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, 2010 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 9, 2011
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, 2010	Three Months Ended December 31, 2009
Operating revenue	$ 17,877	$ 18,355
Operating expenses:		
Compensation and benefits	12,716	12,792
Retiree health benefits	1,952	1,897
Workers' compensation	(432)	186
Transportation	1,661	1,513
Other	2,270	2,230
Total operating expenses	18,167	18,618
Loss from operations	**(290)**	**(263)**
Interest and investment income	6	6
Interest expense	(45)	(40)
Net loss	**$ (329)**	**$ (297)**

See accompanying notes to the financial statements. (unaudited)

United States Postal Service
Balance Sheets - Assets

(Dollars in millions)	December 31, 2010 (Unaudited)	September 30, 2010 (Audited)
Current Assets		
Cash and cash equivalents	$ 908	$ 1,161
Receivables:		
Foreign countries	835	714
U.S. government	135	173
Other	255	224
Receivables before allowances	1,225	1,111
Less: Allowances	34	32
Total receivables, net	1,191	1,079
Supplies, advances and prepayments	158	114
Total Current Assets	**2,257**	**2,354**
Noncurrent Assets		
Property and equipment, at cost:		
Buildings	23,979	23,822
Equipment	20,573	20,646
Land	2,972	2,974
Leasehold improvements	1,023	1,026
	48,547	48,468
Less: Allowances for depreciation and amortization	28,346	28,333
	20,201	20,135
Construction in progress	1,150	1,460
Total property and equipment, net	21,351	21,595
Other assets - principally revenue forgone receivable	362	377
Total Noncurrent Assets	**21,713**	**21,972**
Total Assets	**$ 23,970**	**$ 24,326**

See accompanying notes to the financial statements. (unaudited)

United States Postal Service
Balance Sheets - Liabilities and Net Deficiency

(Dollars in millions)	December 31, 2010 (Unaudited)	September 30, 2010 (Audited)
Current Liabilities		
Compensation and benefits	$ 2,609	$ 2,924
Retiree health benefits	1,375	-
Workers' compensation	1,185	1,115
Payables and accrued expenses:		
Trade payables and accrued expenses	1,122	1,311
Foreign countries	687	586
U.S. government	152	136
Total payables and accrued expenses	1,961	2,033
Deferred revenue-prepaid postage	2,991	2,584
Customer deposit accounts	1,437	1,429
Outstanding postal money orders	642	639
Prepaid box rent and other deferred revenue	446	452
Short-term portion of debt	7,800	7,500
Total Current Liabilities	**20,446**	**18,676**
Noncurrent Liabilities		
Workers' compensation costs	9,842	11,474
Employees' accumulated leave	1,925	2,088
Deferred appropriation and other revenue	375	392
Long-term portion capital lease obligations	500	512
Deferred gains on sales of property	308	309
Contingent liabilities and other	276	248
Long-term portion of debt	4,500	4,500
Total Noncurrent Liabilities	**17,726**	**19,523**
Total Liabilities	**38,172**	**38,199**
Net Deficiency		
Capital contributions of the U.S. government	3,132	3,132
Deficit since 1971 reorganization	(17,334)	(17,005)
Total Net Deficiency	**(14,202)**	**(13,873)**
Total Liabilities and Net Deficiency	$ **23,970**	$ **24,326**

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, 2009	$	3,087	$	(8,500)	$	(5,413)
Additional Capital Contribution		39		-		39
Net loss		-		(297)		(297)
Balance, December 31, 2009	**$**	**3,126**	**$**	**(8,797)**	**$**	**(5,671)**
Balance, September 30, 2010	$	3,132	$	(17,005)	$	(13,873)
Net loss		-		(329)		(329)
Balance, December 31, 2010	**$**	**3,132**	**$**	**(17,334)**	**$**	**(14,202)**

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, 2010	December 31, 2009
Cash flows from operating activities:		
Net loss	$ (329)	$ (297)
Adjustments to reconcile net loss to cash provided by operations:		
Depreciation and amortization	573	627
Loss (gain) on disposals of property and equipment, net	12	(22)
Decrease in other assets - primarily appropriations receivable revenue forgone	15	29
Decrease in noncurrent workers' compensation liability	(1,632)	(893)
Decrease in noncurrent employees accumulated leave	(163)	(87)
Decrease in noncurrent deferred appropriations and other revenue	(1)	-
(Decrease) increase in other noncurrent liabilities	27	(10)
Changes in current assets and liabilities:		
Receivables, net	(112)	(97)
Supplies, advances and prepayments	(44)	(15)
Compensation and benefits	(315)	(536)
Retiree health benefits	1,375	1,375
Workers' compensation	70	(3)
Payables and accrued expenses	(72)	(201)
Deferred revenue-prepaid postage	407	(215)
Customer deposit accounts	8	36
Outstanding postal money orders	3	31
Prepaid box rent and other deferred revenue	(7)	4
Net cash used in operating activities	(185)	(274)
Cash flows from investing activities:		
Purchases of property and equipment	(341)	(396)
Proceeds from deferred building sale	1	-
Proceeds from sales of property and equipment	1	27
Net cash used in investing activities	(339)	(369)
Cash flows from financing activities:		
Issuance of notes payable	1,800	-
Payments on notes payable	(1,900)	(975)
Net change in revolving credit line	400	(1,683)
Payments on capital lease obligations	(13)	(14)
U.S. government appropriations - expensed	(16)	(16)
Net cash provided by (used in) financing activities	271	(2,688)
Net decrease in cash and cash equivalents	(253)	(3,331)
Cash and cash equivalents at beginning of year	1,161	4,089
Cash and cash equivalents at end of period	**$ 908**	**$ 758**
Supplemental cash flow disclosures:		
Interest paid	$ 43	$ 39

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 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, 2010. 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 2011 and 2010.

In Quarter I, 2011, the Postal Service improved the estimation technique employed to estimate deferred revenue-prepaid postage for Forever Stamps. During the quarter, certain usage data indicated that a refinement of the estimation process for Forever stamp usage was necessary. As a result of this enhancement, deferred revenue-prepaid postage was increased by $170 million. The change is accounted for as a change in accounting estimate, and is therefore reflected in operating results as a decrease to revenue in Quarter I, 2011.

