14, 2018. Such factors, many of which we cannot control or influence, may cause actual results to differ materially from those currently contemplated.

Our operating results for the three months ended December 31, 2018, are presented in accordance with accounting principles generally accepted in the United States ("GAAP"). These results are not necessarily indicative of the results to be expected for the year ended September 30, 2019, and should be read in conjunction with our Annual Report. All references to years in this report, unless otherwise stated, refer to fiscal years beginning October 1 and ending September 30. All references to quarters, unless otherwise stated, refer to quarters within fiscal years 2019 and 2018.

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

OVERVIEW

With our mandate to provide universal postal services to the nation, we serve retail and commercial customers in the U.S., as well as internationally. Our operations include an extensive and integrated retail, distribution, transportation and delivery network, and we operate as a single segment throughout the U.S., its possessions and territories.

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

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

We have established a core set of goals that drive our strategic initiatives and continuous improvement efforts:

1. Deliver a world-class customer experience;
2. Equip, empower and engage employees;
3. Innovate faster to deliver value; and
4. Invest in our future platforms.

As part of these efforts, we aim to achieve long-term financial stability, as well as a reduction in our debt. Our focus on maintaining liquidity and reducing operating expenses reflects current trends, as well as projected future volume of mail and packages. We believe that financial stability is within reach with legislative and regulatory reform to address our overall cost structure and enhance our revenue-generating opportunities as we continue to identify and create innovative and affordable services, and deliver high levels of performance and service.

RESULTS OF OPERATIONS

SUMMARY

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

Three Months Ended December 31, 2018

Operating revenue for the three months ended December 31, 2018, increased \$559 million, or 2.9%, compared to the same period last year.

As more fully described below in *Operating Revenue and Volume*, our revenue from *First-Class Mail* decreased \$81 million, or 1.2%, while volume declined 428 million pieces, or 2.8%, for the period, compared to the same period last year, reflecting the continuing migration from mail to electronic communication and transaction alternatives. However, our revenue from *Marketing Mail* increased \$218 million, or 4.9%, while volume increased 1.0 billion pieces, or 4.8%, for the period, compared to the same period last year, driven by increases in political and election mail associated with the 2018 mid-term election season. Our revenue and volume from political and election mail, a component of *Marketing Mail*, increased by approximately \$250 million and 1.4 billion pieces, respectively, compared to the same period last year. Meanwhile, our Shipping and Packages revenue increased by \$516 million, or 8.7%, as we continued to see growth in this lower-contribution service category during the quarter.

As more fully described below in *Operating Expenses*, our operating expenses for the three months ended December 31, 2018, increased nearly \$1.6 billion, or 7.9%, compared to the same period last year. The increase in operating expenses was primarily due to the following:

- Compensation and benefits expense increase of \$657 million, or 5.1%, due to additional overtime hours incurred, as well as contractual wage adjustments;
- Workers' compensation expense increase of \$621 million, of which \$505 million was the result of changes in discount rates, which are outside of management's control; and
- Transportation expenses increase of \$207 million, or 9.7%, largely driven by higher unit costs per mile due to supplier cost pressures resulting in part from a national shortage of truck drivers, as well as higher average fuel costs.

These changes in revenue and expenses resulted in a net loss of \$1.5 billion for the three months ended December 31, 2018, compared to a net loss of \$540 million for the same period last year.

Non-GAAP Controllable (Loss) Income

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

The following table reconciles our GAAP net loss to controllable (loss) income for the three months ended December 31, 2018, and 2017:

(in millions)	Three Months Ended December 31,	
	2018	2017
Net loss	\$ (1,537)	\$ (540)
PSRHBf unfunded liability amortization expense ¹	275	297
Change in workers' compensation liability resulting from fluctuations in discount rates	505	—
Other change in workers' compensation liability ²	55	(67)
CSRS unfunded liability amortization expense ³	360	434
FERS unfunded liability amortization expense ⁴	239	229
Controllable (loss) income	\$ (103)	\$ 353

¹ Expense for the accrual for the annual payment due to PSRHBf by September 30 of the respective fiscal year, for the amortization of the unfunded liability based on Postal Service estimates to OPM's preliminary calculations with updated discount rate assumptions.

² Net amounts include changes in assumptions, valuation of new claims and revaluation of existing claims, less current year claim payments.

³ Expense for the accrual for the annual payment due to OPM by September 30 of the respective fiscal year, based on information provided by OPM, to amortize the unfunded CSRS retirement obligation. Payments are to be made through 2043 based on OPM invoices.

⁴ Expense for the accrual for the annual payment due to OPM by September 30 of the respective fiscal year, based on information provided by OPM, to amortize the unfunded FERS retirement obligation. Payments are to be made through 2047 based on OPM invoices.

Our controllable loss increased \$456 million for the three months ended December 31, 2018, compared to the same period last year. This increase was largely driven by higher compensation and benefits expenses of \$657 million, higher transportation expenses of \$207 million, and the higher controllable portion of the normal cost of retiree health benefits expenses of \$118 million, partially offset by the \$559 million increase in operating revenue.

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

OPERATING REVENUE AND VOLUME

The combined categories of *First-Class Mail* and *Marketing Mail* continued to provide the majority of our revenue, despite long-term trends away from hard-copy communication to electronic media. Although this migration to electronic media has resulted in significant volume declines in *First-Class Mail* over the last decade, *Marketing Mail* volume had remained relatively steady since 2009, although *Marketing Mail* volume declined at a greater rate beginning in 2017 and continued to decline through the first half of 2018. However, *Marketing Mail* volume rebounded in the second half of 2018 and has continued increasing through the first quarter of 2019, driven by increases in political and election mail associated with the 2018 mid-term elections.

