Postal Regulatory Commission
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UNITED STATES
POSTAL REGULATORY COMMISSION
Washington, D.C. 20268-0001

FORM 10-Q

(Mark One)

☑ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2011 OR**

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

Commission File Number: N/A

UNITED STATES POSTAL SERVICE

(Exact name of registrant as specified in its charter)
+

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☐

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

Not Applicable ☑

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☑
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock	Outstanding Shares as of February 09, 2012
No Common Stock	N/A

United States Postal Service
Quarterly Financial Report Index

Part I

Part II

Part I

Item 1 – Financial Statements

United States Postal Service
Statements of Operations

(Unaudited)

(Dollars in millions)	Three Months Ended December 31, 2011	Three Months Ended December 31, 2010
Operating revenue	$ 17,677	$ 17,877
Operating expenses:		
Compensation and benefits	12,486	12,666
Retiree health benefits	3,680	1,952
Workers' compensation	745	(432)
Transportation	1,766	1,661
Other	2,246	2,320
Total operating expenses	20,923	18,167
Loss from operations	**(3,246)**	**(290)**
Interest and investment income	6	6
Interest expense	(47)	(45)
Net loss	**$ (3,287)**	**$ (329)**

See accompanying notes to the financial statements. (unaudited)

United States Postal Service
Balance Sheets - Assets

(Dollars in millions)	December 31, 2011	September 30, 2011
	(Unaudited)	(Audited)
Current Assets		
Cash and cash equivalents	$ 1,002	$ 1,488
Receivables:		
Foreign countries	670	669
U.S. government	138	154
Other	316	255
Receivables before allowances	1,124	1,078
Less: Allowances	37	37
Total receivables, net	1,087	1,041
Supplies, advances and prepayments	172	120
Total Current Assets	**2,261**	**2,649**
Noncurrent Assets		
Property and equipment, at cost:		
Buildings	24,343	24,263
Equipment	20,551	20,409
Land	2,940	2,952
Leasehold improvements	1,137	1,112
	48,971	48,736
Less: Allowances for depreciation and amortization	29,451	29,023
	19,520	19,713
Construction in progress	492	624
Total property and equipment, net	20,012	20,337
Other assets - principally revenue forgone receivable	382	427
Total Noncurrent Assets	**20,394**	**20,764**
Total Assets	**$ 22,655**	**$ 23,413**

See accompanying notes to the financial statements. (unaudited)

United States Postal Service
Balance Sheets - Liabilities and Net Deficiency

(Dollars in millions)	December 31, 2011	September 30, 2011
	(Unaudited)	(Audited)
Current Liabilities		
Compensation and benefits	$ 2,456	$ 2,338
Retiree health benefits	3,075	7
Workers' compensation	1,328	1,255
Payables and accrued expenses:		
Trade payables and accrued expenses	939	1,041
Foreign countries	684	652
U.S. government	114	119
Total payables and accrued expenses	1,737	1,812
Deferred revenue-prepaid postage	3,698	3,497
Customer deposit accounts	1,348	1,386
Outstanding postal money orders	693	688
Prepaid box rent and other deferred revenue	461	502
Short-term portion of debt	7,403	7,500
Total Current Liabilities	**22,199**	**18,985**
Noncurrent Liabilities		
Workers' compensation costs	13,286	13,887
Employees' accumulated leave	2,060	2,082
Deferred appropriation and other revenue	309	326
Long-term portion capital lease obligations	451	460
Deferred gains on sales of property	317	345
Contingent liabilities and other	760	768
Long-term portion of debt	5,500	5,500
Total Noncurrent Liabilities	**22,683**	**23,368**
Total Liabilities	**44,882**	**42,353**
Net Deficiency		
Capital contributions of the U.S. government	3,132	3,132
Deficit since 1971 reorganization	(25,359)	(22,072)
Total Net Deficiency	**(22,227)**	**(18,940)**
Total Liabilities and Net Deficiency	**$ 22,655**	**$ 23,413**

See accompanying notes to the financial statements. (unaudited)

United States Postal Service
Changes in Net Deficiency
(Unaudited)

(Dollars in millions)	Capital Contributions of U.S. Government		Deficit Since Reorganization		Total Net Deficiency	
Balance, September 30, 2010	$	3,132	$	(17,005)	$	(13,873)
Net loss		-		(329)		(329)
Balance, December 31, 2010	**$**	**3,132**	**$**	**(17,334)**	**$**	**(14,202)**
Balance, September 30, 2011	$	3,132	$	(22,072)	$	(18,940)
Net loss		-		(3,287)		(3,287)
Balance, December 31, 2011	**$**	**3,132**	**$**	**(25,359)**	**$**	**(22,227)**

See accompanying notes to the financial statements. (unaudited)

United States Postal Service
Statements of Cash Flows
(Unaudited)

(Dollars in millions)	Three Months Ended December 31, 2011	Three Months Ended December 31, 2010
Cash flows from operating activities:		
Net loss	$ (3,287)	$ (329)
Adjustments to reconcile net loss to cash provided by operations:		
Depreciation and amortization	545	573
(Gain) loss on disposals of property and equipment, net	(16)	12
Decrease in other assets - primarily appropriations receivable revenue forgone	20	15
Decrease in noncurrent workers' compensation liability	(601)	(1,632)
Decrease in noncurrent employees accumulated leave	(22)	(163)
Decrease in noncurrent deferred appropriations and other revenue	(1)	(1)
(Decrease) increase in other noncurrent liabilities	(8)	27
Changes in current assets and liabilities:		
Receivables, net	(61)	(112)
Supplies, advances and prepayments	(52)	(44)
Compensation and benefits	118	(315)
Retiree health benefits	3,068	1,375
Workers' compensation	73	70
Payables and accrued expenses	(75)	(72)
Customer deposit accounts	(38)	407
Deferred revenue-prepaid postage	201	8
Outstanding postal money orders	5	3
Prepaid box rent and other deferred revenue	(29)	(7)
Net cash used in operating activities	(160)	(185)
Cash flows from investing activities:		
Purchases of property and equipment	(251)	(341)
Proceeds from sales of property and equipment	47	2
Net cash used in investing activities	(204)	(339)
Cash flows from financing activities:		
Issuance of notes payable	2,500	1,800
Payments on notes payable	(2,500)	(1,900)
Net change in revolving credit line	(97)	400
Payments on capital lease obligations	(9)	(13)
U.S. government appropriations - expensed	(16)	(16)
Net cash (used in) provided by financing activities	(122)	271
Net decrease in cash and cash equivalents	(486)	(253)
Cash and cash equivalents at beginning of year	1,488	1,161
Cash and cash equivalents at end of period	**$ 1,002**	**$ 908**
Supplemental cash flow disclosures:		
Interest paid	$ 44	$ 43

See accompanying notes to the financial statements. (unaudited)

Notes to Financial Statements (Unaudited)

Note 1 – Basis of Presentation

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

Certain prior year amounts related to compensation and benefits as well as other operating expenses have been reclassified to conform to the current year's presentation. These reclassifications had no effect on previously reported operating losses and net losses.

In the opinion of management, the accompanying unaudited interim financial statements reflect all adjustments (including normal recurring adjustments) necessary to fairly present the financial position of the Postal Service as of December 31, 2011, and the results of operations and cash flows for the three months then ended December 31, 2011, and 2010. Operating results ended December 31, 2011, are not necessarily indicative of the results that may be expected for 2012. Subsequent events have been evaluated through February 9, 2012, the date the Postal Service filed its Form 10-Q for the quarter ended December 31, 2011, with the Postal Regulatory Commission (PRC).

The Postal Service has significant transactions with other U.S. government agencies, as disclosed throughout this report. In addition to the amounts disclosed, deferred revenue of $17 million at December 31, 2011, and $39 million at September 30, 2011, related to government deposits are included in the Balance Sheets in "Customer Deposit Accounts".

Note 2 – Liquidity

SUMMARY OF PROJECTED CASH SHORTFALL

The Postal Service continues to suffer from a severe lack of liquidity caused by over $25 billion of net losses over the past five years including $21 billion of statutory payments for prefunding retiree health benefits. The trend of losses continued into this quarter as the Postal Service had a net loss of $3.3 billion for the three months ended December 31, 2011, and had only $1.0 billion of total cash and $2.1 billion of remaining borrowing capacity on its $15 billion debt facility. The net loss for the three months ended December 31, 2011, included accruals of $3,050 million for retiree health benefits prefunding due in 2012.

The Postal Service's current financial projections indicate that it will not be able to make the required $5.5 billion prefunding payment for retiree health benefits currently due by August 1, 2012, or the required $5.6 billion prefunding payment for retiree health benefits that is due by September 30, 2012. Additionally, even without the Postal Service making the $11.1 billion of scheduled Postal Service Retirement Health Benefit Fund (PSRHBF) payments in the fourth quarter of 2012, current projections indicate that it will have a precariously low level of cash and liquidity at September 30, 2012. This position will continue into mid-October of 2012, when the Postal Service is required to make its annual payment to the Department of Labor (DOL) for workers' compensation estimated to be approximately $1.3 billion.

The Postal Service continues to update its financial forecasts with special attention paid to short-term liquidity. Emergency measures to preserve cash and liquidity, such as prioritizing employee and supplier payments over government payments, may be available to help ensure continued mail delivery. Additionally, the Postal Service continues to seek a refund of $11 billion of overfunding of its Federal Employees Retirement System (FERS) retirement plan, as those funds would provide much needed liquidity in the short-term.

To address its financial challenges the Postal Service has developed a plan to reduce its annual operational expenses by $20 billion by 2015. The Postal Service is aggressively pursuing new revenue streams and reducing costs in areas within its control and has proposed legislative changes to Congress that are also needed. Given the vital part that the Postal Service plays in the U.S. economy, the Postal Service is hopeful that Congress will take the steps needed to enact the proposed legislative changes.

MAJOR FACTORS LEADING TO PROJECTED CASH SHORTFALL

The Postal Service had net losses of $5,067 million, $8,505 million, and $3,794 million for the years ended September 30, 2011, 2010, and 2009, respectively. Cash flow from operations for these years was $494 million in 2011 and $1,573 million in 2009. Cash used by operations was $3,292 million in 2010. However, without the enactment of legislation in 2009 and 2011 by the United States Government to reduce the amount of and change the due by dates of PSRHBF prefunding payments due by September 30, 2009, and 2011, respectively, the last time that the Postal Service would have had positive cash flow from operations would have been over five years ago, in 2006.

In 2012, the Postal Service is required to make $11.1 billion of prefunding payments: a $5.5 billion payment originally due by September 30, 2011, but changed by P.L. 112-74, *Consolidated Appropriations Act 2012* (effective December 23, 2011) to be due by August 1, 2012, plus a $5.6 billion payment due by September 30, 2012, as scheduled in P.L. 109-435, *the Postal Accountability and Enhancement Act* (effective December 20, 2006). To date, no changes have been made to the $22.8 billion in prepayments scheduled for 2013 to 2016 as required by P.L. 109-435.

As noted in previous filings, Postal Service losses for the past three years are attributable to a combination of the significant declines in mail volume that began in 2008, statutory and regulatory provisions that have had the effect of limiting the Postal Service's ability to reduce costs and increase revenue, and the statutory requirement to prefund retiree health benefits. The significant declines in mail volume are a result of the economic recession that began in December 2007 and the protracted economic weakness that has followed. This also accelerated the long-term trend of hard-copy correspondence and transactions migrating to electronic media.

Since peaking at 213 billion pieces in 2006, mail volume dropped 45 billion pieces, or 21.2%, to 168 billion pieces in 2011. The decline in First-Class Mail volume by 25 billion pieces, or 25%, during that five-year period has had a significant negative impact on profitability and liquidity. Mail volume dropped by 3 billion pieces, or 6%, for the three months ended December 31, 2011, as compared to the same period in the prior year. Revenue trends have followed a similar path as revenue for 2011 was $65.7 billion, a $1.3 billion, or 2%, decrease from 2010 and almost $2.4 billion less than 2009. Revenue for the three months ended December 31, 2011, was $17.7 billion, a $0.2 billion, or 1.1% decrease, when compared to $17.9 billion for the three months ended December 31, 2010.

The volume that has been lost to electronic alternatives is not expected to return because the movement constitutes a fundamental and permanent reduction in the use of mail services by households and businesses. Moreover, unlike a private-sector business, the Postal Service is restricted by law from taking certain steps, such as entering new lines of business, that might generate enough revenue to make up for the loss of First-Class Mail volume. In short, there currently is no foreseen revenue growth solution that would completely resolve the Postal Service's financial problems.

Revenue forecasting in the current economic environment is subject to significant uncertainties. The operational plan for 2012 anticipates another reduction in mail revenue of approximately $2 billion, as compared to 2011. Mail volume tends to increase and decrease based in part on the performance of the overall economy. Because of the uncertain economy, it is possible that mail volume, and therefore revenue, could decrease at a rate greater than, or less than, this projection.

In fiscal year 2011, compensation and benefits expense represented approximately 68% of total operating expenses. However, when workers' compensation and retiree health are added, total personnel expenses increased to approximately 77% of total operating expense. In the first quarter of 2012, total personnel costs increased to approximately 81% of total operating costs due most significantly to increased expense related to retiree health benefits prefunding with payment dates scheduled in 2012, as discussed above. Prefunding retiree health benefits expenses rose to almost 15% of total operating expenses in the first quarter of 2012 as compared to approximately 8% of total operating expenses in the first quarter of 2011.

Although many significant steps have been taken to decrease compensation and benefits expense in response to declining mail volume, many of these expenses remain beyond the Postal Service's direct control due to its statutorily-mandated participation in federal programs such as retirement, health benefits, life insurance, and workers' compensation. Retirement benefits are not determined by management but rather by the federal government, and healthcare benefit costs mandated by law or contract continue to rise well above the rate of inflation. In addition, the Postal Service's ability to adjust its workforce and network infrastructure is limited by contractual, statutory, regulatory and political obstacles. Furthermore, contracts with postal unions are negotiated for a fixed period of time, usually three to five years. They cannot be modified during the contract period except by mutual consent.