Certain prior year balances have been reclassified to conform to the current year's presentation. These reclassifications had no effect on previously reported operating or net losses.

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 $55 million at December 31, 2010 and $71 million at September 30, 2010, related to government deposits are included in the Balance Sheets in "Customer Deposits".

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, 2010, and the results of operations and cash flows for the three months then ended. Operating results for the three month period ended December 31, 2010, are not necessarily indicative of the results that may be expected for 2011. Subsequent events have been evaluated through February 9, 2011, the date the Postal Service filed its Form 10-Q for the quarter ended December 31, 2010, with the Postal Regulatory Commission (PRC).

Note 2 – Liquidity

The Postal Service's current financial projections indicate that, as of September 30, 2011, it will have a cash shortfall. In addition, the statutory limit on borrowing will have been exhausted. Without changes in the applicable laws, the Postal Service will be unable to meet all of its financial obligations on September 30, 2011.

The Postal Service had net losses of $329 million and $297 million for the three months ended December 31, 2010 and 2009, respectively. Annual losses were $8,505 million, $3,794 million, and $2,806 million for the years ended September 30, 2010, 2009 and 2008, respectively. The Postal Service had negative cash flow from operations in its first quarter of 2011 and 2010, and also experienced negative cash flow from operations for fiscal years 2010 and 2008. Operating cash flow would have been negative in fiscal year 2009 as well had Public Law 111-68, *Making appropriations for the Legislative Branch for the fiscal year-ending September 30, 2010, and for other purposes* (P.L.111-68), which reduced the required payment to the Postal Service Retiree Health Benefits Fund (PSRHBF) by $4 billion, not been enacted. P.L. 111-68 did not, however, address future payments to the PSRHBF, including the $5.5 billion pre-funding payment required in September 2011. Even with a continuing mild economic recovery, steps to generate revenue, and stringent cost control efforts, the Postal Service will likely not generate sufficient funds during 2011 to meet all of its projected financial obligations.

By statute, the Postal Service is limited to an annual net increase in debt of $3 billion, and total outstanding debt of $15 billion. The Postal Service has two substantial cash payments scheduled for September and October 2011: $5.5 billion due to the PSRHBF on September 30, 2011; and approximately $1.2 billion due in October 2011 to the Department of Labor (DOL) for the Postal Service's annual payment on its workers' compensation liability. Based on the cash balance and the remaining borrowing capacity of $2.7 billion at December 31, 2010, along with the projected cash that will be generated by operations in 2011, there will be insufficient cash available to fund these financial obligations absent regulatory and legislative adjustments to some, or all, of these obligations. The legal and/or regulatory consequences to the Postal Service if the PSRHBF or the workers' compensation obligations cannot be fully funded are unknown.

Mail volume has declined by almost 20% since its peak of 213 billion pieces in 2006. The current Postal Service projection indicates that 2011 mail volume will increase by approximately 1.1% over the 2010 volume of 170.6 billion pieces. However, the volume of First-Class Mail, the Postal Service's most profitable product, is expected to decline by 3.0 billion pieces, or 3.8%, in 2011 compared to 2010. First-Class Mail volume decreased by 1.2 billion pieces, or 5.7%, in Quarter 1, 2011, compared to the same quarter for 2010.

In January 2011, the Postal Service filed new Mailing Services prices with the PRC. Price increases are limited to the Consumer Price Index cap, consistent with the *2006 Postal Accountability and Enhancement Act, Public Law 109-435* (P.L. 109-435) and PRC regulations. The increase, which will become effective in April 2011, is the first increase in Mailing Services prices in almost two years. The price changes, which do not impact the cost of a First-Class stamp, are expected to generate approximately $340 million of revenue in the current fiscal year. In addition, prices for Shipping Services increased by an average of 3.6% in January 2011. If the economic recovery is weaker than anticipated, the rate of diversion from traditional postal services to electronic media accelerates, or other adverse factors impact customers' usage of postal services and products, mail volume and revenues could be less than currently projected.

Personnel costs including compensation and benefits, retiree health benefits (including the PSRHBF requirement), and workers' compensation costs represent approximately 78% of total operating costs. As a result of management initiatives, work hours were reduced 6.4 million hours in the first quarter. This is in addition to reductions of 75 million, 115 million and 50 million work hour reductions in fiscal years 2010, 2009, and 2008, respectively. Although significant actions have been implemented to decrease these personnel costs, many are fixed by statute, regulation, or contract and, therefore, beyond the sole control of management. Wage rates and work rules affecting bargaining employees are contractually negotiated and are fixed for the duration of the labor contract; retirement benefits are determined by law, rather than by management; and health care premium costs continue to rise well above the rate of inflation.

To further reduce costs, in January 2011 the Postal Service announced plans to significantly redesign administrative functions within the organization by reducing the number of Area and District Offices and further decrease the number of administrative, supervisor, and Postmaster positions by approximately 7,500. The redesign, which is expected to be completed by the end of 2011, is anticipated to capture annualized savings of over $700 million starting in 2012.

Despite these efforts, 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. Given these restrictions, Postal Service efforts to positively impact cash flow will likely not be, either individually or in the aggregate, sufficient to avoid a cash shortfall in 2011. Absent significant changes in the economy and regulatory environment, the $15 billion debt ceiling will be reached in September 2011, thereby exhausting the Postal Service's external funding ability. No assurance can be given that Postal Service efforts to secure legislative changes will be successful, or that Congress will enact restructuring legislation in time to impact 2011, or at all.

Even if legislation is enacted to address shorter-term liquidity matters such as the PSRHBF pre-funding payment schedule, the Postal Service still faces longer-term financial stability concerns. To begin the process of addressing these issues, in March 2010 the Postal Service issued its action plan for the next decade, *Ensuring a Viable Postal Service for America*. In this plan, the Postal Service estimated that during the next decade, there could be cumulative financial losses of approximately $238 billion, absent significant operational and legislative changes. The Postal Service further estimated that approximately $123 billion of the projected losses could be addressed and resolved by aggressive management actions within the existing statutory and regulatory structure, assuming the full cooperation of all Postal Service stakeholders. Addressing the remaining projected deficit will require additional legislation and the cooperation of a range of stakeholders, and include changes in the following areas: reduction of retiree health benefits funding; reassessment of the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS) obligations; delivery frequency; modernized access to postal services; workforce flexibility; pricing flexibility; expansion of products and services; and oversight.