The following table summarizes our operating revenue and volume for the three months ended December 31, 2018, and 2017, by each service category:

(in millions)	Three Months Ended December 31,	
	2018	2017
Operating Revenue:		
First-Class Mail ¹	\$ 6,623	\$ 6,704
Marketing Mail ²	4,665	4,447
Shipping and Packages ³	6,461	5,945
International	724	771
Periodicals	311	336
Other ⁴	927	949
Total operating revenue	\$ 19,711	\$ 19,152
Volume:		
First-Class Mail ¹	14,849	15,277
Marketing Mail ²	22,045	21,045
Shipping and Packages ³	1,818	1,725
International	253	279
Periodicals	1,198	1,314
Other ⁵	87	90
Total volume	40,250	39,730

¹ Excludes *First-Class Package Service - Retail*.
² Excludes *Marketing Mail Parcels*.
³ Includes *Priority Mail, USPS Retail Ground, Parcel Select Mail, Parcel Return Service Mail, Marketing Mail Parcels, Package Service Mail, First-Class Package Service - Retail, First-Class Package Service - Commercial* and *Priority Mail Express*.
⁴ Revenue includes *PO Box services, Certified Mail, Return Receipts, Insurance, Other Ancillary Services, Shipping and Mailing Supplies, Collect on Delivery, Registered Mail, Stamped Envelopes and Cards, Money Orders* and Other services.
⁵ Volume includes Postal Service internal mail and free mail provided to certain Congressionally-mandated groups.

For the three months ended December 31, 2018, *First-Class Mail* generated approximately 34% of operating revenue, a 1% decrease from the same period last year, and 37% of our volume, a 1% decrease from the same period last year. *Marketing Mail* generated approximately 24% of operating revenue, a 1% increase from the same period last year, and 55% of our volume, a 2% increase from the same period last year.

We continued to experience strong results in our Shipping and Packages business, and it represented approximately 33% of our revenues for the three months ended December 31, 2018, which is a 2% increase from the same period last year. Shipping and Packages generated 5% of our volume for the three months ended December 31, 2018, which is a 1% increase from the same period last year.

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

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

We have also focused on providing new services and innovating with *Marketing Mail*. We have expanded service offerings such as *Informed Delivery*, which enables customers to preview mail and manage packages scheduled to arrive as a means of merging digital and physical mail, and we believe these service offerings will further stabilize *Marketing Mail* volume.

With our Shipping and Packages category, we have focused on implementing marketing campaigns that help us capitalize on the growing e-commerce business. By offering day-specific delivery, improved tracking and text alerts, and up to \$50 of free insurance on most *Priority Mail* packages, we have demonstrated our responsiveness to our customers.

We implemented price increases of 0.9% and 1.9% on certain Market-Dominant services in January 2017 and January 2018, respectively. We also implemented price increases of 3.9% and 4.1% on certain Competitive services in January 2017 and January 2018, respectively. On October 10, 2018, we filed notices with the PRC of our intent to increase prices for certain Market-Dominant and Competitive services by an average of 2.5% and 7.4%, respectively. On November 13, 2018, the PRC approved both the Market-Dominant and Competitive services price increase plans and these price increases went into effect on January 27, 2019.

First-Class Mail

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

For the three months ended December 31, 2018, *First-Class Mail* revenue decreased \$81 million, or 1.2%, and volume declined 428 million pieces, or 2.8%, compared to the same period last year. The most significant factor contributing to the declining trend in *First-Class Mail* volume was the continuing migration from mail to electronic communication and transaction alternatives.

Marketing Mail

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

Marketing Mail has generally proven to be a relatively resilient marketing channel, and its value to U.S. businesses remains strong due to healthy customer returns on investment, and better data and technology integration. Between 2009 and 2016, *Marketing Mail* experienced relatively flat volume, although volume declined significantly in 2017 and continued to decline through the first half of 2018. However, *Marketing Mail* volume rebounded in the second half of 2018 and has continued increasing through the first quarter of 2019, driven by increases in political and election mail associated with the 2018 mid-term elections.

For the three months ended December 31, 2018, *Marketing Mail* revenue increased \$218 million, or 4.9%, and volume grew by 1.0 billion pieces, or 4.8%, compared to the same period last year. *Marketing Mail* revenue is impacted by the volume of political and election mail with the mailings associated with periodic primary and general election seasons. For the three months ended December 31, 2018, our revenue and volume from political and election mail, a component of *Marketing Mail*, increased by approximately \$250 million and 1.4 billion pieces, respectively, compared to the same period last year. If not for the positive impact of political and election mail, *Marketing Mail* revenue and volume would have decreased for the three months ended December 31, 2018.