FUTURE CASH DEMANDS

By statute, the Postal Service is limited to an annual net increase in debt of $3 billion, up to a total outstanding debt level of $15 billion. As of December 31, 2011, total outstanding debt was $12.9 billion, leaving $2.1 billion of borrowing capacity for future needs. This was a decrease in total debt of $0.1 billion, or 0.8% compared to September 30, 2011, when total outstanding debt was $13 billion. Historically, the end of the first quarter of the year has represented the Postal Service's highest liquidity levels such that a lower utilization of borrowing capacity has been necessary at this time of year.

As noted above, the total required prefunding payment for retiree health benefits to the PSRHBF in 2012 is $11.1 billion: $5.5 billion due by August 1, 2012, and $5.6 billion due by September 30, 2012. In addition, the Postal Service has a cash payment scheduled for October 2012 estimated to be approximately $1.3 billion to the DOL for the Postal Service's annual payment on its workers' compensation liability.

The Postal Service plans to continue to pay its employees, suppliers, and contract partners to ensure continued delivery of the mail. This may result in defaults on some or all of these government obligations. In order to avoid default, statutory or regulatory adjustments to some, or all, of these obligations are necessary. The legal and/or regulatory consequences to the Postal Service of a default on the required PSRHBF contributions, or the workers' compensation payments to the U.S. Government, are unknown.

POSTAL ACTIONS TAKEN TO IMPROVE LIQUIDITY

The Postal Service has taken numerous actions to generate additional revenue and reduce operating expenses. Some of these are discussed below.

The Postal Service increased prices by an average of 1.7% for Mailing Services in April 2011, for the first time in nearly two years, and by an average of 3.6% for Shipping Services in January 2011. The Postal Service also implemented a 2.1% average price increase for Mailing Services and a 4.6% average price increase for Shipping Services on January 22, 2012. Both the April 2011, and the January 2012, Mailing Services' price increases were the maximum amounts permitted under law. At the same time, efforts have been made to increase revenues with services, including the expansion of simplified addressing for businesses, Priority Mail Regional Rate Boxes, and Every Door Direct Mail. While these new services have incrementally increased revenue, they have not and are not expected to offset the significant declines in First-Class Mail volume and revenue.

The Postal Service continues to reduce costs and work hours, and to strive for more favorable contract terms which will better reflect the current business environment and therefore have a positive effect on liquidity and profitability. As a result of cost-control initiatives, work hours for 2011 were reduced by 34 million hours compared to 2010, and another 8 million hours were similarly saved for the three months ended December 31, 2011. This is in addition to reductions of 75 million and 115 million work hours in fiscal years 2010 and 2009, respectively.

A new labor contract with the American Postal Workers Union (APWU), which became effective in Quarter III, 2011, fixed wage levels for two years, increased workforce flexibility and the use of noncareer employees, and established reduced pay levels for new career employees. Contract negotiations are currently at an impasse with the National Association of Letter Carriers (NALC) and National Postal Mail Handlers Union (NPMHU) for contracts that expired in November 2011. Additionally, the Postal Service and the National Rural Letter Carriers Association (NRLCA) continue interest arbitration proceedings related to the contract which expired in November 2010. To further reduce costs, the Postal Service realigned administrative functions and suspended discretionary pay awards in 2011 and has frozen officer, executive and non-bargaining employee compensation for 2012. The 2011 discretionary award freeze remains in place. Pay consultations between the Postal Service and management associations regarding non-bargaining pay and benefits are ongoing. Additionally, the Postal Service continues to reduce the size of our workforce. Over the last five fiscal years, the Postal Service has decreased its workforce by approximately 140,000 career employees and reduced annual costs by over $14 billion.

As noted in previous filings, the Postal Service filed a request with the PRC, seeking an advisory opinion regarding the elimination of congressionally mandated six-day mail delivery to street addresses and associated changes. This is projected to save approximately $3 billion annually and remains a crucial component of the Postal Service's efforts to restructure its operations. The PRC responded to this request on March 24, 2011, and indicated, among other things, that they believe the Postal Service would save $1.7 billion annually from the elimination of Saturday delivery according to their calculations. At approximately the same time, the Government Accountability Office (GAO) issued its own report, *Ending Saturday Delivery Would Reduce Costs, But Comprehensive Restructuring is Also Needed,* on March 29, 2011. The GAO reported that "when fully implemented, 5-day delivery would provide USPS with needed cost savings, although the extent of those savings is uncertain" and that "USPS's 5-day proposal should be considered in the context of other restructuring strategies both within and outside the delivery network." The Postal Service continues to pursue this matter.

In September 2011, the Postal Service announced plans to realign its mail processing, delivery, and retail networks, along with revisions to service standards. These efforts are expected to help the Postal Service to reduce labor and benefits costs. The majority of the expected savings from the network realignment will come from reduced work hours and employee complement. These programs consist of a variety of initiatives that are expected to help reduce labor and benefits costs and include the following:

- Streamlining the network of mail processing facilities.
- Modifying delivery routes, apart from five-day delivery.
- Studying underutilized Post Office locations for reduction in staffed operating hours, potential consolidation, closure, or conversion to a contract unit or a Village Post Office.
- Enhancing and expanding alternate access sites, including Village Post Offices and *http://www.usps.com*.
- Modifying service standards which will allow for longer operating windows in mail processing facilities and will reduce the requirements for equipment, facilities, and work hours.

On December 5, 2011, the Postal Service filed a request for a non-binding advisory opinion from the PRC, regarding the change in service standards required to execute the mail processing network realignment. The PRC regulations require the Postal Service to file a request for an advisory opinion ninety days before implementing a change in service. The PRC has scheduled proceedings with respect to this filing, which would result in their rendering an advisory opinion no earlier than July 2012. In December 2011, the Postal Service decided to delay the closing or consolidation of a Post Office or mail processing facility until May 15, 2012. This action was taken in hopes that this period will help facilitate the enactment of comprehensive postal legislation. On January 18, 2012, the Postal Service submitted a motion to the PRC for consideration which would expedite their review schedule and establish a new procedural schedule that would result in an advisory opinion being rendered by mid-April 2012. The PRC denied this motion on January 31, 2012.

The Postal Service is also exploring the establishment of a health insurance program, separate from the Federal Employees Health Benefit Program (FEHBP) administered by OPM, as significant levels of potential cost savings have been estimated. The separate Postal health plan could also reduce the need for the prefunding of retiree health benefits at the levels currently scheduled in P.L. 109-435 as the future obligations are projected to be lower.

In total, the Postal Service has identified and is pursuing savings opportunities which are expected to reduce its annual operational expenses by $20 billion by 2015.

As previously noted, the ability of the Postal Service to execute strategies to increase efficiency and reduce costs by adjusting its network, infrastructure, and workforce, and to retain and grow revenue, is constrained by contractual, statutory, regulatory, and political restrictions. As a result of these restrictions, Postal Service efforts to positively impact cash flow will not be sufficient, either individually or in the aggregate, to avoid a cash shortfall. The Postal Service has asked Congress to restructure the payment schedule for 2012 and future years; however, there can be no assurance that Congress will restructure any of the scheduled payments. As a result, the Postal Service will pay employees, suppliers, and contract partners to ensure continued delivery of the mail, but absent significant changes in the law, the Postal Service will default on the $5.5 billion prepayment due to the PSRHBF by August 1, 2012, and on the $5.6 billion prepayment due by September 30, 2012. Additionally, even if legislation changes or eliminates the $11.1 billion of prefunding payments currently due to the PSRHBF in 2012, the $15 billion debt ceiling could be reached in October 2012, thereby exhausting the Postal Service's external funding ability.

POSTAL LEGISLATIVE REQUESTS

Even if legislation is enacted to address shorter-term liquidity matters such as the PSRHBF prefunding payment schedule and FERS overfunding, the Postal Service will continue to face concerns as to its financial stability. The Postal Service has taken, and continues to take, specific actions to address those elements under management's control. Despite these changes, the financial outlook continues to show the necessity of legislative changes, the following for which the Postal Service has already asked Congress to make:

- Resolve the retiree health benefits prefunding requirement.
- Refund the FERS overfunding which was $10.9 billion according to OPM's calculation as of September 30, 2010, the latest actual data available. OPM estimated that this grew to $11.4 billion by September 30, 2011.
- Grant the Postal Service the authority to adjust delivery frequency.
- Allow the Postal Service to offer non-postal products and services.
- Allow the Postal Service to restructure the healthcare benefit plans offered to employees and retirees.
- Develop a more streamlined governance model for the Postal Service that would allow for quicker pricing and product development decisions than exists within the current regulatory framework.

Due to the gravity of the financial situation, more than a dozen different postal reform-related bills have been introduced in Congress in the past year, in addition to a plan proposed by the Administration to the Joint Select Committee on Deficit Reduction. These plans address some of the short- and long-term issues that the Postal Service is facing. However, no individual bill achieves all the legislative changes noted above. Nevertheless, the Postal Service is continuing to reach out to Congress and other stakeholders to discuss the needed legislative changes. Given the vital part the Postal Service plays in the U.S. economy, the Postal Service is hopeful that Congress will enact the legislation necessary to resolve the Postal Service's financial challenges.

MITIGATING CIRCUMSTANCES

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

The Postal Service continues to inform the Administration, Congress, the PRC, and other stakeholders of the immediate and longer-term financial issues the Postal Service faces and the legislative changes that would help ensure the availability of sufficient liquidity on September 30, 2012, and beyond. However, there can be no assurances that the requested adjustments to the PSRHBF prefunding payment schedule, or any other legislative changes, will be made in time to impact 2012, or at all.

Note 3 – Debt

Debt payable to the Federal Financing Bank (FFB), a government-owned corporation under the general supervision of the Secretary of the Treasury, consisted of the following at December 31, 2011, and September 30, 2011:

Indebtedness to Federal Financing Bank
(Dollars in millions)

Maturity	Debt Type	December 31, 2011 Balance (Unaudited)	December 31, 2011 Rate (Unaudited)	September 30, 2011 Balance (Audited)	September 30, 2011 Rate (Audited)
Fixed rate notes - short term					
October 20, 2011	Fixed rate-payable at maturity	-	- %	1,300	0.338 %
November 17, 2011	Fixed rate-payable at maturity	-	-	1,200	0.201
April 26, 2012	Fixed rate-payable at maturity	500	0.186	-	-
November 15, 2012	Fixed rate-payable at maturity	1,300	0.227	-	-
Fixed rate notes - long term					
January 31, 2014	Fixed rate-payable at maturity	300	2.035	300	2.035
May 2, 2016	Fixed rate-payable at maturity	300	2.844	300	2.844
November 15, 2018	Fixed rate-payable at maturity	500	3.048	500	3.048
February 15, 2019	Fixed rate-payable at maturity	700	3.296	700	3.296
May 15, 2019	Fixed rate-payable at maturity	1,000	3.704	1,000	3.704
May 15, 2019	Fixed rate-payable at maturity	500	3.513	500	3.513
August 16, 2021	Fixed rate-payable at maturity	1,000	2.066	1,000	2.066
May 17, 2038	Fixed rate-payable at maturity	200	3.770	200	3.770
February 15, 2039	Fixed rate-payable at maturity	1,000	3.790	1,000	3.790
Floating rate notes and revolving credit line - short term					
December 15, 2011	Floating rate	-	-	700	0.135
June 15, 2012	Floating rate[1]	300	0.135	300	0.135
June 15, 2012	Floating rate[1]	800	0.135	800	0.135
December 14, 2012	Floating rate[2]	700	0.130	-	-
October 15, 2012	Floating rate[3]	700	0.145	-	-
	Short-term revolving credit line	2,821	0.125	3,200	0.125
	Overnight revolving credit line	282	0.135		
Total debt		**$ 12,903**		**$ 13,000**	
Less: Current portion of debt		**7,403**		**7,500**	
Long-term portion of debt		**$ 5,500**		**$ 5,500**	

[1] Floating Rate Note — Repurchasable at par on each interest rate reset date and the interest rate resets on March 15, 2012.

[2] Floating Rate Note — Repurchasable at par on each interest rate reset date and the interest rate resets on March 14, 2012, June 14, 2012, and September 14, 2012.

[3] Floating Rate Note — Repurchasable at par on each interest rate reset date and the interest rate resets on January 17, 2012, April 16, 2012, and July 16, 2012.

The Postal Service has two credit lines with the FFB, both of which are available until September 30, 2012. One, a short-term credit line, enables it to draw up to $3,400 million with two days prior notice. Borrowings under this credit line are typically on an overnight basis, but can have a maximum term of up to one year. The second credit facility, which only allows for borrowings on an overnight basis, enables borrowings of up to $600 million on the same business day that funds are requested. In addition, the Postal Service can use a series of other notes with varying provisions to draw upon with two days prior notice. These credit facilities and note arrangements provide the flexibility to borrow short- or long-term, using fixed- or floating-rate notes. Fixed-rate notes can be either callable or non-callable at the option of the Postal Service. Debt, all of which is unsecured and not subject to sinking fund requirements, can be repaid at any time at a price determined by the Secretary of the Treasury, based on prevailing interest rates in the Treasury Security market at the time of repayment.

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

Scheduled principal repayments, exclusive of capital leases, as of December 31, 2011, are as follows:

Scheduled Debt Principal Repayments - By Fiscal Year (Dollars in millions)		
(Unaudited)		
2012	**$**	**4,703**
2013		**2,700**
2014		**300**
2015		**-**
2016		**300**
After 2016		**4,900**
Total Debt	**$**	**12,903**

Note 4 – Property and Equipment

Property and equipment are recorded at cost, which includes the interest on borrowings used to pay for the construction of major capital additions. Interest capitalized during the three month period ended December 31, 2011 and 2010 was not significant. Property and equipment are depreciated over estimated useful lives that range from 3 to 40 years, except for buildings with historic status, which are depreciated over 75 years, using the straight-line method.

Assets classified as held for sale of $93 million as of December 31, 2011, and $58 million as of September 30, 2011, are included on the Balance Sheets in “Land” and “Buildings”. Impairment charges for the three month period ended December 31, 2011, were $27 million as compared to $5 million for the three month period ended December 31, 2010.

In September 2011, the Postal Service announced plans to realign its mail processing, delivery, and retail networks. See Note 2 - *Liquidity* for details. As a result, an assessment was performed on both the real estate and equipment associated with the proposed realignment efforts to determine if any impairment should be recognized. There are no related impairment charges in the current period or any periods presented in these statements related to these plans. As of December 31, 2011, final decisions regarding the potential closure of any specific site(s) have not been made. Once final decisions are made, further determination of impairments, if any, will be made by management.