The Postal Service's status as a self-supporting entity within the federal government presents unique requirements and restrictions, but also 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 government service and 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 contract 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 it faces and the legislative changes that would help ensure the availability of sufficient liquidity on September 30, 2011, and beyond. There can be no assurance that the requested adjustments to the PSRHBF payment schedule, or any other legislative changes, will be made in time to impact 2011, 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, 2010, and September 30, 2010:

Debt to Federal Financing Bank Payments Due by Fiscal Year (Dollars in millions) Maturity	Debt Type	December 31, 2010 Balance	 Rate	September 30, 2010 Balance	 Rate
		(Unaudited)		(Audited)	
December 30, 2010	Fixed rate-payable at maturity	$ -	- %	$ 1,900	0.282 %
January 13, 2011	Fixed rate-payable at maturity	500	0.257	-	-
October 20, 2011	Fixed rate-payable at maturity	1,300	0.338	-	-
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
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
July 15, 2011	Floating rate [2]	1,000	0.258	1,000	0.206
July 15, 2011	Floating rate [2]	700	0.258	700	0.206
July 15, 2011	Floating rate [2]	500	0.258	500	0.206
Revolving	Overnight revolving credit line [1]	400	0.176	-	-
Revolving	Short-term revolving credit line [1]	3,400	0.206	3,400	0.206
Total debt		$ 12,300		$ 12,000	
Less: Current portion of debt		7,800		7,500	
Long-term portion of debt		$ 4,500		$ 4,500	

[1] Current revolving credit agreements with FFB expire on May 3, 2011.

[2] Floating Rate Note — Repurchasable at par and the interest rate resets on January 15 and April 15.

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 has two credit lines with the FFB. 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.

The Postal Service is limited by statute to net annual debt increases of $3 billion. Total debt cannot exceed $15 billion. For 2011, the amount of any additional borrowing is constrained by both the annual increase and total debt ceiling limitations to $3 billion.

Scheduled annual principal maturities of debt, exclusive of capital leases, subsequent to December 31, 2010, are as follows:

Scheduled Principal Repayments		
Payments Due by Fiscal Years (Dollars in millions)		
2011	$	6,500
2012		1,300
2013		-
2014		300
2015		-
After 2015		4,200
Total Debt	$	12,300

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 months ended December 31, 2010 and 2009 was not significant. Impairment charges were not significant in the three months ended December 31, 2010, and 2009.

During the three months ended December 31, 2009, the Postal Service received from the General Services Administration under the provisions of the *American Recovery and Reinvestment Act of 2009 (P.L. 111-5)*, approximately 2,700 new fuel-efficient vehicles in exchange for the same number of vehicles then in the fleet. The excess of the fair value of the vehicles received over the fair value of the vehicles traded-in of $39 million was recorded as an additional non-cash capital contribution by the U.S. government.

Note 5 – Leases and Capital Commitments

LEASES

At December 31, 2010, future minimum payments on non-cancellable operating and capital leases were as follows:

Lease Obligations Payments Due by Fiscal Years (Dollars in millions)	Operating	Capital
2011	$ 590	$ 75
2012	734	102
2013	682	96
2014	624	91
2015	566	88
After 2015	4,516	370
Total Lease Obligations	$ 7,712	$ 822
Less: Interest		268
Total Capital Lease Obligations		$ 554
Less: Current Portion of Capital Lease Obligations		54
Long-term Portion of Capital Lease Obligations		$ 500

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

Rental expense for the quarters ended December 31, 2010 and 2009, was as follows:

Rental Expense (Dollars in millions)	Three Months Ended December 31, 2010	 2009
Non-cancellable Real Estate Leases	$ 251	$ 240
GSA Facilities Leases*	10	10
Equipment and Other Short-term rentals	70	55
Total Rental Expense	$ 331	$ 305

*General Services Administration; leases subject to 120-day cancellation notice.

CAPITAL COMMITMENTS

At December 31, 2010, commitments to acquire capital items were $1,150 million, compared to $1,315 million at September 30, 2010. The following table summarizes capital commitments at December 31, 2010:

Capital Commitments (Dollars in millions)	
Mail Processing Equipment	$ 682
Building Improvements	348
Postal Support Equipment	60
Construction and Building Purchase	21
Retail Equipment	33
Vehicles	6
Total Capital Commitments	$ 1,150

Note 6 – Contingent Liabilities

Contingent liabilities consist primarily of claims and suits resulting from labor, equal employment opportunity and environmental issues, property damage claims, injuries on postal properties, issues arising from postal contracts, personal claims and traffic accidents.

Each quarter, new claims and litigation are evaluated for the probability of an adverse outcome. If a claim is deemed probable of an unfavorable outcome and the amount of potential settlement is estimable, a liability for the loss is recorded. Prior claims and litigation are also reviewed quarterly and, when necessary, the liability is adjusted for settlements or revisions to prior estimates. No individual claim currently assessed as probable of an unfavorable outcome is material to the financial statements when taken as a whole. The following table summarizes contingent liabilities provided for in our financial statements at the indicated dates:

Contingent Liabilities (Dollars in millions)	December 31, 2010	September 30, 2010
	(Unaudited)	(Audited)
Labor	$ 207	$ 189
Equal Employment Opportunity	49	49
Environmental	40	40
Tort	38	35
Contractual	12	1
Total Contingent Liabilities	$ 346	$ 314

Based on currently available information, adequate provision has been made for probable losses arising from claims and lawsuits. The current portion of this liability of $119 million at December 31, 2010, and $114 million at September 30, 2010, is included on the Balance Sheets under the heading “Trade payables and accrued expenses”. The noncurrent portion of this liability at December 31, 2010, was $227 million and $200 million at September 30, 2010. These amounts are included in “Contingent liabilities and other” on the Balance Sheets.