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

Shipping and Packages

The following table summarizes our operating revenue and volume for Shipping and Packages for the three months ended December 31, 2018, and 2017, by each service subcategory:

(in millions)	Three Months Ended December 31,	
	2018	2017
Shipping and Packages Revenue:		
Priority Mail Services ¹	\$ 2,981	\$ 2,845
Parcel Services ²	2,107	1,899
First-Class Package Services ³	1,154	979
Package Services	219	222
Total Shipping and Packages revenue	\$ 6,461	\$ 5,945
Shipping and Packages Volume:		
Priority Mail Services ¹	321	309
Parcel Services ²	946	907
First-Class Package Services ³	378	329
Package Services	173	180
Total Shipping and Packages volume	1,818	1,725
¹ Includes <i>Priority Mail</i> , a 1-3 business day delivery service; <i>Priority Mail Express</i> , an overnight delivery service available 365 days per year; and <i>USPS Retail Ground</i> , a retail-only Competitive service priced identically and functionally equivalent to <i>Priority Mail</i> for Zones 1-4. ² Includes <i>Parcel Select</i> , <i>Parcel Return</i> , and <i>Marketing Mail Parcels</i> . ³ Includes <i>First-Class Package Services - Retail</i> and <i>First-Class Package Services - Commercial</i> .		

Our Shipping and Packages business has continued to show solid revenue and volume growth as a result of our successful efforts to compete in shipping services, including “last-mile” e-commerce fulfillment markets and Sunday delivery as well as end-to-end markets, although the rate of growth is slowing. Volume growth has been driven by consumers’ continued use of online shopping, which provided a surge in package volume with a record number of packages delivered during both the calendar year 2017 and 2018 holiday seasons. To accommodate this surge in volume and to avoid service disruptions during the peak holiday seasons, we increased Sunday delivery service for some of our customers in limited U.S. markets and added non-career employees for the peak seasons in accordance with our labor agreements.

Priority Mail Services

Priority Mail Services, our Shipping and Packages subcategory that includes *Priority Mail*, *Priority Mail Express* and *Retail Ground*, allows customers the ability to send documents and packages requiring expedited transportation and handling. While Priority Mail Services revenue continues to grow year over year, its service offerings are somewhat price sensitive, particularly with retail customers, and its growth rate has slowed down and is lower than other Shipping and Packages subcategories used by commercial customers.

Priority Mail Services accounts for our largest portion of Shipping and Packages revenue, representing approximately 46% of the total for the three months ended December 31, 2018, compared to approximately 48% for the same period last year. However, Priority Mail Services accounts for approximately 18% of the total Shipping and Packages volume for the three months ended December 31, 2018, compared to approximately 18% for the same period last year.

For the three months ended December 31, 2018, Priority Mail Services revenue grew by 4.8% on volume growth of 3.9%, compared to the same period last year. Revenue grew more than volume for the period due to the January 2018 price increases applicable to Competitive services.

Parcel Services

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

For the three months ended December 31, 2018, revenue from Parcel Services increased by 11.0% compared to the same period last year. This subcategory showed volume growth of 4.3% over the same period last year, driven largely by the continuing growth of e-commerce. However, this subcategory is primarily a “last-mile” service that bypasses much of our infrastructure and therefore is one of our lowest-priced package services, and as a result, produces a lower yield per piece when compared to many of our other services. Revenue grew more than volume for the period due to the January 2018 price increases applicable to Competitive services.

First-Class Package Services

The First-Class Package Services subcategory includes the competitively priced *First-Class Package Service - Retail*, a Competitive service for under-13-ounce packages targeted to retail customers, and *First-Class Package Service - Commercial*, an under-one-pound Competitive service targeted to commercial customers. This subcategory offers customers that ship primarily lightweight fulfillment parcels the lowest-priced expedited end-to-end tracked package option in the marketplace. First-Class Package Services revenue and volume performance has experienced strong increases for the past several years, primarily attributable to growth in e-commerce.

For the three months ended December 31, 2018, First-Class Package Services revenue increased 17.9% on strong volume growth of 14.9%, compared to the same period last year. Revenue grew more than volume for the period due to the January 2018 price increases applicable to Competitive services.

Package Services

Customers use our Package Services subcategory for shipping merchandise or bound printed matter, including library and media mail, weighing up-to-70 pounds. For the three months ended December 31, 2018, Package Services revenue decreased 1.4% with a volume decline of 3.9%, compared to the same period last year. Revenue in this category has declined due to price caps and bulk rates offered to certain high-volume shippers of bound printed matter parcels.

International Mail

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

For the three months ended December 31, 2018, International Mail revenue decreased 6.1% on a volume decline of 9.3%, compared to the same period last year. The decrease in revenue for the three-month period is largely correlated to the higher-priced outbound volume decline.

The U.S. is a member of the Universal Postal Union (“UPU”), a specialized agency of the United Nations that facilitates the exchange of international mail. Under the UPU, payments to the designated postal operator for the delivery of foreign origin letter post mail are known as “terminal dues.” In August 2018, the President issued a Presidential Memorandum identifying reforms that are needed to the terminal dues system in order for the U.S. to continue to participate in the UPU. In October 2018, the Administration determined that meaningful progress towards achieving those reforms was not being made within the UPU, and the Secretary of State gave notice to the UPU that the U.S. is withdrawing from the UPU effective mid-October 2019. During this one-year period, the Department of State will seek to negotiate agreements that resolve the problems discussed in the Memorandum. If such negotiations are successful, the U.S. will rescind the notice of withdrawal before it takes effect. We are currently evaluating the potential impacts if negotiations are unsuccessful and the U.S. withdraws from the UPU.

Periodicals

Periodicals, also presented as a mail class and a Market-Dominant service category, is designed for newspapers, magazines and other periodical publications whose primary purpose is transmitting information to an established list of subscribers or requesters. For the three months ended December 31, 2018, *Periodicals* revenue decreased by 7.4% and volume declined by 8.8%, compared to the same period last year.

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

Other

Other services include ancillary services such as *Certified Mail*, *PO Box* services, and *Return Receipt* services. Also included in this category are money orders and passport services. Other services revenue decreased by 2.3% for the three months ended December 31, 2018, compared to the same period last year.