Note 5 – Leases and Other Commitments

Leases

At December 31, 2011, the future minimum payments on non-cancelable operating and capital leases were as follows:

Lease Obligations (Dollars in millions)		Operating		Capital
(Unaudited)				
2012	$	570	$	75
2013		703		97
2014		645		92
2015		587		89
2016		518		86
After 2016		4,140		291
Total Lease Obligations	$	7,163	$	730
Less: Interest				223
Total Capital Lease Obligations				507
Less: Current Portion of Capital Lease Obligations				56
Noncurrent portion of Capital Lease Obligations			$	451

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

Rent expense for the three months ended December 31, 2011 and 2010, was as follows:

Rental Expense (Dollars in millions)	Three Months Ended December 31,			
		2011		2010
(Unaudited)				
Non-cancelable real estate leases including related taxes	$	238	$	251
Facilities leased from GSA* subject to 120-day cancellation		10		10
Equipment and other short-term rentals		45		35
Total Rental Expense	$	293	$	296

*General Services Administration

Capital Commitments

At December 31, 2011, commitments to acquire capital assets were $652 million, compared to $881 million at September 30, 2011, as summarized in the following table:

Capital Commitments (Dollars in millions)	As of			
		December 31, 2011		September 30, 2011
		(Unaudited)		(Audited)
Mail Processing Equipment	$	391	$	481
Building Improvements, Construction, and Building Purchase		223		320
Postal Support Equipment		33		75
Vehicles		5		5
Total Capital Commitments	$	652	$	881

Note 6 – Contingent Liabilities

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

Each quarter, significant new claims and litigation are evaluated for the probability of an adverse outcome. If the claim is deemed probable of an unfavorable outcome and the amount of potential resolution is reasonably estimable, a liability for the loss is recorded. Each quarter, any prior claims and litigation are reviewed and adjusted for resolutions or revisions to prior estimates. This evaluation of cases resulted in an increase to the liability of $7 million for the three months ended December 31, 2011. The table summarizes contingent liabilities provided for in our financial statements as of the dates indicated.

Contingent Liabilities (Dollars in millions)		December 31, 2011		September 30, 2011
		(Unaudited)		(Audited)
Labor - Employment	$	668	$	662
Environmental		48		48
Tort		40		39
Contractual		13		13
Total Contingent Liabilities	$	769	$	762

As previously reported, on January 14, 2010, the Equal Employment Opportunity Commission's (EEOC) Office of Federal Operations certified a class action case against the Postal Service in a matter captioned McConnell v. Potter (first instituted in 2006), with the class consisting of all permanent rehabilitation employees and limited duty employees who have been subjected to the National Reassessment Process (NRP) from May 5, 2006, to the present. The Postal Service used the NRP to ensure that its records were correct and that employees receiving workers' compensation benefits were placed in jobs consistent with their abilities. The case alleges violations of the Rehabilitation Act of 1973 resulting from the NRP's failure to provide a reasonable accommodation, the NRP's wrongful disclosure of medical information, the creation by the NRP of a hostile work environment, and the NRP's adverse impact on disabled employees. The class is seeking injunctive relief and damages of an uncertain amount on behalf of a yet unidentified population of employees. If the plaintiffs were able to prove their allegations in this matter and to establish the damages they assert, then an adverse ruling could have a material impact on the Postal Service. However, the Postal Service disputes the claims asserted in this class action case and is vigorously contesting the matter. There was no material changes in the status of this case during the quarter ended December 31, 2011.

Based on currently available information, adequate provision has been made for probable losses arising from claims and suits. The current portion of this liability of $69 million at December 31, 2011, and $72 million as of September 30, 2011, is included on the Balance Sheets in “Trade payables and accrued expenses”. The long-term portion of this liability was $700 million at December 31, 2011 and $690 million at September 30, 2011, and is included on the Balance Sheets in “Contingent liabilities and other”.

In addition to the amounts accrued in the financial statements, the Postal Service also has claims and lawsuits which it deems reasonably possible of an unfavorable outcome which range from $600 million to $700 million at December 31, 2011. No provisions for these reasonably possible losses are accrued or included in the financial statements.

Note 7 – Health Benefits Programs

CURRENT EMPLOYEES HEALTH BENEFITS

Substantially all career employees are covered by the Federal Employees Health Benefits Program (FEHBP). The Office of Personnel Management (OPM) administers the program and allocates the cost of the program to the participating government agency employers. The Postal Service cannot direct the costs, benefits, or funding requirements of the plan and, therefore, accounts for program expenses using accounting standards for multiemployer plan accounting. The Postal Service portion of the cost is based on the weighted-average premium cost of the various employee coverage choices and the specific coverage choices made by current employees. Employees paid approximately 22% of the premium costs in the three months ended December 31, 2011, compared to 21% in the three months ended December 31, 2010. The Postal Service paid the remaining employee health care expense which was $1,307 million and $1,299 million in Quarter I, 2012 and 2011, respectively. These expenses are included in "Compensation and benefits" in the Statements of Operations.

RETIREE HEALTH BENEFITS

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

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

In addition to payments to OPM for the Postal Service share of FEHBP retiree premiums, P.L. 109-435 as amended, established the PSRHBF, which requires prefunding of retiree health benefit premiums from 2007 through 2016. The current schedule of these remaining prefunding payments is as follows:

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

Although P.L. 109-435 included a ten year, $55,800 million payment prefunding schedule that dictates the amounts and timing of payments through 2016, the amounts to be paid and the timing of the payments can be changed at any time with the passage of a new law, or amendment of the existing law. On October 1, 2009, P.L. 111-68, *Continuing Appropriations Resolution, 2010,* decreased the scheduled payment in 2009 by $4.0 billion — from $5.4 billion to $1.4 billion. This law affected only the payment scheduled in 2009 and did not change any future payment requirements. On September 30, 2011, P.L. 112-33, *Continuing Appropriations Act, 2012,* changed the required PSRHBF payment of $5.5 billion scheduled to be due by September 30, 2011, to be due by October 4, 2011. This was then changed again by five subsequent laws. P.L. 112-74, *Consolidated Appropriations Act, 2012*, the most recent law affecting the PSRHBF payment, changed the due date of the $5.5 billion originally due September 30, 2011 to August 1, 2012. As a result, the total required PSRHBF payment in 2012 is $11.1 billion: $5.5 billion due by August 1, 2012, and $5.6 billion due by September 30, 2012. To date, no law changes have altered the payment requirements for the original $5.6 billion due by September 30, 2012, or for the 2013 to 2016 scheduled payments. As a result of these legislative changes, the Postal Service is accruing the $5.5 billion payment due by August 1, 2012, in equal amounts over ten months and the $5.6 billion due by September 30, 2012, in equal amounts throughout the year. The Postal Service has asked

Congress to resolve the retiree health benefits prefunding for 2012 and future years. There can be no assurance that Congress will restructure any of the scheduled payments.

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

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

The Postal Service has contributed $38 billion to the PSRHBF from inception to date. These funds, which are invested by OPM, earn interest at rates between 2% and 5%. The PSRHBF balance, as calculated by OPM at the last valuation date of September 30, 2011, was $44.1 billion. For further details, see the Annual Report on Form 10-K for the year ended September 30, 2011.

Retiree Health Benefits	Three Months Ended December 31,	
(Dollars in millions)	2011	2010
(Unaudited)		
Employer Premium Expense	$ 630	$ 577
P.L. 109-435 Payment to PSRHBF	3,050	1,375
Total Retiree Health Benefit Expense	$ 3,680	$ 1,952

Total retiree health benefits expenses were $3,680 million and $1,952 million for the three months ended December 31, 2011, and 2010, respectively. These costs which are reflected as “Retiree health benefits” in the Statement of Operations consists of payments to OPM for the Postal Service share of FEHBP retiree premiums currently being paid plus prefunding payments to the Postal Service Retirement Health Benefit Fund (PSRHBF) for current employees who will retire in the future.

Employer premium expense for retiree health benefits expense for the three months ended December 31, 2011, and 2010 was $630 million and $577 million, respectively. The Postal Service recognized $3,050 million and $1,375 million of PSRHBF expense for the three months ended December 31, 2011, and 2010, respectively. Because the amounts to be paid into the PSRHBF are set by legislation, the Postal Service retiree health expense may represent more or less than the full cost of the benefits earned by Postal Service employees.

Note 8 – Retirement Programs

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

EMPLOYEE/EMPLOYER CONTRIBUTIONS

P.L. 109-435 suspends until 2017 the employer contributions to CSRS that would otherwise have been required under Title 5, Section 8334(a)(1) of the United States Code. At that time OPM will determine whether additional funding is required for the benefit of postal retirees. As required by law, the Postal Service contribution rate was 11.9% of base salary for current FERS employees for the three months ended December 31, 2011 and 11.7% of base salary for FERS employees for the three months ended December 31, 2010. The Postal Service is required to contribute to the TSP a minimum of 1% per year of the basic pay of employees covered by this system. It is also required to match a voluntary employee contribution up to 3% of the employee's basic pay, and 50% of an employee's contribution of between 3% and 5% of basic pay.

The Postal Service has overfunded its FERS obligations by $10.9 billion at September 30, 2010, the latest actual data available. OPM's most recent calculation shows that the FERS surplus is projected to grow to $11.4 billion by September 30, 2011. In 2011, the Postal Service had sought to apply any overfunded balance to amounts currently due for employer contributions and ceased making employer contributions in June 2011. The Postal Service resumed the regular biweekly payments for FERS employer's contributions and remitted all previously withheld payments in December 2011, including the $911 million accrued at September 30, 2011. The Postal Service continues to seek a refund of the overfunded balance.

Retirement expense was $1,483 million and $1,493 million for the three months ended December 31, 2011, and 2010, respectively. Retirement expense is recorded in "Compensation and benefits" in the Statements of Operations.

Note 9 – Workers' Compensation

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

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

A liability is recorded for the present value of estimated future payments to postal employees, or their qualified survivors, who have been injured through the end of the reporting period. The estimated total cost of a claim is based on the date of the injury, pattern of historical payments, frequency or severity of the claim-related injury or injuries, and the expected trend in future costs. The liability for claims arising more than 10 years ago is determined by an independent actuary. Because the FECA structure allows payments for the rest of the lives of the claimants, payments will, in some cases, often be superior to benefits available under normal federal retirement.

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

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

Workers' Compensation Liability Inflation and Discount Rates	December 31, 2011	Quarter Ended September 30, 2011	December 31, 2010	September 30, 2010
(Unaudited)				
Compensation Claims Liability:				
Discount Rate	2.3%	2.3%	3.6%	2.9%
Wage inflation	2.9%	2.9%	2.9%	2.9%
Medical Claims Liability:				
Discount Rate	2.3%	2.4%	3.6%	3.0%
Medical Inflation	8.6%	8.6%	7.4%	7.4%

An increase of 1% in the discount rate would decrease the December 31, 2011 liability and Quarter I, 2012 expense by approximately $1.6 billion. A decrease of 1% in the discount rate would increase the December 31, 2011 liability and Quarter I, 2012 expense by approximately $2.0 billion.

At December 31, 2011, the present value of the liability for future workers' compensation payments was $14,614 million, compared to $15,142 million at September 30, 2011, a decrease of $528 million. The decrease was due to the annual payment to the DOL of $1,255 million, which was made in October 2011. The current portion of this liability was $1,328 million at December 31, 2011, compared to $1,255 million at September 30, 2011 an increase of $73 million. These amounts are accrued under "Workers' compensation costs" on the Balance Sheets.

Workers' compensation expense, including the impact of changes in the discount rates, for the three month period ended December 31, 2011, and 2010 was as follows:

Workers' Compensation Expense (Dollars in millions)	Three Months Ended December 31, 2011	2010
(Unaudited)		
Impact of Discount Rate Changes	$ 87	$ (820)
Actuarial valuation of new cases and revaluation of existing cases	641	373
Subtotal	728	(447)
Administrative Fee	17	15
Total Workers' Compensation Expense	$ 745	$ (432)

Note 10 – Fair Value Measurements

The Postal Service estimates that the carrying value of current assets and liabilities approximates fair values. The Postal Service also has non-current financial instruments, such as the long-term portion of debt (see Note 3-*Debt*) and long-term receivables (see Note 11-*Revenue Forgone*), that must be measured for disclosure purposes on a recurring basis under authoritative accounting literature in GAAP. The Postal Service also applies these requirements to various non-recurring measurements of financial and non-financial assets and liabilities, such as the impairment of property and equipment. Measurement of assets and liabilities at fair value is performed using inputs from the following three levels of the fair value hierarchy as defined in the authoritative literature:

- Level 1 inputs include unadjusted quoted prices in active markets for identical assets or liabilities as of the balance sheet date.

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

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

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

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

Fair Value of Long-Term Financial Assets and Liabilities (Dollars in millions)	December 31, 2011 Carrying Amount	December 31, 2011 Fair Value	September 30, 2011 Carrying Amount	September 30, 2011 Fair Value
	(Unaudited)		(Audited)	
Revenue Forgone	$ 377	$ 538	$ 393	$ 540
Total Long-Term Financial Assets	377	538	393	540
Long-Term Portion of Debt	5,500	6,180	5,500	6,148
Total Long-Term Financial Liabilities	$ 5,500	$ 6,180	$ 5,500	$ 6,148

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

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

Reconciliation of Fair Value of Level 3 Instruments (Dollars in millions)	(Unaudited)
Debt	
Balance at September 30, 2011	$ 6,148
New Indebtedness	-
Repayment of Debt	-
Unrecognized Loss	32
Balance at December 31, 2011	$ 6,180

For the quarter ended December 31, 2011, there were no significant transfers between Level 1 and Level 2 assets or liabilities.

Non-financial assets, such as property and equipment, are measured at fair value when there is an indicator of impairment or when a decision is made to dispose of an asset, and recorded at fair value only when impairment is recognized. Independent appraisals, adjusted for estimated selling costs, are used to determine the fair value of non-financial assets deemed impaired or being held for sale. Independent third party appraisals are deemed Level 2 inputs as defined above. See Note 4–*Property and Equipment* for details on impairments.

Note 11 – Revenue Forgone

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

For the three months ended December 31, 2011, the Postal Service recognized revenue of $13 million, including $6 million of imputed interest income from these appropriations, compared to $26 million, including $6 million of imputed interest, for the three months ended December 31, 2010.