The Postal Service also has other claims and lawsuits which it deems reasonably possible of an unfavorable outcome which range from $1.4 billion to $1.6 billion at December 31, 2010. No provisions for these possible losses are accrued or included in the financial statements.

Note 7 – Health Benefits Programs

CURRENT EMPLOYEES

Substantially all career employees of the Postal Service 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 various participating government agency employers. The Postal Service’s 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 21% of the premium costs in Quarter I, 2011, and 19% in Quarter I, 2010. The Postal Service paid the remaining employee health care premiums which was $1,299 million in Quarter I, 2011, compared to $1,285 million in Quarter I, 2010. These expenses are included in “Compensation and benefits” in the Statements of Operations.

RETIREES

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. Because the Postal Service cannot direct the costs, benefits or funding requirements for the federally-sponsored plan, it accounts for these retiree costs using multiemployer plan accounting rules and records expense when payments are due to OPM. Employer premium expense for retiree health benefits expense for Quarter I, 2011, and Quarter 1, 2010 was $577 million and $522 million, respectively.

In addition to payments to OPM for the Postal Service share of FEHBP retiree premiums, P.L. 109-435 established the PSRHBF, which requires pre-funding of retiree premiums. The schedule of these pre-funding payments is as follows:

Postal Service Retiree Health Benefit Fund Commitment (Dollars in millions by fiscal year)	P.L. 109-435 Requirement
2011	$ 5,500
2012	5,600
2013	5,600
2014	5,700
2015	5,700
2016	5,800
Total Retiree Health Benefit Fund Commitment	$ 33,900

PSRHBF expense was $1,375 million for both Quarter I, 2011, and Quarter I, 2010.

The PSRHBF will be used, commencing in 2017, to pay the Postal Service share of health insurance premiums for current and future Postal Service retirees. Beginning in 2017, the Postal Service will also be required to fund the actuarially determined normal cost.

The law also requires that, not later than 2017, OPM 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 scheduled timing and amounts of PSRHBF payments can be changed with the passage of a new law or amendment of an existing law. The Postal Service has asked Congress to restructure the payment schedule for 2011 and future years. There can be no assurance that Congress will restructure any of the scheduled PSRHBF payments.

Note 8 – Retirement Programs

Employees participate in one of three pension programs based upon the starting date of employment with the federal government. Employee contributions are made to the CSRS, the Dual CSRS/Social Security (Dual/CSRS) or 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.

P.L. 109-435 suspends until 2017 the employer contribution 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. The Postal Service made contributions of 11.7% of base salary for current FERS employees in Quarter I, 2011, and 11.2% of base salary in Quarter I, 2010.

Retirement expense for Quarter I, 2011, was $1,493 million compared to $1,469 million for Quarter I, 2010, and 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 Department of Labor’s (DOL) 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.

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 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. The payout of the estimated liability will, in some cases, be for the rest of the lives of the claimants. Because the FECA benefit structure is often superior to benefits available under normal retirement, the payout of the estimated liability will, in some cases, be for the rest of the lives of the claimants.

The liability for estimated future workers' compensation payments is recorded at its present value. 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 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, 2010	September 30, 2010	December 31, 2009
Compensation Claims Liability:			
Discount Rate	3.6%	2.9%	5.0%
Wage inflation	2.9%	2.9%	2.9%
Medical Claims Liability:			
Discount Rate	3.6%	3.0%	4.5%
Medical Inflation	7.4%	7.4%	4.4%

The estimation of the liability is highly sensitive to changes in inflation and discount rates. An increase of 1% in the discount rate would decrease the December 31, 2010 liability and Quarter I, 2011 expense by approximately $1,066 million. A decrease of 1% in the discount rate would increase the December 31, 2010 liability and Quarter I, 2011 expense by $1,300 million.

At December 31, 2010, the present value of the liability for future workers' compensation payments is $11,027 million, compared to $12,589 million at September 30, 2010, a decrease of $1,562 million. The majority of the decrease is due to the annual payment to the DOL of $1,115 million, which was made in October 2010. The current portion of the liability is $1,185 million at December 31, 2010, compared to $1,115 million at September 30, 2010.

Including the $820 million and $193 million expense reduction attributable to changes in the discount rate for the periods ended December 31, 2010 and 2009, workers' compensation expenses are as follows:

Workers' Compensation Expense	Three Months Ended December 31,	
(Dollars in millions)	2010	2009
Impact of discount & inflation rate changes	$ (820)	$ (193)
New cases and actuarial revaluation of existing cases	373	365
Administrative fee	15	14
Total Workers' Compensation Expense	$ (432)	$ 186

In the three months ended December 31, 2010, the Postal Service experienced a $16 million, or 15.2%, increase in medical claims payments, and a $32 million, or 17.8%, increase in compensation claim payments compared to the three months ended December 31, 2009. 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.

Note 10 – Fair Value Measurements

The Postal Service assumes that the carrying value of current assets and liabilities approximates fair values. The Postal Service also has noncurrent 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 as promulgated by the Financial Accounting Standards Board. 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 long-term 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 long-term U.S. Treasury securities that have a similar maturity, a Level 2 input.

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

Fair Value of Long-Term Financial Assets and Liabilities	December 31, 2010		September 30, 2010	
(Dollars in millions)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(Unaudited)		(Audited)	
Revenue Forgone	$ 348	$ 441	$ 360	$ 490
Total Long-Term Financial Assets	348	441	360	490
Long-Term Portion of Debt	4,500	4,473	4,500	4,815
Total Long-Term Financial Liabilities	$ 4,500	$ 4,473	$ 4,500	$ 4,815

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 value of the long-term portion of debt calculated using Level 3 inputs is shown below:

Reconciliation of Fair Value of Level 3 Instruments (Dollars in millions)		
Debt		
Balance at September 30, 2010	$	4,815
Repayment of Debt		-
Unrecognized Gain		(342)
Balance at December 31, 2010	$	4,473

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.

Note 11 – Revenue Forgone

Revenue forgone is an appropriation which reimburses the Postal Service for the cost of statutorily-required free and reduced rate mailing services to certain groups. During the three months ended December 31, 2010, the Postal Service recognized revenue of $26 million, including $6 million of imputed interest income, from these appropriations, compared to $22 million, including $6 million of imputed interest, during the same period last year.