OPERATING EXPENSES

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

Our mail processing and distribution network was designed to provide overnight delivery service of *First-Class Mail* within specified delivery areas for a much higher volume of mail than we are required to process and deliver today, and the network's legacy capabilities are not completely aligned to today's mail mix and volumes. Consequently, certain of our processing and distribution facilities continue to operate at less than full capacity. Our challenge to contain costs is also compounded by the increasing number of delivery points, which, when combined with lower hard-copy mail volume, has resulted in a drop in the average number of pieces delivered per delivery point per day from approximately 5.5 pieces in 2007 to 3.5 pieces in 2018, a reduction of approximately 37%.

Compensation and Benefits

Compensation and benefits is our largest operating expense category. These expenses consist of costs related to our active career and non-career employees. Overall, our compensation and benefits expenses increased 5.1% for the three months ended December 31, 2018, respectively, compared to the same periods last year.

The following table presents compensation and benefits expenses for the three months ended December 31, 2018, and 2017:

(in millions)	Three Months Ended December 31,	
	2018	2017
Compensation	\$ 10,437	\$ 9,860
FERS employees' current year service	1,747	1,683
Employee health benefits	1,315	1,301
Other	86	84
Total compensation and benefits	\$ 13,585	\$ 12,928

Compensation

Compensation expense increased 5.9% for the three months ended December 31, 2018, compared to the same period last year. This increase was primarily due to contractual wage adjustments and additional overtime hours, compared to the same period last year.

For the three months ended December 31, 2018, total work hours were approximately 312 million, which was an increase of 2.5%, compared to the 304 million total work hours for the three months ended December 31, 2017. This increase is the result of additional overtime hours, along with increases due to the labor mix and rates.

The number of career employees decreased by approximately 2,400, or 0.5%, at December 31, 2018, compared to the same date a year ago. The decrease in the number of career employees primarily reflects normal attrition as we continue efforts to align our workforce with declining mail volume.

The number of non-career employees increased by approximately 500, or 0.3%, at December 31, 2018, compared to the same date a year ago. The additional use of both non-career employees and employees newly converted from non-career to career at a lower wage structure mitigates some of the upward wage and benefit pressures for career employees.

In May 2018, we agreed to extend contract negotiations relating to a new collective bargaining agreement with the National Rural Letter Carriers' Association ("NRLCA"). The contract with the NRLCA expired on May 20, 2018, and the respective parties mutually agreed to extend negotiations beyond the deadline. The respective parties will continue to follow the current agreement until a new contract is reached. No new agreement has been reached as of the date of this report.

In September 2018, we agreed to extend contract negotiations relating to a new collective bargaining agreement with the American Postal Workers Union, AFL-CIO ("APWU"). The contract with the APWU expired on September 20, 2018, and the respective parties mutually agreed to extend negotiations beyond the deadline. On December 21, 2018, our negotiations with the APWU came to an impasse. The respective parties will continue to follow the current agreement until a new contract is reached through the dispute resolution process. No new agreement has been reached as of the date of this report.

FERS Employees' Current Year Service

The majority of our career employees participate in either CSRS or FERS based on the starting date of their employment with us or another U.S. government employer. We incur normal costs for FERS employees; however, by law we do not pay normal costs for CSRS retirement benefits. Career 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. Our TSP expenses are related only to our contributions for FERS employees who participate in the TSP.

Our expense for FERS employees' current year service consists of FERS normal costs, Social Security and employer TSP contributions, and is reported within *Compensation and benefits* under *Operating expenses* in the accompanying unaudited *Statements of Operations*. We record our contributions to FERS, Social Security and TSP as an expense in the period during which the contribution is due. We recognize the expense for each period's legally required contribution, and record a liability for any contribution due and unpaid at the end of each reporting period. The cost of unfunded FERS retirement benefits is reported separately within *Unfunded retirement benefits* in the accompanying *Balance Sheets*, as discussed below. For additional information, see below and see *Item 1. Financial Statements, Notes to Unaudited Financial Statements, Note 9 - Retirement Plans*.

The following table presents the details of FERS employees' current year service expenses for the three months ended December 31, 2018, and 2017:

(in millions)	Three Months Ended December 31,	
	2018	2017
FERS normal costs	\$ 887	\$ 868
Social Security	579	544
TSP	281	271
Total FERS employees' current year service	\$ 1,747	\$ 1,683

FERS employees' current year service expenses increased 3.8% for the three months ended December 31, 2018, respectively, compared to the same period last year, driven by general wage growth partially offset by the slight decrease in the number of career employees.

Our FERS normal cost contribution rates remained steady for participants during both 2019 and 2018. Expenses for the FERS normal costs, Social Security and employer TSP contributions each increased for the three months ended December 31, 2018, compared to the same period last year. As most of our employees participate in FERS, this was also consistent with the trends in compensation for the period, described above in *Compensation*.

Employee Health Benefits

Our expense for employee health benefits is most significantly impacted by the number of employees electing coverage and the premium costs of the selected plans. Our active employees may participate in the Federal Employees Health Benefits ("FEHB") Program, which OPM administers. We account for employee benefit costs as an expense in the period in which our contributions to the plans under the program are due.

Employee health benefits expense increased 1.1% for the three months ended December 31, 2018, compared to the same period last year, primarily due to an approximately 1.5% average increase in our premium contributions for the 2018 calendar year. This premium increase affected the three months ended December 31, 2018, although it was partially offset by the reduction in number of career employees, as previously discussed.