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

The related amount of the receivable was $403 million at December 31, 2011, and $467 million at September 30, 2011. The current portion of this receivable was $26 million at December 31, 2011, and $74 million at September 30, 2011, and is recorded under “Receivables – U.S. government” on the Balance Sheets.

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

Cautionary Statements

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

Management's Discussion and Analysis of Financial Condition and Results of Operations and other parts of this report include statements representing expectations about the United States Postal Service business and financial results. These may be affected by risks and uncertainties discussed here and in the Annual Report on Form 10-K for the year ended September 30, 2011, such as, but not limited to, effectiveness of operating initiatives; rate of electronic diversion; changes in laws and regulations; costs and delays associated with new regulations imposed by the Postal Regulatory Commission (PRC) or other regulatory bodies; the amount of required prefunding payments to the Postal Service Retiree Health Benefits Fund (PSRHBF); success in advertising and promotional efforts; changes in national and local business and economic conditions, including their impact on consumer and business confidence; fluctuations in currency exchange and interest rates; labor and other operating costs; oil, fuel, and other transportation costs; the effects of war and terrorist activities; competition, including pricing and marketing initiatives and new service offerings by our competitors; consumer preferences or perceptions concerning our service offerings; spending patterns and demographic trends; availability of qualified personnel; severe weather conditions; labor relations; effects of legal claims; cost and deployment of capital; and changes in applicable accounting policies and practices. The foregoing list of important factors is not all-inclusive. Some of these and other factors, many of which we cannot control or influence, may cause actual results to differ materially from those currently contemplated. We have no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise. Operating results for the three month period ended December 31, 2011, are not necessarily indicative of the results to be expected for the year ending September 30, 2012. This report should be read in conjunction with the United States Postal Service Annual Report on Form 10-K for the year ended September 30, 2011. As in that report, all references to years, unless otherwise stated, refer to the fiscal year beginning October 1 and ending September 30. All references to quarters, unless otherwise noted, refer to quarters within fiscal years 2012 and 2011.

Introduction

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

We serve individual and commercial customers in the communications, distribution and delivery, advertising and retail markets throughout the nation and, as a result, have a very diverse customer base and are not dependent upon a single customer or small group of customers. No single customer represents more than 1.5% of operating revenue; however, advertising mail in general accounts for more than half of our volume.

P.L. 109-435 divides postal services into two broad categories: market-dominant and competitive. Market-dominant services include, but are not limited to, First-Class Mail, Standard Mail, Periodicals and certain Package Services. Price increases for these services are subject to a price cap by class of mail based on the Consumer Price Index–All Urban Consumers (CPI-U). Competitive services, such as Priority Mail, Express Mail, Bulk Parcel Post and Bulk International Mail have greater pricing flexibility. Prices and fees are subject to a review process by the Board and by the independent Postal Regulatory Commission (PRC). Throughout this document, and in the day-to-day operation of the organization, market-dominant services are referred to as "Mailing Services" and competitive services as "Shipping Services".

Mailing and Shipping Services are sold through a network of approximately 32,000 postal-managed Post Offices, stations, and branches, plus thousands of contract postal units, community post offices, Village Post Offices, a network of retail establishments that sell postage stamps and other services, all of which enhance the convenience of our customers, and our website, http://*www.usps.com*. Mail deliveries are made to over 151 million city, rural, Post Office box, and highway delivery points. Operations are conducted primarily in the domestic market, with international sales representing approximately 4% of total revenue. In December 2011, Oxford Strategic Consulting named USPS the best postal service within the world's top 20 largest economies for access to services, resource efficiency and public trust after their comprehensive review of the performance of universal postal service providers. The report found that USPS delivers nearly double the number of letters per employee as its closest ranking global competitor.

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

The labor force is primarily represented by the American Postal Workers Union (APWU), National Rural Letter Carriers Association (NRLCA), National Postal Mail Handlers Union (NPMHU), and National Association of Letter Carriers (NALC). More than 85% of career employees are covered by collective bargaining agreements. The current contract with the APWU became effective May 23, 2011, and extends through May 20, 2015. The NRLCA contract expired on November 20, 2010, and the NPMHU and NALC contracts expired on November 20, 2011. If agreements are not reached during negotiations, a federal mediator is appointed, unless the parties agree otherwise. Impasses in collective bargaining negotiations may ultimately be resolved through arbitration. The Postal Service has reached an impasse in negotiations with the NRLCA. The Postal Service and the NRLCA have agreed to bypass mediation and move directly to interest arbitration. Interest arbitration hearings began on December 5, 2011. The Postal Service has also reached an impasse in negotiations with the NPMHU and NALC as of the date of this report. By law, we consult with management organizations representing most of the employees not covered by collective bargaining agreements. Consultation with those organizations is ongoing as of the publication of this report.

We participate in federal employee benefit programs for retirement, health and workers' compensation benefits. Under P.L. 109-435, we are obligated to fully fund the established health and retirement benefits of current retirees and current postal employees who have not yet retired. To accomplish this, the law established the Postal Service Retiree Health Benefits Fund (PSRHBF) and requires that we make annual prefunding payments of between $5.6 billion and $11.1 billion into the PSRHBF between 2012 and 2016. These amounts are in addition to the $38 billion contributed from 2007 through 2010 and in addition to the premiums paid for the health benefits of current retirees. There were no contributions made in 2011.

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

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

Critical Accounting Judgments and Estimates

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

The accounting policies deemed either the most judgmental or which involve the selection or application of alternative accounting policies, and are material to the interim financial statements, are described in *Critical Accounting Estimates* contained in *Management's Discussion and Analysis of Financial Condition and Results of Operations* of the Annual Report on Form 10-K for the year ended September 30, 2011. Management discusses the development and selection of accounting policies and estimates with the Audit and Finance Committee of the Board.

Recent Accounting Pronouncements

New Accounting Standards

There were no accounting standards adopted during the three months ended December 31, 2011, that had a material impact on our financial statements.

Standards Issued But Not Yet Effective

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

Results of Operations

For the three months ended December 31, 2011, operating revenue was $17,677 million, compared to $17,877 million for the three months ended December 31, 2010, a decrease of $200 million, or 1.1%. Our net loss was $3,287 million for the three months ended December 31, 2011, compared to a net loss of $329 million for the same period last year.

Although significant efforts continue to be made to increase revenues and contain controllable costs to offset declining volume over the past few quarters, the impact of the large PSRHBF prefunding payments, increasing fuel costs, and legally-required continuation of six-days-per-week delivery have greatly affected our ability to become profitable.

Key Operating Statistics	Three Months Ended December 31,			
(Dollars and mail volume per day in millions)		2011		2010
Operating Revenue	$	17,677	$	17,877
PSRHBF Expense	$	3,050	$	1,375
Loss from Operations	$	(3,246)	$	(290)
Net Loss	$	(3,287)	$	(329)
Average Mail Volume per day		583		618

Stronger than expected holiday shipping activity, driven by strong growth in online merchandise sales and successful USPS marketing efforts helped the Postal Service grow its Shipping Services business in the first quarter. As explained further in the Revenue and Volume section below, on a comparative basis, Shipping Services revenue when adjusted for First-Class Package Service for the three months ended December 31, 2011, of $2,764 million increased $179 million, or 6.9%, on a volume increase of 9.9% over the same period last year. Higher consumer spending, higher e-commerce retail sales plus increased returns of holiday gifts or other online merchandise drove much of the significant growth in Shipping Services revenue and volume. However, this was not enough to offset the declines in Mailing Services. Mailing Services revenue, when adjusted for the change in First-Class Mail parcels (see discussion in Revenue and Volume section below), totaled $14.5 billion, a decrease of 2.9% and volume totaled 43.1 billion pieces, a decrease of 6.2%. Increases in Shipping Services revenue were not enough to offset the losses in First-Class Mail and Standard Mail revenue and volume resulting from the electronic diversion of mail and the prolonged weak economic recovery.

Operating expenses were $20,923 million for the three months ended December 31, 2011, compared to $18,167 million for the same period last year, an increase of $2,756 million, or 15.2%, driven by expenses related to the legally mandated prefunding PSRHBF payments scheduled in 2012.

As described in *Note 7 – Health Benefits Programs*, the original PSRHBF payment of $5.5 billion scheduled to be due by September 30, 2011, was changed to be due by August 1, 2012, resulting in two payments due by the end of the year: $5.5 billion changed to be due by August 1, 2012, plus the originally scheduled $5.6 billion due by September 30, 2012. Taking into account the accruals for PSRHBF prepayments of $3,050 million in Quarter I, 2012, and $1,375 million in Quarter I, 2011, total retiree health benefit costs were $3,680 million for the three months ended December 31, 2011, compared to $1,952 million in the same quarter last year. Note that while no PSRHBF prepayments were made in 2011, during the first three quarters of the year the expense was ratably accrued but was then reversed in the fourth quarter when the prepayment due by September 30, 2011, was changed to ultimately being due by August 1, 2012.

Compensation and benefits expense decreased by $180 million, or 1.4%, compared to the same period last year due primarily to the decrease in work hours. Workers' compensation expenses were $745 million for the three months ended December 31, 2011, compared to a reduction of expenses of $432 million for the period ended December 31, 2010. The $1,177 million, or 272.5%, increase was driven primarily by the large impact of discount rate changes that occurred in Quarter I, 2012 and 2011. Transportation expenses increased by $105 million, or 6.3%, due to rising fuel costs, while other expenses decreased by $74 million, or 3.2%.

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

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

(Loss) Income before Impact of PSRHBF Expense and Discount Rate Changes	Three Months Ended December 31,			
(Dollars in millions)		2011		2010
Net Loss	$	(3,287)	$	(329)
Impact of:				
PSRHBF Expense		3,050		1,375
Discount Rate Changes on Workers' Compensation		87		(820)
(Loss) Income before Impact of PSRHBF Expense and Discount Rate Changes	$	(150)	$	226

Without the impact of these non-controllable factors, the net loss would have been $150 million for the quarter ended December 31, 2011, compared to a net income of $226 million for the quarter ended December 31, 2010.

Revenue and Volume

Revenue and volume are closely linked to two factors: the strength of the U.S. economy and changes in how our customers use the mail. Historically, the more significant factor has been cyclical changes in the rate of economic growth, versus what is more significant today: the rate that relevant new technology has been introduced and accepted into the market place and supplanted the role of traditional hard-copy mail.

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

Between 2008 and 2010, the American economy experienced its worst economic downturn since the Great Depression, and mail volume fell precipitously. The recovery from the recession in 2011 was slow, weak, and uneven. Lingering high unemployment, a weak housing market and low levels of consumer confidence remain a major concern. In the quarter ended December 31, 2011, gross domestic product (GDP) growth stood at 2.8% with the unemployment rate over 8%. As a result, consumer spending and business investment did not provide the growth stimulus necessary to return mail volumes in the current period to the levels that the Postal Service experienced in the mid-2000s. However, there were promising signs of growth in certain lines of business.

The more important factor affecting 2011 and Quarter I, 2012 revenues and volumes was the continuing impact that technology has had on how customers use the mail. Volume and revenue continue to be lost to electronic alternatives, and it is not expected to return because the movement constitutes a fundamental and permanent change in mail use by households and businesses.

Technological change has had an especially negative effect on our First-Class Mail revenues as yearly First-Class Mail revenue in 2011 declined more than 16% on a volume decline of 24% from the 2007 revenue peak. As discussed below, First-Class Mail continued to drop another 4% in Quarter I, 2012. The nature of the recent recession which saw traditional media lag in the overall economic recovery as well as technology have negatively impacted Standard Mail revenue, which declined 6% in Quarter 1, 2012, and remains far from its 2007 peak of 104 billion pieces. Advertisers have become more selective in targeting their mailings, and have many more platforms from which to choose, thus negatively impacting mail volume.

New technology, however, has helped us grow our Shipping Services businesses, which when adjusted for the new First-Class package service line, increased revenue 6.9% in 2011, compared to 2010. At the same time, the combined First-Class Package Service and First-Class Mail Parcels (FCM Parcels) increased $56 million or 16.7%. However, because Shipping Services represents approximately 17% of our total revenues, these increases cannot fully offset the declines in First-Class Mail revenue.

Moreover, unlike a private-sector business, the Postal Service is restricted by law from taking certain steps, such as entering new lines of business, that might generate enough revenue to make up for the decline in First-Class Mail revenue. In short, there currently is no foreseen revenue growth solution that would completely resolve the Postal Service's financial problems.

In April 2011, the Postal Service increased prices for Mailing Services by an average of 1.7%. It was the first increase in Mailing Services prices in almost two years. In addition, prices for Shipping Services increased by an average of 3.6% in January 2011. On January 22, 2012, the Postal Service increased Mailing Services prices an average of 2.1% and increased Shipping Services prices an average of 4.6%. The latter price increases did not impact the financial results for Quarter I, 2012, or Quarter I, 2011.

In 2012, with the concurrence of the PRC, the Postal Service reclassified certain light weight commercial parcels previously classified in Mailing Services as FCM Parcels to the newly created First-Class Package Services in Shipping Services. Periodic reclassifications and expansions of services, which require approval from the PRC, between Mailing Services and Shipping Services are necessary due to the limitations in our Mailing Services category, such as price caps based on the Consumer Price Index (CPI). The additional flexibility provided in Shipping Services allows the Postal Service to better offer services that meet customer needs, to increase business for the Postal Service, and to allow us to price our products and services competitively within the market that we operate.

In order to facilitate a comparison of year over year mailing and shipping revenue and volume results, the following sections include Mailing Services and Shipping Services information before and after the inclusion of FCM Parcels and First-Class Package Services in their respective categories. Since FCM Parcels are more characteristic of our Shipping Services, they are discussed in combination with First-Class Package Service in the Shipping Services Section.

Excluding the amounts attributed to First-Class Package Service, Shipping Services revenue of $2,764 million for the three months ended December 31, 2011, increased $179 million, or 6.9%, on a volume increase of 42 million pieces compared to the three months ended December 31, 2010. Including First-Class Package Service, for the three months ended December 31, 2011, total Shipping Services revenue of $2,969 million increased $384 million, or 14.9%, on a volume increase of 141 million pieces compared to the three months ended December 31, 2010. Mailing Services revenue of $14,708 million decreased by $584 million, or 3.8%, in the three months ended December 31, 2011, compared to the three months ended December 31, 2010, on a volume decrease of 2,929 million pieces, or 6.4%. Excluding the amounts attributed to FCM Parcels, Mailing Services revenue decreased $435 million, or 2.9%. At the same time, the combined First-Class Package Service and FCM Parcels increased $56 million or 16.7%.