The related receivable was $379 million at December 31, 2010, and $449 million at September 30, 2010. The current portion of this receivable was $31 million at December 31, 2010, and $89 million at September 30, 2010, 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

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, 2010, such as economic conditions, regulatory and legislative changes, changes in actuarial assumptions, and known and anticipated trends believed relevant to future operations. Some of these factors may cause actual results to differ materially from those currently contemplated. Operating results for the three-month period ended December 31, 2010, are not necessarily indicative of the results that may be expected for the year ending September 30, 2011. This report should be read in conjunction with the Annual Report on Form 10-K for the year ended September 30, 2010. As in the Annual Report on Form 10-K, all references to years, unless otherwise stated, are to the fiscal year beginning October 1 and ending September 30. All references to quarters, unless otherwise noted, are to quarters within fiscal years 2011 and 2010.

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 nine 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 unreasonably vary 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 3% of operating revenue; however, advertising mail in general accounts for more than half of our volume. Prices and fees are subject to a review process by the independent Postal Regulatory Commission (PRC).

P.L. 109-435 divides postal services into two broad categories: market-dominant and competitive. Market-dominant services include, but are not limited to, First-Class Mail, Standard Mail, Periodicals and certain Package Services. Price increases for these services are subject to a price cap 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. 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 and community post offices, retail establishments that sell postal products as a convenience for their customers, and on-line at *www.usps.com*. Mail deliveries are made to over 150 million city, rural, Post Office box, and highway delivery points. Operations are conducted primarily in the domestic market, with international operations representing approximately 4% of total revenue.

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 comports with the management and structure of expense incurrence within the organization.

The labor force is primarily represented by the American Postal Workers Union (APWU), National Association of Letter Carriers (NALC), National Postal Mail Handlers Union (NPMHU), and National Rural Letter Carriers Association (NRLCA). More than 85% of career employees are covered by collective bargaining agreements. The APWU and the NRLCA contracts expired on November 20, 2010, and the NPMHU and NALC contracts expire in November 2011. If an agreement is not reached during negotiations, a federal mediator is appointed. Impasses in collective bargaining negotiations may ultimately be resolved through arbitration. As of the date of this report, the Postal Service is continuing the negotiation process with the APWU and NRLCA.

By law, we consult with management organizations representing most of the employees not covered by collective bargaining agreements. We participate in federal employee benefit programs for retirement, health and workers' compensation benefits.

The United States 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 *www.usps.com*.

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 may also be found on our website. 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 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. The Postal Service maintains a thorough process to review its 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, 2010. Management discusses the development and selection of accounting policies and estimates with the Audit and Finance Committee of the Board of Governors.

In Quarter I, 2011, the Postal Service improved the estimation technique employed to estimate deferred revenue-prepaid postage for Forever Stamps. During the quarter, certain usage data indicated that a refinement of the estimation process for Forever stamp usage was necessary. As a result of this enhancement, deferred revenue-prepaid postage was increased by $170 million. The change is accounted for as a change in accounting estimate, and is therefore reflected in operating results as a decrease to revenue in Quarter I, 2011.

Results of Operations

Losses in First-Class Mail volume resulting from the weak economy and electronic diversion of mail continue to significantly impact our operating revenue. Although significant efforts have been made to contain costs to offset declining volume over the past few quarters, the impact of the large PSRHBF expenses has greatly affected our ability to become profitable.

Our net loss was $329 million for the three months ended December 31, 2010, compared to a net loss of $297 million for the same period last year.

Key Operating Statistics	Three Months Ended December 31,			
(Dollars & pieces in millions)		2010		2009
Operating Revenue	$	17,877	$	18,355
Operating Loss	$	(290)	$	(263)
Net Loss	$	(329)	$	(297)
Average Daily Volume		618		609

Net losses for the three months ended December 31, 2010 and 2009 include a reduction to expenses due to discount and inflation rate changes that decreased the workers' compensation expense by $820 million and $193 million for the three months ended December 31, 2010 and 2009, respectively. 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. Over the course of the three years ended September 30, 2010, yields on Treasury securities generally trended downward, corresponding with the weakness in the economy. As a result, the present value of our workers' compensation liability increased substantially for those fiscal years, although actual cash outflows have not been impacted. However, for the quarters ended December 31, 2010 and 2009, interest rates increased from the rates used at the end of the preceding quarters and, as a consequence, the present value of our workers' compensation liability decreased. These changes in the present value of the workers' compensation liability are recorded as operating expenses or reductions of operating expenses.

Further, we have incurred expenses for retiree health benefits of $1,375 million for the quarters ended December 31, 2010 and 2009, for the legally-mandated pre-funding payments to the PSRHBF at each year-end.

Because expenses related to discount and inflation rate changes and legislative mandates 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 ongoing business activities when these factors are not considered, and reconciles this amount to our GAAP net loss.

	Three Months Ended December 31,			
(Dollars in millions)		2010		2009
Net Loss	$	(329)	$	(297)
Impact of:				
Discount & Inflation Rate Changes on Workers' Compensation		(820)		(193)
PSRHBF Expense		1,375		1,375
Income before Impact of Discount and Inflation Rate Changes and PSRHBF Expense	**$**	**226**	**$**	**885**

Without the impact of these non-controllable factors, net income would have been $226 million for the three months ended December 31, 2010, compared to $885 million for the three months ended December 31, 2009.

For the three months ended December 31, 2010, operating revenue was $17,877 million, compared to $18,355 million for the three months ended December 31, 2009, a decrease of $478 million, or 2.6%. This reduction includes a $170 million reduction of revenue as a result of refining the estimation methodology for deferred revenue-prepaid postage related to Forever Stamps. The continuing shift in our Mailing Services sales mix away from First-Class Mail, our most profitable service, resulted in a decline in revenue despite an increase in total mail volume. For the three months ended December 31, 2010, Mailing Services revenue decreased by $520 million, or 3.3%, on a volume increase of 697 million pieces, or 1.5%, compared to the same period in 2009. Shipping Services revenue of $2,575 million increased $42 million, or 1.7% for the three months ended December 31, 2010 compared to the same period last year.