Our share of healthcare premiums for our employees represented 72.7% and 73.7% of the total healthcare premium costs for the three months ended December 31, 2018, and 2017, respectively. These decreases in our share of healthcare premium costs for employees were consistent with the terms of our contractual agreements; however, these decreases were offset by overall rising premium costs.

CSRS and FERS Unfunded Retirement Benefits Amortization

OPM periodically notifies us regarding its revaluation of unfunded CSRS and FERS retirement benefits. The amounts we record as expenses for our unfunded CSRS and FERS liabilities may be significantly impacted by changes in actuarial assumptions used by OPM to revalue the unfunded liabilities. Prior to 2018, OPM calculated these obligations using government-wide economic and demographic data, rather than Postal Service-specific demographics and economic assumptions. In October 2017, OPM issued a new rule announcing its intent to calculate future unfunded CSRS and FERS obligations using Postal Service-specific demographic assumptions, effective with the October 2018 actuarial report.

In its actuarial report, OPM projects the annual amortization payments to be \$1.4 billion for CSRS and \$958 million for FERS. Accordingly, we have accrued \$360 million for the three months ended December 31, 2018, for the CSRS amortization expense. Likewise, we have accrued \$239 million for the three months ended December 31, 2018, for the FERS amortization expense.

We expect to receive invoices from OPM for the actual amounts due September 30, 2019, for CSRS and FERS during the fourth quarter of fiscal 2019, and the amounts invoiced could differ from the original projected amounts, due to changes in discount rates, actuarial assumptions and experience as of the calculation date.

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

Retiree Health Benefits

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

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

For the three months ended December 31, 2018, our total retiree health benefits expense increased by \$96 million, or 8.1%, compared to the same period last year. Of this increase, \$118 million is attributable to normal cost, while amortization of the PSRHBF unfunded liability decreased by \$22 million.

Based on preliminary calculations provided by OPM using updated discount rate assumptions, we have estimated the amount of our PSRHBF normal cost payment due September 30, 2019, to be \$4.0 billion. As of December 31, 2018, we had accrued \$1.0 billion for this expense, an increase from the \$882 million that we accrued for the same period last year.

Also, based on preliminary calculations provided by OPM in October 2018 using updated discount rate assumptions, we have projected the PSRHBF amortization payment amount due September 30, 2019, to be \$1.1 billion, and we have therefore accrued \$275 million for this expense as of December 31, 2018, a decrease from the \$297 million that we accrued for the same period last year.

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

Workers' Compensation

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

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

The following table presents the components of workers' compensation expense, including the cash payments made by DOL on behalf of workers' compensation obligations, for the three months ended December 31, 2018, and 2017:

(in millions)	Three Months Ended December 31,	
	2018	2017
Impact of discount rate changes	\$ 505	\$ —
Actuarial revaluation of existing cases	68	(79)
Cost of new cases	290	326
Administrative fee	24	19
Total workers' compensation expense	\$ 887	\$ 266
Less cash payments made by DOL on behalf of workers' compensation obligations	(327)	(333)
Total workers' compensation non-cash expense (benefit)	\$ 560	\$ (67)

For the three months ended December 31, 2018, the portion of workers' compensation expense due to the impact of discount rate changes increased \$505 million, compared to the same period last year. These changes are the result of changes in interest rates, outside of management's control.

The combined costs of new workers' compensation cases and revaluation of existing workers' compensation cases increased by \$111 million for the three months ended December 31, 2018, compared to the same periods last year. Changes in actuarial valuation are primarily attributable to the combined impacts of routine changes in actuarial estimation, the progression of existing cases and updated cost-of-living-adjustment ("COLA") assumptions, which are largely outside of management's control.

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

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

Transportation

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

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

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

The components of transportation expenses for the three months ended December 31, 2018, and 2017, are presented in the following table:

(in millions)	Three Months Ended December 31,	
	2018	2017
Highway	\$ 1,323	\$ 1,203
Air	841	748
International	168	175
Other	10	9
Total transportation expenses	\$ 2,342	\$ 2,135

Overall, transportation expenses increased 9.7% for the three months ended December 31, 2018, compared to the same period last year.

Highway transportation expenses increased 10.0% during the three months ended December 31, 2018, compared to the same period in last year. This increase was due primarily to higher average diesel fuel prices, an increase in the number of miles driven and higher unit costs per mile due to supplier cost pressures resulting in part from a national shortage of truck drivers.

Air transportation expenses increased 12.4% during the three months ended December 31, 2018, compared to the same period last year. This increase was due primarily to increased package volume and higher average jet fuel prices.

International transportation expenses are related only to outbound services that allow customers in the U.S. to send mail and packages to other countries. For the three months ended December 31, 2018, international transportation expenses decreased 4.0% compared to the same period last year, primarily due to a decrease in our international service volumes.

Other Operating Expenses

Other operating expenses for the three months ended December 31, 2018, and 2017, are detailed in the following table:

<i>(in millions)</i>	Three Months Ended December 31,	
	2018	2017
Supplies and services	\$ 750	\$ 767
Depreciation and amortization	417	417
Rent and utilities	426	419
Information technology and communications	217	205
Vehicle maintenance service	159	160
Rural carrier equipment maintenance	159	137
Fuel - delivery vehicles	142	122
Miscellaneous other	268	268
Total other operating expenses	\$ 2,538	\$ 2,495

Other operating expenses increased by 1.7% for the three months ended December 31, 2018, compared to the same period in the prior year. While this overall increase was relatively immaterial, there were noteworthy increases in delivery vehicle fuel and rural carrier equipment maintenance.