Total Revenue and Volume (Dollars and pieces in millions)	Three Months Ended December 31, 2011	2010
Total Mailing Services	$ 14,708	$ 15,292
Total Shipping Services	2,969	2,585
Total Operating Revenue	**$ 17,677**	**$ 17,877**
Total Mailing Volume	43,184	46,113
Total Shipping Volume	564	423
Total Mail Volume	**43,748**	**46,536**

As these results show, the growth and success of our Shipping Services and combined First-Class Package Service and FCM Parcels, was not enough to overcome the decline in Mailing Services, especially the decline in First-Class Mail revenue.

MAILING SERVICES

Mailing Services revenue of $14,708 million decreased by $584 million, or 3.8%, in the three months ended December 31, 2011, compared to the three months ended December 31, 2010, on a volume decrease of 2,929 million pieces. This revenue reduction reflects the continued decline in First-Class Mail and a quarterly decline in Standard Mail. Additionally, the decline can be partially attributed to the parcels previously categorized as FCM Parcels in Mailing Services that were reclassified to First-Class Package Service in Shipping Services in 2012. Excluding FCM Parcels, Mailing Services decreased $435 million or 2.9% to $14,522 million for the three months ended December 31, 2011, as compared to the prior year.

Mailing Services Revenue (Dollars in millions)	Three Months Ended December 31, 2011	2010
First-Class Mail[1]	$ 8,068	$ 8,413
Standard Mail	4,691	4,996
Periodicals	444	480
Package Services	453	447
Other Mailing Services[2]	866	621
Total Mailing Services without Parcels	**$ 14,522**	**$ 14,957**
FCM Parcels	186	335
Total Mailing Services	**$ 14,708**	**$ 15,292**

[1] Excludes FCM Parcels

[2] Includes Certified Mail, Return Receipts, PO Boxes, Insurance, Other Ancillary Fees.

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

In recent years, there have been fundamental changes in the way businesses and consumers use the mail. Correspondence mail has long been a declining part of mail volume. With the availability of inexpensive telephone service, e-mail, and other internet-based forms of communication such as e-cards and social networking, there is little chance that the decline in correspondence mail will be reversed. Customer usage of postal services continues to shift away from transactions, correspondence, and Periodicals Mail. For the three months ended December 31, 2011, combined First-Class Mail and Standard Mail, which represent approximately 95% of our total mail volume, decreased 2,729 million pieces, or 6.2%, compared to the same period last year, with an associated drop in revenue of $650 million, or 4.8%.

Compared to the same quarter last year, excluding FCM parcels, First-Class Mail revenue of $8,068 million decreased $345 million, or 4.1%, on a volume decline of 929 million pieces, or 4.7%. Single-piece First-Class letter revenue declined $300 million, or 9.1%, for the quarter, compared to the same period last year. The largest contributing factor to this decline was the fundamental change in the way businesses and consumers use the mail, the continuing migration away from First-Class Mail toward electronic alternatives. This trend is expected to continue. An additional factor impacting this decrease was the continuing weak global economy.

To combat this negative trend in First-Class Mail, the Postal Service is developing services to make it easier to use the mail. For example, the Postal Service partnered with Apple Inc. to develop a "Cards" mobile application for the iPhone. Another initiative focused on increasing the convenience of First-Class Mail is the Hallmark card featuring prepaid postage. However, these initiatives are in their early stages and did not have a material impact upon revenues in the current quarter.

Standard Mail revenue of $4,691 million decreased $305 million, or 6.1%, in the three months ended December 31, 2011, as volume decreased 1,800 million pieces, or 7.5%, compared to the three months ended December 31, 2010. Standard Mail volumes were significantly impacted by the decline in advertising spending resulting from the recent recession and also by the continued muted growth of the economy. In addition, advertisers continue to become more sophisticated in the targeting of their mailings, which also offsets some potential volume growth.

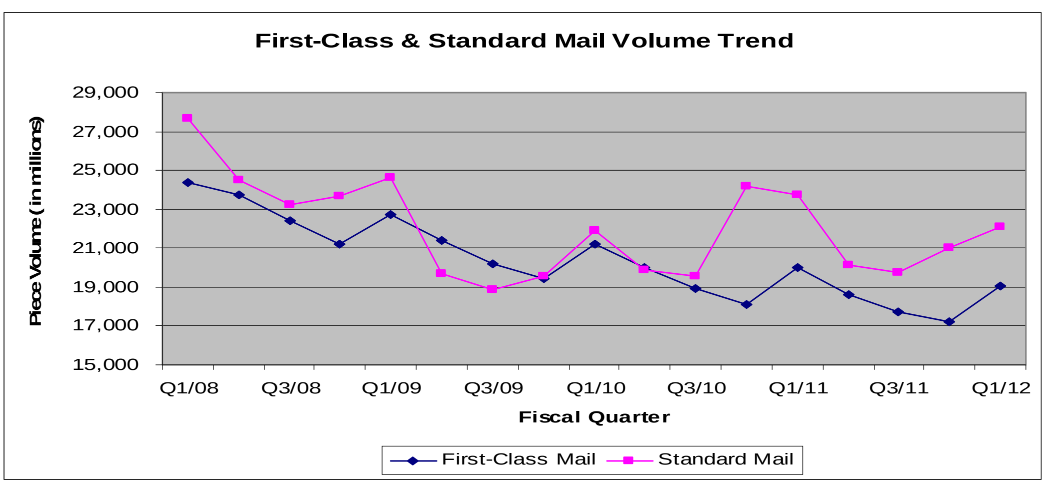
Mailing Services Volume	Three Months Ended December 31,	
(Pieces in millions)	2011	2010
First-Class Mail[1]	18,946	19,875
Standard Mail	22,072	23,872
Periodicals	1,728	1,846
Package Services	178	188
Other Mailing Services[2]	172	163
Total Mailing Services without Parcels	**43,096**	**45,944**
FCM Parcels	88	169
Total Mailing Services Volume	**43,184**	**46,113**

[1] Excludes FCM Parcels

[2] Includes Certified Mail, Return Receipts, PO Boxes, Insurance, Other Ancillary Fees.

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

The following chart depicts First-Class and Standard Mail volumes since 2008:



Revenue from Periodicals decreased $36 million, or 7.5%, in the three months ended December 31, 2011, compared to the same period last year. For the three months ended December 31, 2011, the average per piece weights for Periodicals decreased by 11%, compared to the same period last year. Periodicals continue to be depressed by trends in reading behavior and shifts of advertising away from print. The three months ended December 31, 2011, continued to see E-readers and similar electronic devices becoming increasingly popular with the public.

Package Services revenue increased $6 million, or 1.3% for the three months ended December 31, 2011, compared to the three months ended December 31, 2010; however, volume decreased 10 million pieces, or 5.3%. Shifts to the more profitable Priority Mail Flat Rate Box in Shipping Services negatively impacted Package Services in the Mailing Services category but improved total revenues overall.

SHIPPING SERVICES

As discussed above, some of the $205 million revenue for First-Class Package Service in Quarter I, 2012, was reclassified from parcels in the First-Class Mail category in Mailing Services. Excluding the First-Class Packages for comparison purposes, Shipping Services revenue of $2,764 million increased $179 million, or 6.9%. Including First-Class Package Service, total Shipping Services revenue increased $384 million, or 14.9%, for the three months ended December 31, 2011, compared to the same period last year, as volume increased 141 million pieces, or 33.3%.

Shipping Services Revenue (Dollars in millions)	Three Months Ended December 31, 2011	Three Months Ended December 31, 2010
Priority Mail	**$ 1,708**	**$ 1,643**
Parcel Select Services[1]	**282**	**213**
Express Mail	**202**	**206**
International Mail	**493**	**459**
Other Shipping Services Revenue[2]	**79**	**64**
Total Shipping Services Revenue without FC Package Services	**$ 2,764**	**$ 2,585**
First Class Package Service	**205**	**0**
Total Shipping Services Revenue	**$ 2,969**	**$ 2,585**

[1] Parcel Select Services Includes Parcel Select Mail and Parcel Return Service Mail.

[2] Other Shipping Services Revenue includes shipping and mailing supplies, premium forwarding services, greeting cards, and nonpostal services and fees.

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

The increase in Shipping Services revenues is partially attributed to strong holiday shopping sales, particularly online sales. According to ShopperTrak, overall consumer retail spending rose 4.7% in first 24 days of December 2011, compared with the same period last year while retail e-commerce spending for the entire 2011 holiday season was 15% higher as compared to the prior year.

Increased online consumer spending also led to increased returns of holiday gifts or other online merchandise which were up 4% from the previous year according to the National Retail Federation estimated holiday gift returns. Looking ahead, it is expected that e-commerce will continue to grow and this trend will continue to boost Shipping Service volume.

Shipping Services Volume (Pieces in millions)	**Three Months Ended December 31, 2011**	**2010**
Priority Mail	**231**	**225**
Parcel Select Services[1]	**146**	**113**
Express Mail	**10**	**10**
International Mail	**78**	**75**
Total Shipping Services Volume without FC Package Services	**465**	**423**
First Class Package Service	**99**	**0**
Total Shipping Services Volume	**564**	**423**

[1] Parcel Select Services Includes Parcel Select Mail and Parcel Return Service Mail.

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

Priority Mail, which represented 58% of our total Shipping Services revenue, increased $65 million, or 4%. Priority Mail Flat Rate advertising campaigns continued to contribute to increased revenues in that category. Initially launched in May 2009, this campaign reinforces the message that USPS is a convenient, simpler solution for shipping.

The newly created First-Class Package Service generated revenue of $205 million for the three months ended December 31, 2011. Including the $186 million from FCM Parcels, total revenues of $391 million increased $56 million or 16.7% on a volume increase of 10.7%. First-Class Package Service and FCM Parcels performed especially well as a result of management's continued emphasis on package service options. The strong growth in these combined services from the prior year reflects the consumer's response to a product that provides a high level of service at a reasonable price.

Parcel Select Services which includes Parcel Select Mail and Parcel Return Services for the three months ended December 31, 2011, increased $69 million over the same period of the prior year driven by the higher holiday online spending and returns as discussed above.

Our domestic products portfolio has been enhanced over the past few years to take advantage of the growing e-commerce market and now includes options such as regional rate boxes, several ground parcel services, and samples in the mail, all which continue to grow.

International mail revenues for the three months ended December 31, 2011, were $493 million, an increase of $34 million, or 7.4%, over the three months ended December 31, 2010. A newly designed price information tool for Express and Priority Mail International that gives customers on-the-spot price comparisons helped boost this category.

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

Operating Expenses – Compensation and Benefits

COMPENSATION AND BENEFITS

Compensation and benefits expense in Quarter I, 2012, was $12,486 million, a $180 million, or 1.4% decrease as compared to Quarter I, 2011. Compensation expense decreased by $158 million, or 1.6%, in Quarter I, 2012, compared to the same period last year as the result of fewer employees and work hours used. This was primarily due to a decrease in work hours of 8 million, a 2.8% decrease. Retirement expense decreased $10 million or 0.7% while other compensation of $108 million in Quarter I, 2012, decreased $20 million, or 15.5%. These reductions were partially offset by an increase in health benefits expense of $8 million, or 0.6%.

Compensation and Benefits Expense (Dollars in millions)	Three Months Ended December 31, 2011	2010
Compensation	$ 9,588	$ 9,746
Retirement	1,483	1,493
Health Benefits	1,307	1,299
Other	108	128
Total Compensation & Benefits	$ 12,486	$ 12,666

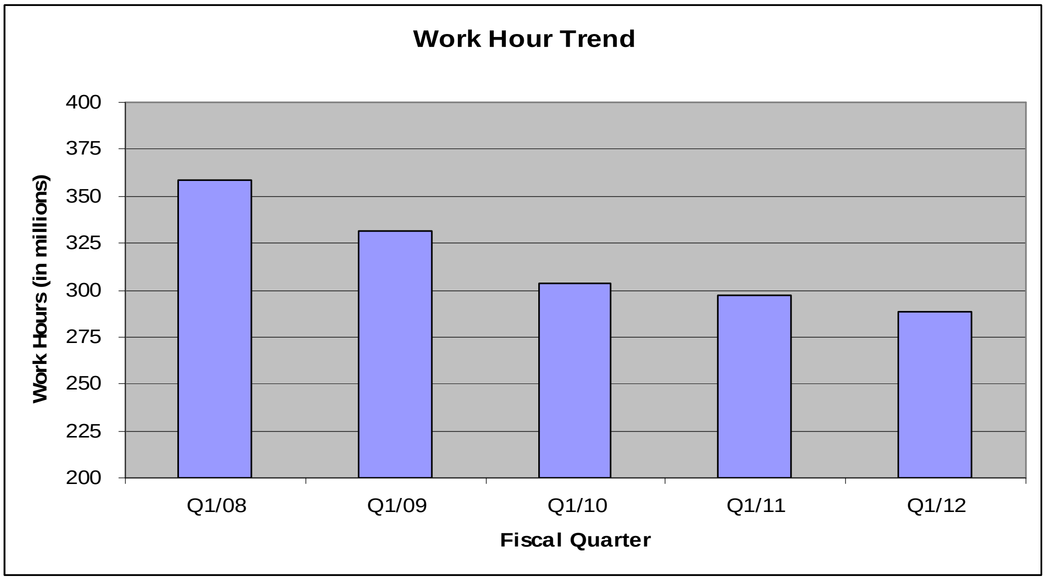
WORK HOURS

The Postal Service reduced work hours in the quarter ended December 31, 2011, by 8.4 million hours, or 2.8%, compared to the same period last year. This represents a reduction of approximately 4,790 full time equivalent employees.

Work Hours (Hours in Thousands)	Three Months Ended December 31, 2011	2010
City Delivery	99,799	102,762
Mail Processing	56,936	58,363
Customer Services Operations	37,526	39,569
Rural Delivery	44,745	44,493
Postmasters	14,278	14,665
Other, including Retail, Plant, Vehicle Services, Operational, Support, & Administration	35,410	37,274
Total	288,694	297,126

Work hours typically increase in the first quarter of the year as compared to the other quarters of the year as volume increases for the fall and holiday mailing season as displayed in the graph below. Overall, historical trends show that work hours have steadily declined, with cumulative reductions totaling over 485 million hours since 2000. In 2012, we continue to target the elimination of 50 million additional work hours.