Operating expenses were $18,167 million for the three months ended December 31, 2010, compared to $18,618 million for the same period last year, a decrease of $451 million, or 2.4%. However, excluding the impact of the $820 million and $193 million workers' compensation expense reductions for the three months ended December 31, 2010 and 2009, respectively, operating expenses would have increased $176 million, or 0.9%. Compensation and benefit expenses decreased by $76 million, or 0.6%. Retiree health benefits expense increased $55 million, or 2.9%, reflecting a larger number of retirees and higher insurance premiums. Workers' compensation expenses increased $9 million, or 2.4%, when fair value adjustments are excluded. Transportation expenses increased by $148 million, or 9.8%, while other expenses increased by $40 million, or 1.8%, for the three months ended December 31, 2010, compared to the three months ended December 31, 2009.

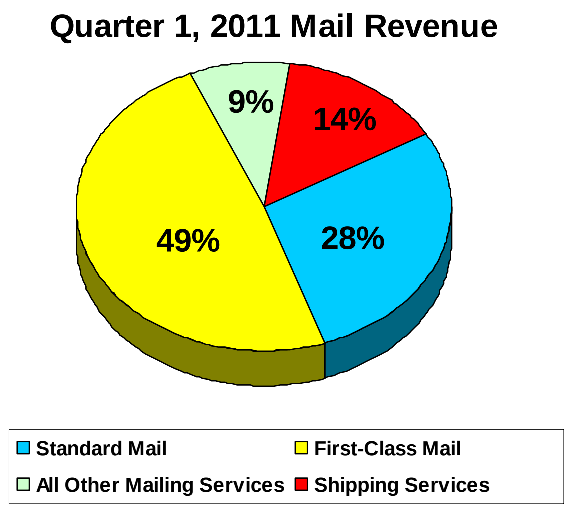
Revenue and Volume

There were no price increases for Mailing Services in 2010. Our Shipping Services prices increased an average of 3.3% in January 2010.

Revenue (Dollars in millions)	Three Months Ended December 31, 2010	Three Months Ended December 31, 2009
First-Class Mail	$ 8,766	$ 9,310
Standard Mail	4,995	4,662
Periodicals	480	492
Package Services	431	412
Other Mailing Services*	630	946
Total Mailing Services	15,302	15,822
Total Shipping Services	2,575	2,533
Total Operating Revenue	$ 17,877	$ 18,355

*Includes Certified Mail, Return Receipts, PO Boxes, Insurance, and 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.



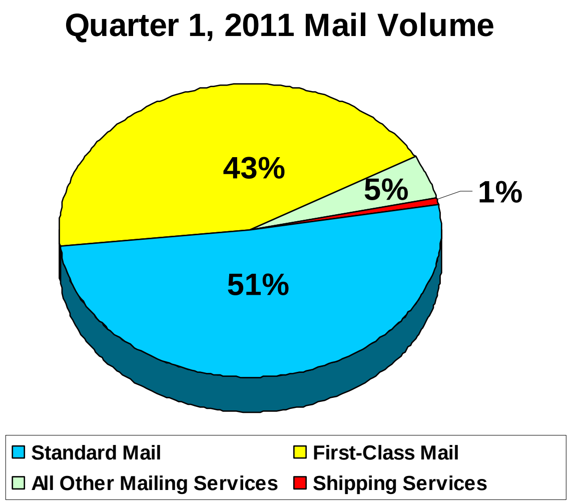
Although the economic recession has ended, its lingering impact, including the sluggish economic growth following its end, continues to affect the Postal Service. In addition, and possibly more importantly, there appears to have been a structural change in the way businesses and consumers use the mail. As a result, although total mail volume increased a modest 707 million pieces, or 1.5%, for Quarter I, 2011, compared to Quarter I, 2010, the volume levels remain well below the 2006 peaks. Much of the growth in volume is being generated by Standard Mail, which has lower profit margins than First-Class Mail.

Mailing Services revenue decreased by $520 million, or 3.3%, in Quarter I, 2011, compared to Quarter I, 2010, on a volume increase of 697 million, or 1.5%. The decline in revenue on an increase in volume was due to the fact that Standard Mail, which generates much less revenue per piece than a piece of First-Class Mail, grew while First-Class volume continued to decline. Also impacting the decrease is a $170 million reduction of revenue as a result of refining the estimation methodology for deferred revenue-prepaid postage related to Forever Stamps. For Quarter I, 2011, Shipping Services revenue of $2,575 million increased $42 million, or 1.7%, on a volume increase of 10 million pieces.

Mail Volume by Type (Pieces in millions)	Three Months Ended December 31, 2010	2009
First-Class Mail	19,989	21,186
Standard Mail	23,757	21,867
Periodicals	1,846	1,871
Package Services	186	178
Other Mailing Services*	157	136
Total Mailing Services	45,935	45,238
Total Shipping Services	422	412
Total Mail Volume	46,357	45,650

* Includes US Postal Service Mail and Free Matter for the Blind

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



MAILING SERVICES

Despite an increase of 693 million pieces, or 1.6%, for First-Class Mail and Standard Mail combined as compared to the same period last year, revenue dropped by $211 million, or 1.5%, as the product mix shifted significantly. The volume of First-Class Mail was 43.1% of total mail volume in Quarter I, 2011, compared to 46.4% of total volume in Quarter I, 2010; this resulted in a revenue decrease of $544 million. The decrease in First-Class mail volume reflects the continued migration of First-Class Mail to electronic alternatives. Standard Mail was 51.2% of mail volume in Quarter I, 2011, compared to 47.9% in Quarter I, 2010. The Standard Mail growth offset $333 million of the $544 million revenue loss from First-Class Mail. The Standard Mail increase did not fully offset the First-Class Mail revenue loss since the revenue per piece of Standard Mail is much lower than a piece of First-Class Mail.