The delivery vehicle fuel component of other operating expense increased approximately 16% primarily due to increases in average unleaded fuel prices and the number of delivery points. The rural carrier equipment maintenance component of other operating expense increased approximately 16% primarily due to an increase in rates allocated to rural carriers for vehicles and higher usage due to the increasing number of delivery points and increasing fuel prices.

LIQUIDITY AND CAPITAL RESOURCES

We held unrestricted cash and cash equivalents of \$9.3 billion and \$10.1 billion as of December 31, 2018, and September 30, 2018, respectively. Our average daily liquidity balance during the three months ended December 31, 2018, was \$11.6 billion, representing approximately 55 days of liquidity available, which we define as unrestricted cash plus available borrowing capacity divided by estimated average cash disbursements (including capital expenditures) per calendar day (365 days per year).

CASH FLOW ANALYSIS

Although our cash balances have increased since 2012, they remain insufficient to support an organization with approximately \$74 billion in annual operating expenses, to make capital investments necessary for continuity of operations and to prepare for unexpected contingencies. This cash improvement would not have occurred but for the temporary exigent surcharge, which allowed us to collect a total of \$4.6 billion in incremental revenue between January 2014 and April 2016, and had the Postal Service not defaulted on the annual statutorily set PSRHBF prefunding payments from 2012 through 2016, and not paid the RHB normal cost, and RHB, CSRS and FERS amortization payments in 2017 and 2018.

In addition to not making \$33.9 billion of PSRHBF statutorily set prefunding payments, we did not make the approximately \$6.9 billion in payments due both September 30, 2018, and 2017, for PSRHBF normal cost and amortization on PSRHBF, CSRS and FERS unfunded liabilities, in order to preserve liquidity, and to ensure that our ability to fulfill our primary universal service mission was not placed at undue risk.

We continue to face challenges from the ongoing migration of mail to electronic alternatives, and we are legally limited under current law in how we can price our products and streamline our legacy business model. We are further challenged by onerous payment requirements for legacy pension and PSRHBF obligations that, barring legislative reform, will continue indefinitely.

Our operations will require significant capital investment over the next few years to modernize and improve our processing and delivery infrastructure and update our delivery fleet in order to continue to meet our statutory obligation to provide prompt, reliable and efficient postal services to the nation. Furthermore, given our inability to raise cash through the issuance of additional debt beyond the \$15.0 billion debt ceiling, we will not be likely to have sufficient cash balances to meet all of our existing legal obligations and make all of the critical investments in our infrastructure that are necessary for operational continuity and that have been deferred in recent years.

Operating Activities

Cash (used in) provided by operating activities decreased by \$500 million for the three months ended December 31, 2018, compared to the same period last year. This decrease is primarily the result of higher cash expenditures for compensation and benefits and transportation, along with an increase in receivables, partially offset by the increase in revenue.

Investing Activities

We invested \$401 million in the purchase of property and equipment for the three months ended December 31, 2018, which is an increase of \$78 million, or 24.1%, compared to the same period last year. The current amount of our projected capital expenditures is approximately \$1.7 billion for 2019.

Financing Activities

Except as described otherwise in this quarterly report, the nature and amounts of our payment obligations under our debt, capital and operating lease agreements, purchase commitments and other liabilities as of December 31, 2018, have not materially changed from those described in our Annual Report.

In 1999, we entered into the Note Purchase Agreement ("NPA") with the Federal Financing Bank ("FFB"), a government-owned corporation under the general supervision of the Secretary of the Treasury, to establish standardized procedures for us to issue our debt. Under the NPA, we can issue a series of notes with established terms and conditions by providing two days prior notice. Also under the NPA, we can make borrowings against two annually-renewable revolving credit line facilities.

The maximum borrowing amount allowed under our statutory debt ceiling is \$15.0 billion, which we first reached in September 2012, and had generally maintained until mid-September 2018. In late September 2018, we reduced our debt level by \$1.8 billion, lowering it from \$15.0 billion to \$13.2 billion. Our current plan is to reduce our debt level by an additional \$2.2 billion during 2019.

As of December 31, 2018, the aggregate principal balance of our outstanding debt was \$13.2 billion. Of this amount, the current portion of our debt was \$11.0 billion, and the noncurrent portion was \$2.2 billion.

Our debt is borrowed from the FFB and consists of fixed-rate notes and two revolving credit facilities with various maturities with an aggregate principal balance of \$13.2 billion as of December 31, 2018, and September 30, 2018.

The two revolving credit facilities have interest rates determined by the U.S. Department of the Treasury each business day and enable us to draw up to \$4.0 billion in total. As of December 31, 2018, and September 30, 2018, these facilities were fully drawn and were included in the current portion of debt. These annually-renewable facilities were last renewed on April 20, 2018, and are scheduled to expire in April 2019.

On September 28, 2018, under a recent amendment to the NPA, the FFB extended the NPA for one quarter, until December 31, 2018. On December 28, 2018, the FFB amended the NPA again and extended it for 60 days, until February 28, 2019. These recent amendments represent a change in the FFB's previous practice of annually extending the NPA for a full fiscal year. These changes did not affect the terms of any of our outstanding debt as of September 30, 2018, and December 31, 2018, respectively.