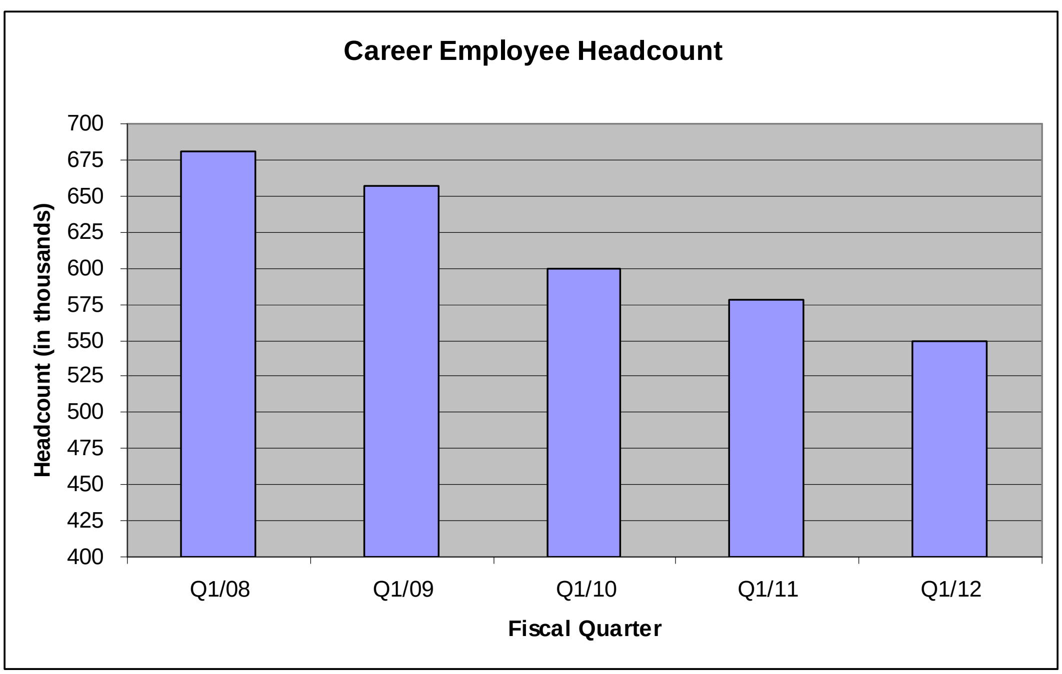
The following chart illustrates our first quarter work hour usage since 2008:



EMPLOYEE WORKFORCE

The total number of employees at December 31, 2011, was approximately 650,000, of which approximately 550,000 were career employees. There has been a cumulative reduction of approximately 134,000 career employees since September 30, 2007, which includes an additional reduction of 6,920 career employees during the three months ended December 30, 2011. This reduction has been accomplished primarily through attrition and incentives to retire or resign.

The following graph depicts the number of Postal Service career employees for the first quarter each year since 2008:



RETIREMENT EXPENSE AND HEALTH BENEFITS EXPENSE– CURRENT EMPLOYEE

Retirement expense was $1,483 million, compared to $1,493 million for the same period last year, a decrease of $10 million, or 0.7%. The decrease was driven by a reduction in the number of employees in the three month period ended December 31, 2011, despite the 0.2% OPM-mandated increase in the employer contribution rate for the Federal Employment Retirement System (FERS) employees. The rate increased to 11.9% of eligible payroll in 2012, up from 11.7% in 2011. This 0.2% increase in 2012 is in addition to the 0.5% increase that occurred in 2011.

According to the Office of Personnel Management (OPM), the Postal Service has overfunded its FERS obligations by $10.9 billion at September 30, 2010, the latest actual data available. OPM's most recent calculation shows that the FERS surplus is projected to grow to $11.4 billion by September 30, 2011. As a result of the overfunding, in June 2011 the Postal Service sought to apply any overfunded balance to amounts due at that time for employer contributions to FERS and ceased making employer contributions. In December 2011, the Postal Service resumed the regular biweekly payments for its FERS employer's contributions and remitted all previously withheld payments, including the $911 million accrued at September 30, 2011. The Postal Service continues to seek a refund of the overfunded balance.

In January 2010, the Office of Inspector General (OIG) issued a report, *The Postal Service's Share of CSRS Pension Responsibility* in which it evaluated the funding of the Postal Service's CSRS responsibility, concluding that the Postal Service had overfunded its obligation by $75 billion. At the Postal Service's request, the PRC initiated an independent actuarial review of this issue and issued a report in June 2010 in which the independent actuary determined that, although the cost allocation methodology used in 1971 was appropriate at the time, modern actuarial and accounting guidance suggest that an alternative allocation methodology would be more fair and equitable. If an updated allocation methodology were employed, the PRC's independent actuary estimates that the Postal Service may have overfunded its CSRS obligation by $50 billion to $55 billion.

On October 13, 2011, the U.S. Government Accountability Office (GAO) released its report, *Allocation of Responsibility for Pension Benefits between the Postal Service and the Federal Government*. While the Postal Service appreciates GAO's observation that reallocation of the CSRS pension surplus would not, by itself, solve the organization's financial problems, we are disappointed that the report rejects the findings of two independent actuaries. We believe the GAO report does not address the core question about whether the current allocation of costs is fair and equitable and we continue to contend that, under current law, OPM is in no way precluded from affecting a more equitable split. We also contend that a more balanced report from GAO would be one containing a more objective analysis and would provide more compromise options for Congress to consider.

OPM and GAO agree that, using the long-term funding assumption of the CSRS Board of Actuaries, the Postal Service's portion of the FERS program was overfunded by $6.9 billion as of September 30, 2009 ($10.9 billion at September 30, 2010, according to OPM); however, it is OPM's position that they are currently restricted by law from authorizing the return of those funds. As a result, various legislative initiatives have been introduced to resolve the matter. See "Legislative Update" in this Form 10-Q and our Annual Report on Form 10-K for the year ended September 30, 2011.

The Postal Service's share of the health care premiums for our employees was $1,307 million or 78%, for the three months ended December 31, 2011, compared to $1,299 million, or 79%, for the three months ended December 31, 2010. The $8 million increase was driven by a 3.8% increase in premiums despite an approximate decrease of 27,000, or 5%, in the number of career employees.

Operating Expenses – Retiree Health Benefits

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

On September 30, 2011, P.L. 112-33, *Continuing Appropriations Act, 2012,* changed the required PSRHBF payment of $5.5 billion previously scheduled to be due by September 30, 2011, to be due by October 4, 2011. This date was then changed by a number of laws subsequently passed. The most recent law affecting the PSRHBF payment, P.L. 112-74, *Consolidated Appropriations Act, 2012*, changed the due date to August 1, 2012. As a result, the total required PSRHBF payment in 2012 is $11.1 billion: $5.5 billion due by August 1, 2012, and $5.6 billion due by September 30, 2012. To date, no law changes have altered the payment requirements for the original $5.6 billion due by September 30, 2012, or the 2013 to 2016 scheduled payments. As a result of these legislative changes, the Postal Service is accruing the $5.5 billion payment due by August 1, 2012, in equal amounts over ten months, and the $5.6 billion due by September 30, 2012, in equal amounts throughout the year. See Note 7, *Health Benefit Programs*, for additional information.

The Postal Service has asked Congress to restructure the payment schedule for 2012 and future years; however, there can be no assurance that Congress will restructure any of the scheduled payments. As a result, and as discussed in *Note 2 – Liquidity*, we will pay our employees, our suppliers and our contract partners to ensure continued delivery of the mail, but we may be forced to default on the payment into the PSRHBF unless a legislative solution can be achieved by August 1, 2012, the due date of the first PSRHBF payment. Further, if no legislation is passed which impacts the $5.6 billion payment due by September 30, 2012; we may also be forced to default on this payment.

The components of retiree health benefits expense for the three months ended December 31, 2011, and 2010 are as follows:

Retiree Health Benefits (Dollars in millions)	Three Months Ended December 31, 2011	 2010
Employer Premium Expense	**$ 630**	**$ 577**
P.L. 109-435 Payment to PSRHBF	**3,050**	**1,375**
Total Retiree Health Benefit Expense	**$ 3,680**	**$ 1,952**

Note that while no PSRHBF prepayments were made in 2011, during the first three quarters of the year the expense was ratably accrued but was then reversed in the fourth quarter when the prepayment due by September 30, 2011, was changed to ultimately being due by August 1, 2012. Expenses for Quarter I, 2012, for retiree health benefits employer premiums increased $53 million, or 9.2%, from the same period last year. The major drivers of retiree health benefit employer premium expense are the number of current participants on the rolls and premium costs of the plans they select. As of December 31, 2011, there were approximately 469,000 participants, a decrease of 3,000 participants, compared to approximately 472,000 participants at December 31, 2010. Despite this decrease in the number of plan participants, retiree health benefit premium expense increased due to a 3.8% increase in the cost of premiums.

Operating Expenses – Workers' Compensation

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

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

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

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

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

Workers' Compensation Liability Inflation and Discount Rates	Quarter Ended December 31, 2011	September 30, 2011	December 31, 2010	September 30, 2010
Compensation Claims Liability:				
Discount Rate	**2.3%**	**2.3%**	**3.6%**	**2.9%**
Wage inflation	**2.9%**	**2.9%**	**2.9%**	**2.9%**
Medical Claims Liability:				
Discount Rate	**2.3%**	**2.4%**	**3.6%**	**3.0%**
Medical Inflation	**8.6%**	**8.6%**	**7.4%**	**7.4%**

An increase of 1% in the discount rate would decrease the December 31, 2011 liability and Quarter I, 2012 expense by approximately $1.6 billion. A decrease of 1% in the discount rate would increase the December 31, 2011 liability and Quarter I, 2012 expense by $2.0 billion.

At December 31, 2011, the present value of the liability for future workers' compensation payments was $14,614 million, compared to $15,142 million at September 30, 2011, a decrease of $528 million. In October 2011, we made payments of $1,255 million to the DOL. The current portion of the liability was $1,328 million at December 31, 2011, compared to $1,255 million at September 30, 2011.

Workers' compensation expense, including the impact of changes in the discount rates, for the three month period ended December 31, 2011, and 2010 was as follows:

Workers' Compensation Expense (Dollars in millions)	Three Months Ended December 31, 2011	2010
Impact of Discount Rate Changes	**$ 87**	**$ (820)**
Actuarial valuation of new cases and revaluation of existing cases	**641**	**373**
Subtotal	**728**	**(447)**
Administrative Fee	**17**	**15**
Total Workers' Compensation Expense	**$ 745**	**$ (432)**

In the three months ended December 31, 2011, the Postal Service experienced a $28 million, or 13.4%, increase in compensation claim payments and a $14 million, or 11.2%, decrease in medical claims payments compared to the three months ended December 31, 2010. The increase in compensation payments for the three months ended December 31, 2011, continues to be pronounced after a reassessment of employees on light or limited duty status resulted in an increase in benefits payments to some beneficiaries. On a quarterly basis, changes in the number of claims and amounts paid are highly volatile and depend on a number of factors including, but not limited to: the number, timing and severity of injuries; the number of new claims and closed claims within the period; and the amount and timing of payments made by the OWCP on our behalf. Medical and compensation claims payments fluctuate significantly from quarter to quarter, so the change in the number of paid medical and compensation claims for any quarter compared to the same period last year may not necessarily be representative of the results to be expected for the full year.

Operating Expenses – Transportation

Transportation expenses are primarily made up of highway, air, and international transportation costs. Transportation expenses for Quarter I, 2012, were $1,766 million, an increase of $105 million, or 6.3%, compared to $1,661 million for the same period last year.

Transportation Expense	Three Months Ended December 31,			
(Dollars in millions)		2011		2010
Highway Transportation	$	894	$	862
Air Transportation		599		550
International Transportation		262		234
Other Transportation		11		15
Total Transportation Expense	$	1,766	$	1,661

Highway transportation expenses were $894 million, an increase of $32 million, or 3.7%, in Quarter I, 2012, compared to Quarter I, 2011. These increases are primarily attributable to increases in the cost of diesel fuel. Diesel fuel, which makes up approximately 93% of fuel purchased for highway contracts, with an average cost of $3.87 per gallon during Quarter I, 2012, compared to $3.15 per gallon in Quarter I, 2011, an increase of 23%.

Partially offsetting the increases in fuel costs during the first three months of 2012 was a 78 million mile, or 5%, decrease in contracted highway miles compared to Quarter I, 2011. This is a result of continuing national and local surface transportation utilization improvement initiatives.

Air transportation expenses of $599 million for the quarter ended December 31, 2011, increased by $49 million, or 8.9%, from $550 million for the same quarter last year. Similar to highway transportation, air transportation expenses were highly influenced by rising fuel prices. At the same time, however, declining volume and the shifting of some volume previously transported by air being delivered by lower-cost highway transportation has offset these increases.

International transportation expenses of $262 million for the quarter ended December 31, 2011, increased $28 million, or 12%, compared to last year as international foreign postal transaction rates increased, and as the ratio of packages to the less expensive First-Class Mail increased. The largest component of international transportation expense is the fee that we pay to foreign postal administrations for transportation and delivery of mail within their country. These foreign postal transaction fees represented 69% of the total international transportation expense in Quarter I, 2012.

Operating Expenses – Other Operating Expense

Other operating expenses of $2,246 million for the three months ended December 31, 2011, were $74 million, or 3.2% less than the $2,320 million of other operating expenses for the same period last year.

Other Operating Expense (Dollars in millions)	Three Months Ended December 31, 2011	2010
Supplies and Services	$ 536	$ 573
Depreciation and Amortization	545	573
Rent and Utilities	405	423
Vehicle Maintenance Service	245	223
Information Technology and Communications	138	137
Rural Carrier Equipment Maintenance Allowance	148	146
Other	229	245
Total Other Operating Expense	$ 2,246	$ 2,320

Decreases in other expenses were driven by reductions in supplies and services of $37 million, or 6.5%, depreciation of $28 million, or 4.9%, and rent expense of $18 million or 4.3%. These reductions reflect the management's continued efforts to control such costs.