First-Class Mail revenue of $8,766 million decreased $544 million, or 5.8%, in Quarter I, 2011, on a volume decline of 1,197 million pieces, or 5.7%, compared to the same period last year. Revenue from single-piece First-Class letters and cards declined $347 million, or 9.2%, for Quarter I, 2011, compared to Quarter I, 2010. While price has some effect on First-Class Mail volume, the economy and electronic diversion are the primary drivers behind the volume decline. We anticipate any positive impacts of the economic recovery on single-piece First-Class Mail will be largely offset by the continuing technology-driven decline in single-piece First-Class Mail.

Standard Mail revenue of $4,995 million increased $333 million, or 7.1%, in Quarter I, 2011, as volume increased 1,890 million pieces, or 8.6%, compared to the same period last year**.** Standard Mail volume, which had been significantly impacted by the decline in advertising spending during the recent recession, rebounded as advertisers ramped up efforts as the recession receded and the holiday season approached. We expect that the volume of advertising mail will continue to increase, relative to 2010, as the economy continues to slowly improve. However, we expect the rate of increase to be more modest than in previous post-recessionary periods.

Revenue from Periodicals decreased $12 million, or 2.4%, in Quarter I, 2011, from the same period last year, as volume decreased 25 million pieces, or 1.3%. Trends in hard copy reading behavior have been depressing this segment for years and are not expected to rebound as e-readers and electronic content proliferates. On a positive note, the average weight per piece for Periodicals increased by 2.8%, reflecting an increase in the number of advertising pages.

Package Services revenue increased $19 million, or 4.6%, in Quarter I, 2011 compared to Quarter I, 2010, as volume increased 8 million pieces, or 4.5%, in the same period. The increase in volume in the package industry reflects the improved state of the economy.

SHIPPING SERVICES

Shipping Services revenue increased $42 million, or 1.7%, in Quarter I, 2011, compared to the same period last year, as volume increased 10 million pieces, or 2.4%. The volume increases in Shipping Services are indicative of the early stages of economic recovery. The subgroups within Shipping Services showed mixed results as some increased and others experienced decreases.

Additional discussion on volume and revenue projections can be found in the "Outlook" discussion later in this document. Detailed data on Mailing Services volume and revenue may be found in the Quarterly Revenue, Pieces and Weight reports on www.usps.com/financials/rpw.

Operating Expenses – Compensation and Benefits

Compensation and benefits expense for the three months ended December 31, 2010, was $12,716 million, which is $76 million, or 0.6%, less than the three months ended December 31, 2009. Despite a reduction of 6.4 million work hours, or 2.1%, from the same period last year, the savings from the work hour reductions were partially offset by an average hourly wage increase of 2.3% and an increase in total retirement and health benefits expense of 1.4%.

Compensation and Benefits	Three Months Ended December 31,	
(Dollars in millions)	2010	2009
Compensation	$ 9,796	$ 9,892
Retirement	1,493	1,469
Health Benefits	1,299	1,285
Other	128	146
Total	$ 12,716	$ 12,792

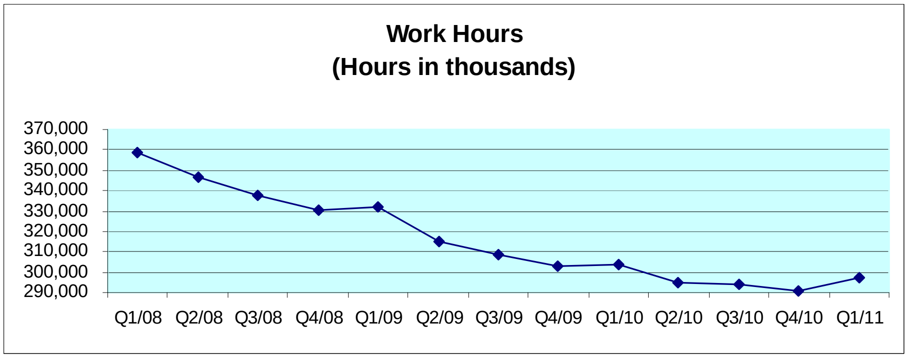
Compensation expense decreased by $96 million, or 1.0%, for the quarter ended December 31, 2010, compared to the same period in 2009. For the three months ended December 31, 2009, the Postal Service incurred $112 million of expenses related to incentives for approximately 7,400 APWU and NPMHU employees who elected to retire or resign from the Postal Service. There was no comparable expense in the three months ended December 31, 2010. Without the impact of the severance incentive, compensation expense would have increased $16 million, or 0.2%, despite the 6.4 million, or 2.1%, decrease in work hours used in the three months ended December 31, 2010, compared to the same period last year.

WORK HOURS

The Postal Service reduced work hours in the quarter ended December 31, 2010, by 6.4 million hours, or 2.1%, compared to the same period of last year, which represents a reduction of approximately 3,600 full time equivalent employees. Included in total work hours are overtime hours, which increased by 3.2 million hours, or 14.9%, compared to the same period of last year. The overall work hour reduction was achieved even though the number of delivery points increased by approximately 559,000 during the twelve months ended December 31, 2010. Labor intensive functions such as mail processing, customer services operations, and city delivery had the largest work hour reductions. The decrease in hours was especially pronounced in the mail processing and customer services functions which each had drops of 2.5 million work hours, or 4.1% and 5.9%, respectively. Partially offsetting these declines was an approximately one million hour increase in rural delivery hours, as 53% of the growth in delivery points was in this category. We have targeted the elimination of over 40 million work hours this year. This is in addition to reductions of 240 million hours achieved in the prior three years.