If we are unable to extend the NPA beyond February 28, 2019, we have no assurance that we could obtain alternative debt financing after that date on comparable terms. However, we believe that should the NPA not be renewed, we would be able to maintain adequate liquidity through existing and new financing arrangements, as necessary and allowed by statute, to fund our operations for the foreseeable future.

LIQUIDITY OUTLOOK

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

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

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

PRC Ten-year Review

In December 2016, the PRC initiated its ten-year review of the system for regulating rates and classes for Market-Dominant products as required by the PAEA. On December 1, 2017, the PRC announced its initial decision in connection with its ten-year review. The purpose of the ten-year review was to determine if the system for regulating such rates and classes has achieved the objectives Congress established in the PAEA. As part of this review, the PRC evaluated the CPI-U price cap for our Market-Dominant services.

The PRC concluded that the rates system has not achieved its necessary objectives and needs to be changed, primarily because it does not enable us to achieve our mission of providing prompt, reliable, and efficient universal postal services to the American people in a financially sustainable manner. The PRC's proposed changes to the system do not include the elimination of the CPI-U price cap; however, its proposal does provide for some additional pricing authority within a price cap system. We continue to assert that the price cap should be eliminated and that the PRC should engage in "after-the-fact," "light-touch" review of the Market-Dominant prices we set to ensure that those prices are just and reasonable.

The PRC has been expected to issue a final rule after considering the comments and reply comments of any interested stakeholders, which were due no later than March 1, 2018, and March 30, 2018, respectively. As of the date of this report, the PRC has not issued a final rule. Additional information regarding the ten-year review may be found at the PRC website: <https://www.prc.gov/press-releases/prc-concludes-rate-system-has-not-achieved-necessary-objectives-and-issues-proposed>.

2019 and Beyond

We anticipate that given our ongoing liquidity concerns, and without legislative action and regulatory reform, we may not be able to pay all legally-required obligations and also invest in much-needed capital expenditures in 2019 and future years that are necessary to ensure our ability to fulfill our primary mission. Furthermore, we believe that continuing productivity improvements alone will not be sufficient to address the challenges presented by declining Market-Dominant volume and revenue, and that growth in operating revenue will unlikely be able to keep pace with increased costs.

Legally-Required Obligations

In addition to our previously discussed obligations for unfunded retirement and retiree health benefits of approximately \$7.5 billion due on September 30, 2019, we expect to pay the DOL approximately \$1.4 billion in October 2019, representing the workers' compensation claims paid by DOL for the chargeback year July 1, 2018, to June 30, 2019, plus the estimated administrative fee.

Capital Investments

We currently estimate that our required cash outlays for capital investments necessary to ensure that we can perform our universal service obligation will amount to approximately \$1.3 billion for the remainder of 2019, and an additional \$10.6 billion for years 2020 through 2023, as we plan to invest in a new fleet of delivery vehicles and other capital expenditures. Although our future projections include these capital cash outlays, future cash flow from operations alone may not generate the cash needed to enable us to fully fund such necessary capital investments.

Mitigating Circumstances

We continue to pursue strategies within our control to increase operational efficiency and improve liquidity. We have conserved capital in recent years by spending only what we believed was essential to maintain our existing facilities and service levels and to increase efficiencies. However, an increase in capital investment is necessary to upgrade our facilities, fleet of vehicles and processing equipment in order to remain operationally viable.

We continue to support legislation that will enable us to increase revenue and reduce costs. Aggressive management of the business, as well as legislative and regulatory reforms, will all be necessary to restore our financial health.

Our status as an independent establishment of the executive branch that does not receive tax dollars for our operations presents unique requirements and restrictions, but also potentially mitigates some of the financial risk that would otherwise be associated with a cash shortfall. With annual total revenue in 2018 of approximately \$71 billion, a financially-sound Postal Service continues to be vital to U.S. commerce.

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

LEGISLATIVE, REGULATORY AND RELATED MATTERS

LEGISLATIVE UPDATE

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

Appropriations

The 115th Congress adjourned without enacting the *Financial Services and General Government Appropriations Act, 2019*. The legislative package passed by the Senate on August 1, 2018 (H.R. 6147), but not yet enacted, included \$55,235,000 in funding for free mail for the blind and overseas voting. The bill required continuation of six-day delivery and prohibited any of the appropriated funds from being used to consolidate or close small rural or other small Post Offices. A House of Representatives amendment to restore 2012 service standards for *First-Class Mail* and *Periodicals* was removed in conference. On January 25, 2019, the President signed into law H.J. Res. 28 (P.L. 116-5), the *Further Additional Continuing Appropriations Act, 2019* to fund those parts of the government not covered by already-passed appropriations bills through February 15, 2019.

Postal Service Reform

The 115th Congress also adjourned without taking action on two major Postal Service reform bills: the *Postal Reform Act of 2018* (H.R. 6076) and the *Postal Service Reform Act of 2018* (S. 2629). Both bills included provisions designed to help us improve our financial viability. Legislative and regulatory reforms remain critical for us to meet the needs of the American public, and we will continue to work with Congress and all of our stakeholders to enact Postal Service reform legislation.

STOP Act

On October 24, 2018, the President signed into law H.R. 6 (P.L. 115-271), the *SUPPORT for Patients and Communities Act*, a package of bills designed to address the opioid epidemic. The bill includes the *STOP Act*, which requires us to arrange to transmit advance electronic data ("AED") to U.S. Customs and Border Protection on 100% of aggregate inbound mail shipments by December 31, 2020. We could be subject to civil penalties if we accept inbound International Mail shipments without AED starting January 1, 2021. Additionally, under the *STOP Act*, a new \$1 customs fee will be required on each international U.S.-bound Express Mail Service item, effective January 1, 2020. The amount of that \$1 fee may be adjusted once a year starting on October 1, 2020.