Somewhat offsetting these decreases was a $22 million or 9.9% increase in vehicle maintenance costs which includes expenses related to fuel and vehicle supply parts. Fuel costs accounted for approximately 97% of the three month increase in vehicle maintenance costs while the remaining increase was attributable to parts and supplies expense incurred as a result of our aging vehicle fleet.

Liquidity and Capital Resources

CASH FLOW ACTIVITY

Cash and cash equivalents totaled $1,002 million at December 31, 2011, compared to $1,488 million and $908 million at September 30, 2011, and December 31, 2010, respectively. The following table provides a summary of our cash flows for the three month periods ended December 31, 2011 and 2010:

Cash Flow Statement (Dollars in millions)	Three Months Ended December 31, 2011	2010
Operating activities:		
Net loss	$ (3,287)	$ (329)
Noncash depreciation and gains on sales	529	585
Changes in assets and liabilities	2,598	(441)
Cash used by operating activities	(160)	(185)
Investing activities:		
Capital expenditures, net of proceeds	(204)	(339)
Cash used by investing activities	(204)	(339)
Financing activities:		
Net change in notes payable	-	(100)
Net change in revolving credit line	(97)	400
Other	(25)	(29)
Cash (used by) provided by financing activities	(122)	271
Net Decrease in Cash and Cash Equivalents	$ (486)	$ (253)

Operating Activities: Operating activities used $160 million of cash during the three months ended December 31, 2011, compared to $185 million used by operating activities for the three months ended December 31, 2010, a decrease of $25 million. In December 2011, the Postal Service resumed its regular biweekly payments for FERS employer's contributions as well as the remittance of all previously withheld payments, including the $911 million accrued at September 30, 2011.

Investing Activities: Purchases of property and equipment were $251 million in the first quarter 2012 compared to $341 million in the first quarter 2011, a decrease of $90 million or 26.4%, as capital spending continued to decrease due to efforts to conserve cash. Proceeds from the sale of property and equipment increased by $45 million, from $2 million to $47 million, in the first three months of 2012, as compared to the same period in the prior year.

Financing Activities: In addition to the cash generated by operations, we use credit lines and notes payable to the Federal Financing Bank to help fund operations. During the three months ended December 31, 2011, we issued $2,500 million in notes payable but also repaid an equal amount of notes payable during the same period.

LIQUIDITY CHALLENGES

SUMMARY OF PROJECTED CASH SHORTFALL

The Postal Service continues to suffer from a severe lack of liquidity caused by over $25 billion of net losses over the past five years including $21 billion of statutory payments for prefunding retiree health benefits. The trend of losses continued into this quarter as we had a net loss of $3.3 billion for the three months ended December 31, 2011, and had only $1.0 billion of total cash and $2.1 billion of remaining borrowing capacity on its $15 billion debt facility. The net loss for the three months ended December 31, 2011, included accruals of $3,050 million for retiree health benefits prefunding due in 2012.

Our current financial projections indicate that we will not be able to make the required $5.5 billion prefunding payment for retiree health benefits currently due by August 1, 2012, or the required $5.6 billion prefunding payment for retiree health benefits that is due by September 30, 2012. Additionally, even without making the $11.1 billion of scheduled PSRHBF payments in the fourth quarter of 2012, current projections indicate that we will have a precariously low level of cash and liquidity at September 30, 2012. This position will continue into mid-October of 2012, when we are required to make our annual payment to the DOL for workers' compensation estimated to be approximately $1.3 billion.

We continue to update our financial forecasts with special attention paid to short-term liquidity. Emergency measures to preserve cash and liquidity, such as prioritizing employee and supplier payments over government payments, may be available to help ensure continued mail delivery. Additionally, we continue to seek a refund of $11 billion of overfunding of our FERS retirement plan, as those funds would provide much needed liquidity in the short-term.

To address our financial challenges we have developed a plan to reduce its annual operational expenses by $20 billion by 2015. We are aggressively pursuing new revenue streams and reducing costs in areas within our control and we have proposed legislative changes to Congress that are also needed. Given the vital part that the Postal Service plays in the U.S. economy, we are hopeful that Congress will take the steps needed to enact the proposed legislative changes.

MAJOR FACTORS LEADING TO PROJECTED CASH SHORTFALL

The Postal Service had net losses of $5,067 million, $8,505 million, and $3,794 million for the years ended September 30, 2011, 2010, and 2009, respectively. Cash flow from operations for these years was $494 million in 2011 and $1,573 million in 2009. Cash used by operations was $3,292 million in 2010. However, without the enactment of legislation in 2009 and 2011 by the United States Government to reduce the amount of and change the due by dates of PSRHBF prefunding payments due by September 30, 2009, and 2011, respectively, the last time that the Postal Service would have had positive cash flow from operations would have been over five years ago, in 2006.

In 2012, we are required to make $11.1 billion of prefunding payments: a $5.5 billion payment originally due by September 30, 2011, but changed by P.L. 112-74, *Consolidated Appropriations Act 2012* (effective December 23, 2011) to be due by August 1, 2012, plus a $5.6 billion payment due by September 30, 2012, as scheduled in P.L. 109-435, *the Postal Accountability and Enhancement Act* (effective December 20, 2006). To date, no changes have been made to the $22.8 billion in prepayments scheduled for 2013 to 2016 as required by P.L. 109-435.

As noted in previous filings, our losses for the past three years are attributable to a combination of the significant declines in mail volume that began in 2008, statutory and regulatory provisions that have had the effect of limiting our ability to reduce costs and increase revenue, and the statutory requirement to prefund retiree health benefits. The significant declines in mail volume are a result of the economic recession that began in December 2007 and the protracted economic weakness that has followed. This also accelerated the long-term trend of hard-copy correspondence and transactions migrating to electronic media.

Since peaking at 213 billion pieces in 2006, mail volume dropped 45 billion pieces, or 21.2%, to 168 billion pieces in 2011. The decline in First-Class Mail volume by 25 billion pieces, or 25%, during that five-year period has had a significant negative impact on our profitability and liquidity. Mail volume dropped by 3 billion pieces, or 6%, for the three months ended December 31, 2011, as compared to the same period in the prior year. Revenue trends have followed a similar path as revenue for 2011 was $65.7 billion, a $1.3 billion, or 2%, decrease from 2010 and almost $2.4 billion less than 2009. Revenue for the three months ended December 31, 2011, was $17.7 billion, a $0.2 billion, or 1.1% decrease, when compared to $17.9 billion for the three months ended December 31, 2010.

The volume that has been lost to electronic alternatives is not expected to return because the movement constitutes a fundamental and permanent reduction in the use of mail services by households and businesses. Moreover, unlike a private-sector business, we are restricted by law from taking certain steps, such as entering new lines of business, that might generate enough revenue to make up for the loss of First-Class Mail volume. In short, there currently is no foreseen revenue growth solution that would completely resolve our financial problems.

Revenue forecasting in the current economic environment is subject to significant uncertainties. The operational plan for 2012 anticipates another reduction in mail revenue of approximately $2 billion, as compared to 2011. Mail volume tends to increase and decrease based in part on the performance of the overall economy. Because of the uncertain economy, it is possible that mail volume, and therefore revenue, could decrease at a rate greater than, or less than, this projection.

In fiscal year 2011, compensation and benefits expense represented approximately 68% of total operating expenses. However, when workers' compensation and retiree health benefits are added, total personnel expenses increased to approximately 77% of total operating expense. In the first quarter of 2012, total personnel costs increased to approximately 81% of total operating costs due most significantly to increased levels of expense related to retiree health benefits prefunding with payment dates scheduled in 2012, as discussed above. Prefunding retiree health benefits expenses rose to almost 15% of total operating expenses in the first quarter of 2012 as compared to approximately 8% of total operating expenses in the first quarter of 2011.

Although many significant steps have been taken to decrease compensation and benefits expense in response to declining mail volume, many of these expenses remain beyond our direct control due to our statutorily-mandated participation in federal programs such as retirement, health benefits, life insurance, and workers' compensation. Retirement benefits are not determined by management but rather by the federal government, and healthcare benefit costs mandated by law or contract continue to rise well above the rate of inflation. In addition, our ability to adjust our workforce and network infrastructure is limited by contractual, statutory, regulatory and political obstacles. Furthermore, contracts with postal unions are negotiated for a fixed period of time, usually three to five years. They cannot be modified during the contract period except by mutual consent.

FUTURE CASH DEMANDS

By statute, the Postal Service is limited to an annual net increase in debt of $3 billion, up to a total outstanding debt level of $15 billion. As of December 31, 2011, total outstanding debt was $12.9 billion, leaving $2.1 billion of borrowing capacity for future needs. This was a decrease in total debt of $0.1 billion, or 0.8% compared to September 30, 2011, when total outstanding debt was $13 billion. Historically, the end of the first quarter of the year has represented our highest liquidity levels such that a lower utilization of borrowing capacity has been necessary at this time of year.

As noted above, the total required prefunding payment for retiree health benefits to the PSRHBF in 2012 is $11.1 billion: $5.5 billion due by August 1, 2012, and $5.6 billion due by September 30, 2012. In addition, we have a cash payment scheduled for October 2012 estimated to be approximately $1.3 billion to the DOL for our annual payment on workers' compensation liability.

We plan to continue to pay our employees, our suppliers, and our contract partners to ensure continued delivery of the mail. This may result in defaults on some or all of these government obligations. In order to avoid default, statutory or regulatory adjustments to some, or all, of these obligations are necessary. The legal and/or regulatory consequences to the Postal Service of a default on the required PSRHBF contributions, or the workers' compensation payments to the U.S. Government, are unknown.

POSTAL ACTIONS TAKEN TO IMPROVE LIQUIDITY

The Postal Service has taken numerous actions to generate additional revenue and reduce operating expenses. Some of these are discussed below.

We increased prices by an average of 1.7% for Mailing Services in April 2011, for the first time in nearly two years, and by an average of 3.6% for Shipping Services in January 2011. We also implemented a 2.1% average price increase for Mailing Services and a 4.6% average price increase for Shipping Services on January 22, 2012. Both the April 2011, and the January 2012, Mailing Services' price increases were the maximum amounts permitted under law. At the same time, efforts have been made to increase revenues with services, including the expansion of simplified addressing for businesses, Priority Mail Regional Rate Boxes, and Every Door Direct Mail. While these new services have incrementally increased revenue, they have not and are not expected to offset the significant declines in First-Class Mail volume and revenue.

We continue to reduce costs and work hours, and we strive for more favorable contract terms which will better reflect the current business environment and therefore have a positive effect on our liquidity and profitability. As a result of cost-control initiatives, work hours for 2011 were reduced by 34 million hours compared to 2010, and another 8 million hours were similarly saved for the three months ended December 31, 2011. This is in addition to reductions of 75 million and 115 million work hours in fiscal years 2010 and 2009, respectively.

A new labor contract with the American Postal Workers Union (APWU), which became effective in Quarter III, 2011, fixed wage levels for two years, increased workforce flexibility and the use of noncareer employees, and established reduced pay levels for new career employees. Contract negotiations are currently at an impasse with the National Association of Letter Carriers (NALC) and National Postal Mail Handlers Union (NPMHU) for contracts that expired in November 2011. Additionally, the Postal Service and the National Rural Letter Carriers Association (NRLCA) continue interest arbitration proceedings related to the contract which expired in November 2010. To further reduce costs, we realigned administrative functions and suspended discretionary pay awards in 2011 and have frozen officer, executive and non-bargaining employee compensation for 2012. The 2011 discretionary award freeze remains in place. Pay consultations between the Postal Service and our management associations regarding non-bargaining pay and benefits are ongoing. Additionally, we continue to reduce the size of our workforce. Over the last five fiscal years, the Postal Service has decreased its workforce by approximately 140,000 career employees and reduced annual costs by over $14 billion.

As noted in previous filings, we have filed a request with the PRC, seeking an advisory opinion regarding the elimination of congressionally mandated six-day mail delivery to street addresses and associated changes. This is projected to save approximately $3 billion annually and remains a crucial component of our efforts to restructure our operations. The PRC responded to this request on March 24, 2011, and indicated, among other things, that they believe the Postal Service would save $1.7 billion annually from the elimination of Saturday delivery according to their calculations. At approximately the same time, the Government Accountability Office (GAO) issued its own report, *Ending Saturday Delivery Would Reduce Costs, But Comprehensive Restructuring is Also Needed,* on March 29, 2011. The GAO reported that "when fully implemented, 5-day delivery would provide USPS with needed cost savings, although the extent of those savings is uncertain" and that "USPS's 5-day proposal should be considered in the context of other restructuring strategies both within and outside the delivery network." We continue to pursue this matter.

In September 2011, the Postal Service announced plans to realign its mail processing, delivery, and retail networks, along with revisions to service standards. These efforts are expected to help us to reduce labor and benefits costs. The majority of the expected savings from the network realignment will come from reduced work hours and employee complement. These programs consist of a variety of initiatives that are expected to help reduce labor and benefits costs and include the following:

- Streamlining the network of mail processing facilities.
- Modifying delivery routes, apart from five-day delivery.
- Studying underutilized Post Office locations for reduction in staffed operating hours, potential consolidation, closure, or conversion to a contract unit or a Village Post Office.
- Enhancing and expanding alternate access sites, including Village Post Offices and *http://www.usps.com*.
- Modifying service standards which will allow for longer operating windows in mail processing facilities and will reduce the requirements for equipment, facilities, and work hours.

On December 5, 2011, we filed a request for a non-binding advisory opinion from the PRC, regarding the change in service standards required to execute the mail processing network realignment. The PRC regulations require the Postal Service to file a request for an advisory opinion ninety days before implementing a change in service. The PRC has scheduled proceedings with respect to this filing, which would result in their rendering an advisory opinion no earlier than July 2012. In December 2011, we decided to delay the closing or consolidation of a Post Office or mail processing facility until May 15. This action was taken in hopes that this period will help facilitate the enactment of comprehensive postal legislation. On January 18, 2012, we submitted a motion to the PRC for consideration which would expedite their review schedule and establish a new procedural schedule that would result in an advisory opinion being rendered by mid-April 2012. The PRC denied this motion on January 31, 2012.

The Postal Service is also exploring the establishment of a health insurance program, separate from the Federal Employees Health Benefit Program (FEHBP) administered by OPM, as significant levels of potential cost savings have been estimated. The separate Postal health plan could also reduce the need for the prefunding of retiree health benefits at the levels currently scheduled in P.L. 109-435 as the future obligations are projected to be lower.

In total, we have identified and are pursuing savings opportunities which are expected to reduce our annual operational expenses by $20 billion by 2015.

As previously noted, our ability to execute strategies to increase efficiency and reduce costs by adjusting our network, infrastructure, and workforce, and to retain and grow revenue, is constrained by contractual, statutory, regulatory, and political restrictions. As a result of these restrictions, our efforts to positively impact cash flow will not be sufficient, either individually or in the aggregate, to avoid a cash shortfall. We have asked Congress to restructure the payment schedule for 2012 and future years; however, there can be no assurance that Congress will restructure any of the scheduled payments. As a result, we will pay employees, suppliers, and contract partners to ensure continued delivery of the mail, but absent significant changes in the law, we will default on the $5.5 billion prepayment due to the PSRHBF by August 1, 2012, and on the $5.6 billion prepayment due by September 30, 2012. Additionally, even if legislation changes or eliminates the $11.1 billion of prefunding payments currently due to the PSRHBF in 2012, the $15 billion debt ceiling could be reached in October 2012, thereby exhausting our external funding ability.

POSTAL LEGISLATIVE REQUESTS

Even if legislation is enacted to address shorter-term liquidity matters such as the PSRHBF prefunding payment schedule and FERS overfunding, we will continue to face concerns as to our financial stability. The Postal Service has taken, and continues to take, specific actions to address those elements under management's control. Despite these changes, the financial outlook continues to show the necessity of legislative changes, the following for which we have already asked Congress to make:

- Resolve the retiree health benefits prefunding requirement.
- Refund the FERS overfunding which was $10.9 billion according to OPM's calculation as of September 30, 2010, the latest actual data available. OPM estimated that this grew to $11.4 billion by September 30, 2011.
- Grant the Postal Service the authority to adjust delivery frequency.
- Allow the Postal Service to offer non-postal products and services.
- Allow the Postal Service to restructure the healthcare benefit plans offered to employees and retirees.
- Develop a more streamlined governance model for the Postal Service that would allow for quicker pricing and product development decisions than exists within the current regulatory framework.

Due to the gravity of the financial situation, more than a dozen different postal reform-related bills have been introduced in Congress in the past year, in addition to a plan proposed by the Administration to the Joint Select Committee on Deficit Reduction. These plans address some of the short- and long-term issues that we are facing. However, no individual bill achieves all the legislative changes noted above. Nevertheless, we are continuing to reach out to Congress and other stakeholders to discuss the needed legislative changes. Given the vital part the Postal Service plays in the U.S. economy, we are hopeful that Congress will enact the legislation necessary to resolve our financial challenges.

MITIGATING CIRCUMSTANCES

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

We continue to inform the Administration, Congress, the PRC, and other stakeholders of the immediate and longer-term financial issues that we face and the legislative changes that would help ensure the availability of sufficient liquidity on September 30, 2012, and beyond. However, there can be no assurances that the requested adjustments to the PSRHBF prefunding payment schedule, or any other legislative changes, will be made in time to impact 2012, or at all.

Contractual Obligations

The Postal Service's cash flow obligations as of December 31, 2011, for 2012 and future years are scheduled in the following table.

Contractual Obligations	Payments Due by Period Ending December 31,				
(Dollars in millions)	Total	Less than 1 Year	1-3 Years	3-5 Years	After 5 Years
Debt [1]	$ 12,903	$ 7,403	$ 300	$ 300	$ 4,900
Interest on debt [1]	2,198	176	345	334	1,343
PSHRBF	33,900	11,100	11,300	11,500	-
Capital lease obligations	730	75	189	175	291
Operating leases	7,163	570	1,348	1,105	4,140
Capital commitments [2]	652	268	293	61	30
Purchase obligations [2]	2,469	1,009	1,445	15	-
Workers' compensation [3]	21,493	1,328	4,047	3,013	13,105
Employees' leave [4]	2,426	365	117	254	1,690
	$ 83,934	$ 22,294	$ 19,384	$ 16,757	$ 25,499

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

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

(3) Assuming no new cases in future years. This amount represents the undiscounted expected workers' compensation payments. The discounted amount of $14,614 million is reflected in our Balance Sheet at December 31, 2011.

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

Legal Matters and Contingent Liabilities

An estimated loss contingency is accrued in our financial statements if it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Assessing contingencies is highly subjective and requires judgments about future events. We regularly review loss contingencies to determine the adequacy of our accruals and related disclosures. The amount of the actual loss may differ significantly from these estimates. As of December 31, 2011, the material claims outstanding remains the following:

McConnell v. Potter: On January 14, 2010, the Equal Employment Opportunity Commission's (EEOC) Office of Federal Operations certified a class action case against the Postal Service in a matter captioned McConnell v. Potter, with the class consisting of all permanent rehabilitation employees and limited-duty employees who have been subjected to the National Reassessment Process (NRP) from May 5, 2006, to the present. The Postal Service used the NRP to ensure that its records were correct and that employees receiving workers' compensation benefits were placed in jobs consistent with their abilities. The case alleges violations of the Rehabilitation Act of 1973 resulting from the NRP's failure to provide a reasonable accommodation, the NRP's wrongful disclosure of medical information, the creation by the NRP of a hostile work environment, and the NRP's adverse impact on disabled employees. The class is seeking injunctive relief and damages of an uncertain amount on behalf of a yet-unidentified population of employees. If the plaintiffs were able to prove their allegations in this matter and to establish the damages they assert, then an adverse ruling could have a material impact on the Postal Service. However, the Postal Service disputes the claims asserted in this class action case and is vigorously contesting the matter. See Note 6, *Contingent Liabilities*, in the Notes to the Financial Statements for additional information.

Fair Value Measurements

As required by authoritative accounting literature, certain fair value disclosures for the three months ended December 31, 2011, are contained in the Notes to the Financial Statements. We did not recognize gains as a result of valuation measurements during Quarter I, 2012. All recognized losses have been incorporated into our financial statements as of December 31, 2011. See Note 10, *Fair Value Measurements.*

Legislative Update

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

<u>MAJOR CONGRESSIONAL POSTAL REFORM PROPOSALS</u>

21st CENTURY POSTAL SERVICE ACT OF 2011

On November 9, 2011, the Senate Homeland Security and Governmental Affairs Committee held a markup of S. 1789, the *21st Century Postal Service Act of 2011*. S. 1789 is a bipartisan bill introduced on November 2, 2011, and provides for reform on a variety of issues. The Committee voted to report S.1789, as amended, favorably to the Senate by a margin of 9-1. The bill now moves to the full Senate for consideration. S. 1789:

- Requires OPM to return a FERS surplus to the Postal Service for each year a surplus is calculated, with some portion of the surplus used for retirement incentives.
- Provides for a restructuring of the existing pre-payment schedule for RHB; and proposes government-wide workers' compensation reforms.
- Prohibits the Postal Service from instituting five-day delivery for a two-year period, following enactment of S. 1789, but would be allowed after a GAO report on the financial necessity of five-day delivery and a second PRC advisory opinion.
- Modifies existing procedures governing the Area Mail Processing (AMP) study process, particularly the public input process.
- Includes other provisions such as requiring an arbitrator to consider the financial condition of the Postal Service when making decisions on collective bargaining agreements, creating service standards for retail access, consolidating door delivery points to curbside, sidewalk or centralized delivery, permitting the Postal Service to offer new non-postal services, and allowing for the mailing of wine and beer.

POSTAL REFORM ACT OF 2011

On October 13, 2011, the House Oversight and Government Reform Committee held a markup of H.R. 2309, the *Postal Reform Act of 2011.* This bill was introduced on June 23, 2011, and provides for reform on a variety of issues. The Committee voted to report H.R. 2309, as amended, favorably to the House by a margin of 22-18. The bill now moves to the full House for consideration. H.R. 2309:

- Would create a Commission on Postal Reorganization (CPR), which would conduct proceedings regarding closures and discontinuances of the Postal infrastructure, including retail facilities, mail processing facilities, and area and district offices.
- Provides the Postal Service the authority to change delivery frequency.
- Establishes a Postal Service Financial Responsibility and Management Assistance Authority, which would operate during any control period. A control period commences whenever the Postal Service has been in default to the U.S. Treasury with respect to borrowing, for a period of 30 days. The Authority would have broad powers during such control period, including assuming all of the powers of the Postal Service Board of Governors.
- Provides guidance on other issues including: modifying collective bargaining agreements, placing limitations on postal contributions to life and health insurance programs under FEGLI and FEHBP, modifying some postal rates, allowing the Postal Service to offer specific non-postal products and services, and making reforms in specific Postal Service contracting practices and provisions.

APPROPRIATIONS

On December 23, 2011, the President of the United States (the President) signed into law H.R. 2055 (P.L. 112-74), *the Military Construction and Veterans Affairs and Related Agencies Appropriations Act, 2012*, a bill to make appropriations for military construction, the Department of Veterans Affairs, and related agencies including the Postal Service for the fiscal year ending September 30, 2012. The bill changes a $5.5 billion Postal Service Retiree Health Benefits Fund (PSRHBF) prepayment originally due by September 30, 2011, to be due by August 1, 2012. It requires that six-day delivery and rural delivery of mail shall continue at not less than the 1983 level and provides approximately $78.1 million for free and reduced rate mail. For the second straight fiscal year, the requested $29 million for revenue forgone was not fully funded.

On December 17, 2011, the President signed H.J. Res. 95 into law (P.L. 112-68), which changed the due date by which the Postal Service must prepay $5.5 billion into the PSRHBF to December 23, 2011.

On December 16, 2011, the President signed H.J. Res. 94 into law (P.L. 112-67), which changed the due date by which the Postal Service must prepay $5.5 billion into the PSRHBF to December 17, 2011.

On November 18, 2011, the President signed H.R. 2112 into law (P.L. 112-55), which changed the due date by which the Postal Service must prepay $5.5 billion into the PSRHBF to December 16, 2011.

On October 5, 2011, the President signed H.R. 2608 into law (P.L. 112-36), which changed the due date by which the Postal Service must prepay $5.5 billion into the PSRHBF to November 18, 2011.

Prior to Quarter I of 2012, the President signed H.R. 2017 into law (P.L. 112-33), which changed the due date by which the Postal Service must prepay $5.5 billion into the PSRHBF to October 4, 2011.

OTHER CONGRESSIONAL POSTAL PROPOSALS

Numerous other postal proposals were introduced by Congress this quarter but have not become law as of the date of this report. Further information can be found at: http://thomas.loc.gov/home/thomas.php.

- On December 20, 2011, H.R. 3744, the *Rural Service Preservation Act,* was introduced in the House.
- On December 16, 2011, S. 2014, the *Postal Investment Act of 2011,* was introduced in the Senate.
- On December 7, 2011, H.R. 3584, the *Community Postal Service Preservation and Cost Savings Act* was introduced in the House.
- On December 7, 2011, H.R. 3577, the *Biennial Budgeting and Enhanced Oversight Act of 2011*, was introduced in the House.
- On December 7, 2011, H.R. 3581, the *Budget and Accounting Transparency Act of 2011*, was introduced in the House.
- On November 29, 2011, the House passed H.R. 2465, the *Federal Workers' Compensation Modernization and Improvement Act.*
- On November 10, 2011, S. 1853, the *Postal Service Protection Act of 2011*, was introduced in the Senate.
- On November 4, 2011, H.R. 3370, the *Protecting Our Rural Post Offices Act of 2011,* was introduced in the House.
- On October 12, 2011, S. 1688, the *Save Our Postal Worker Jobs Act of 2011,* was introduced in the Senate.
- On October 6, 2011, S. 1668, the *Protecting Rural Post Offices Act of 2011*, was introduced in the Senate.
- On October 4, 2011, S.1649, the *United States Postal Service Pension Obligation Recalculation and Restoration Act of 2011*, was introduced in the Senate.

Item 3 – Quantitative and Qualitative Disclosures about Market Risk

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

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

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

Item 4 – Controls and Procedures

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

Disclosure Controls

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

We carried out an evaluation under the supervision and with the participation of management, including the Postmaster General and Chief Financial Officer, of the effectiveness of the design and operation of disclosure controls and procedures as of December 31, 2011. Based upon, and as of the date of, the evaluation, the Postmaster General and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

Internal Controls

There have been no changes in the Postal Service's internal controls over financial reporting during the quarter ended December 31, 2011, that have materially affected, or are reasonably likely to materially affect, the Postal Service's internal control over financial reporting.

Part II

Item 1 – Legal Proceedings

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

Item 1A – Risk Factors

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

Item 6 – Exhibits

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

Signatures

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

United States Postal Service

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

Date: February 9, 2012

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

Date: February 9, 2012

Exhibit 31.1

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

I, Patrick R. Donahoe, certify that:

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

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

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

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

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

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

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

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

5. The Postal Service's other certifying officer and I have disclosed based on our most recent evaluation of internal control over financial reporting, to the Postal Service's auditors and the audit committee of the Postal Service's Board of Governors (or persons performing the equivalent functions):

    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Postal Service's ability to record, process, summarize and report financial information; and

    b. Any fraud, whether or not material, that involves management or other employees who have significant role in the Postal Service's internal control over financial reporting.

Date: February 9, 2012

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

Exhibit 31.2

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

I, Joseph Corbett, certify that:

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

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

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

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

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

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

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

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

5. The Postal Service's other certifying officer and I have disclosed based on our most recent evaluation of internal control over financial reporting, to the Postal Service's auditors and the audit committee of the Postal Service's Board of Governors (or persons performing the equivalent functions):

    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Postal Service's ability to record, process, summarize and report financial information; and

    b. Any fraud, whether or not material, that involves management or other employees who have significant role in the Postal Service's internal control over financial reporting.

Date: February 9, 2012

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

Exhibit 32.1

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

In connection with the Quarterly Report of the United States Postal Service (Postal Service) on Form 10-Q for the period ended December 31, 2011, (the “Report”), I, Patrick R. Donahoe, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 that:

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

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

Dated: February 9, 2012

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

Exhibit 32.2

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

In connection with the Quarterly Report of the United States Postal Service (Postal Service) on Form 10-Q for the period ended December 31, 2011 (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 9, 2012

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