Board of Governors Nominations

The Senate failed to act on the President's nominations to the Board of Ron A. Bloom, Roman Martinez IV and Calvin R. Tucker and those nominations were returned to the President upon the adjournment of the 115th Congress on January 3, 2019.

On January 16, 2019, the Senate received, from the President, re-nominations of those individuals to the Board of Governors for the following terms, as well as a reappointment nomination for Robert M. Duncan, one of our current Governors:

- Ron A. Bloom, for a term expiring December 8, 2020;
- Robert M. Duncan, for a term expiring December 8, 2025 (reappointment);
- Roman Martinez IV, for a term expiring December 8, 2024; and
- Calvin R. Tucker, for a term expiring December 8, 2023.

These nominees await consideration by the Senate Homeland Security and Governmental Affairs Committee.

TASK FORCE ON THE UNITED STATES POSTAL SYSTEM

On December 4, 2018, the Department of Treasury released the Task Force on the United States Postal System's report, *United States Postal System: A Sustainable Path Forward*, pursuant to the President's Executive Order 13829. The Task Force's recommendations include:

- Strengthening the Board and developing enforcement mechanisms to ensure financial commitments and reforms are met;
- Clearly defining the Universal Service Obligation by specifying what are "essential postal services," or types of mail and packages for which a strong social or macroeconomic rationale exists for government protection;
- Developing a new pricing model that removes price caps and charges market-based prices for both mail and package items that are deemed commercial services rather than "essential postal services";
- Changing the current costing standards and cost allocation methodology;
- Pursuing cost-cutting strategies that will help enable us to meet the changing realities of our business model;
- Reforming employee compensation in a manner consistent with proposed reforms to the broader federal workforce;
- Restructuring retiree health benefit liabilities with a new actuarial calculation that is based on employees at or near retirement age; and
- Exploring new services that will potentially enable us to extract value from our existing assets and business lines, but that present no balance sheet risk.

As of the date of this report, we are continuing to review the Task Force's recommendations.

FAIR VALUE MEASUREMENTS

As required by authoritative accounting literature, certain fair value disclosures for the periods ended December 31, 2018, and September 30, 2018, are contained in *Item 1. Financial Statements, Notes to Unaudited Financial Statements*. We did not recognize gains as a result of valuation measurements during the three months ended December 31, 2018. All recognized losses have been incorporated into our financial statements as of December 31, 2018. See *Item 1. Financial Statements, Notes to Unaudited Financial Statements, Note 12 - Fair Value Measurement*.

RELATED PARTY TRANSACTIONS

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

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

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

RECENT ACCOUNTING STANDARDS

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

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

We also have provisions in our debt agreements that allow us to prepay our \$13.2 billion debt at any time at a price determined by the Secretary of the Treasury, based on prevailing interest rates in the U.S. Treasury market at the time of repayment.

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

ITEM 4. CONTROLS AND PROCEDURES

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

DISCLOSURE CONTROLS

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

We carried out an evaluation under the supervision and with the participation of management, including the Postmaster General and the Chief Financial Officer, of the effectiveness of the design and operation of disclosure controls and procedures as of December 31, 2018. Based upon and as of the date of the evaluation, the Postmaster General and the Chief Financial Officer concluded that our disclosure controls and procedures were effective.

INTERNAL CONTROLS

We have made no changes in our internal control over financial reporting during the three months ended December 31, 2018, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

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

ITEM 6. EXHIBITS

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

Signatures

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

United States Postal Service

/s/Megan J. Brennan

Megan J. Brennan
Postmaster General and Chief Executive Officer

Date: February 7, 2019

/s/Joseph Corbett

Joseph Corbett
Chief Financial Officer and Executive Vice
President

Date: February 7, 2019

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

I, Megan J. Brennan, certify that:

1. I have reviewed this quarterly report on Form 10-Q of the United States Postal Service ("Postal Service");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Postal Service as of, and for, the periods presented in this report;
4. The Postal Service's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Postal Service and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Postal Service, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the Postal Service's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the Postal Service's internal control over financial reporting that occurred during the Postal Service's most recent fiscal quarter (the Postal Service's fourth fiscal quarter in the case of an Annual Report) that has materially affected, or is reasonably likely to materially affect, the Postal Service's internal control over financial reporting; and
5. The Postal Service's other certifying officer and I have disclosed based on our most recent evaluation of internal control over financial reporting, to the Postal Service's independent registered accounting firm and the Audit and Finance Committee of the Postal Service's Board of Governors:
 - 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 7, 2019

/s/Megan J. Brennan

Megan J. Brennan

Postmaster General and Chief Executive Officer

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

I, Joseph Corbett, certify that:

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

Date: February 7, 2019

/s/Joseph Corbett

Joseph Corbett

Chief Financial Officer and Executive Vice President

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

In connection with the Quarterly Report of the United States Postal Service ("Postal Service") on Form 10-Q for the period ended December 31, 2018, (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 7, 2019

/s/Megan J. Brennan

Megan J. Brennan

Postmaster General and Chief Executive Officer

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

In connection with the Quarterly Report of the United States Postal Service ("Postal Service") on Form 10-Q for the period ended December 31, 2018, (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 7, 2019

/s/Joseph Corbett

Joseph Corbett

Chief Financial Officer and Executive Vice President