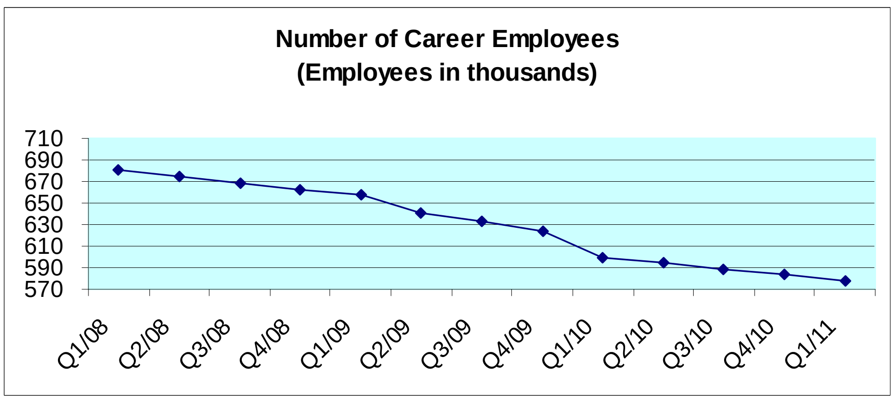
Work Hours by Function	Three Months Ended December 31,	
(Work Hours in thousands)	2010	2009
City Delivery	102,762	104,344
Mail Processing	58,363	60,841
Customer Services Operations	39,569	42,058
Rural Delivery	44,493	43,535
Postmasters	14,665	14,583
Other, including Plant, Operational Support, Retail, and Administrative	37,274	38,161
Total Work Hours	297,126	303,522

Historically, work hours increase in the first quarter of the fiscal year as volume increases for the fall and holiday mailing season. The following table summarizes quarterly work hours since 2007:



EMPLOYEE WORKFORCE

The number of career employees at December 31, 2010, was 578,292, a reduction of 5,616 employees during Quarter I, 2011. Since December 31, 2007, the number of career employees has been reduced by 102,721, or 15.1%. This reduction has been accomplished primarily through attrition and retirement incentives. The following table depicts the number of career employees since 2007:



RETIREMENT AND HEALTH BENEFITS EXPENSE – CURRENT EMPLOYEES

Despite a decrease in the number of employees, during Quarter I, 2011, retirement expense was $1,493 million compared to $1,469 million for the same period last year, an increase of $24 million, or 1.6%. The change is due to an increase in the employer contribution rate for the FERS retirement program to 11.7% of eligible payroll in 2011, up from 11.2% in 2010. We have filed an appeal with the Board of Actuaries of the Civil Service Retirement System requesting a change in the rate being charged to fund our FERS obligation. We requested the change because the Postal Service's FERS obligation, as determined by the Office of Personnel Management (OPM), is overfunded by $6.9 billion as of the most recent valuation date (See our Form 10-K Report dated September 30, 2010, for further details regarding the analysis of the funding of the FERS obligation).

In January 2010, the U.S. Postal Service Office of Inspector General (OIG) released its report *The Postal Service's Share of CSRS Pension Responsibility.* According to this report, the Postal Service has, over many years, overfunded its portion of the obligation of the CSRS fund by approximately $75 billion. At our request, an independent actuary retained by the PRC subsequently determined that the Postal Service had overfunded its CSRS pension obligation by $50-55 billion. A similar issue is the projected overfunding of the Postal Service's FERS obligation, as noted by the OIG in their August 16, 2010 report. Using the long-term economic assumptions of OPM's Board of Actuaries, the FERS obligation was overfunded by $6.9 billion at September 30, 2009. The Postal Service continues to work with all interested parties to resolve these matters. See "Legislative Update" below.

Health benefits expense of $1,299 million increased $14 million, or 1.1%. This increase is attributed to higher health care premiums, which more than offset the impact of decreases in the number of employees and the Postal Service's share of the health care premiums, which declined from 81% for the three months ended December 31, 2009, to 79% for the three months ended December 31, 2010.

Operating Expenses – Retiree Health Benefits

P.L. 109-435 included a 10 year, $55,800 million payment schedule that requires payment of $5,500 million into the PSRHBF in 2011. The Postal Service is recognizing the $5,500 million in equal amounts throughout the year, at a rate of $1,375 million per quarter, the same quarterly amount recognized in 2010. Although P.L. 109-435 dictates the funding requirements through 2016, the amounts to be funded and the timing of funding can be changed at any time with the passage of a new law, or amendment of an existing law. In 2011, the Postal Service is continuing its efforts to seek restructuring of the $5.5 billion 2011 payment and the future years' payments due to the PSRHBF. There can be no assurance that the restructuring of any of these payments will occur.

The components of retiree health benefits expense for the three months ended December 31, 2010 and 2009 are as follows:

Retiree Health Benefits	Three Months Ended December 31,	
(Dollars in millions)	2010	2009
Postal Service Retiree Health Benefit Fund	$ 1,375	$ 1,375
Retiree Health Benefit Premiums	577	522
Total	$ 1,952	$ 1,897

Expenses for retiree health benefit premiums increased $55 million, or 10.5%, from the same period last year. The major drivers of retiree health benefit premium expense are the number of current participants on the rolls and premium costs of the plans they select. As of December 31, 2010, there were 472,256 participants, an increase of 7,806, or 1.7%, compared to the same period last year.

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.

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

We record a liability for the present value of estimated future payments to postal employees, or their qualified survivors, who have been injured through the end of the 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 is often superior to benefits available under normal retirement, the payout of the estimated liability will, in some cases, be for the rest of the lives of the claimants.

The liability for estimated future workers' compensation payments is recorded at its present value. 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. We update inflation and discount (interest) rates as of the date of our financial statements to determine the present value of our 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. An increase of 1% in the discount rate would decrease the December 31, 2010 liability and Quarter I, 2011 expense by $1,066 million. A decrease of 1% in the discount rate would increase the December 31, 2010 liability and Quarter I, 2011 expense by $1,300 million.

Changes in the workers' compensation liability are primarily attributable to the combined impact of changes in the discount and inflation rates, and, to a lesser extent, routine changes in actuarial estimation, new compensation and medical cases and the progression of existing cases. The impact of the changes in discount and inflation rates accounted for $820 million and $193 million of the decrease in the December 31, 2010 and 2009 liability, respectively.

Beginning in Quarter III, 2009, we experienced a significant change in the discount and inflation rates used to estimate the workers' compensation liability. The economic recession that began in December 2007 and corresponding response by the Federal Reserve resulted in interest rates declining significantly. GAAP requires us to use discount rates based on the best available information at the measurement (financial statement) date. Accordingly, discount rates used in estimating the present value of the workers' compensation liability decreased significantly for both 2009 and 2010. However, for the quarters ended December 31, 2010 and 2009 interest rates increased from the rates used at the end of the preceding quarters.

The inflation and discount rates used to estimate our workers' compensation liability and related expense are shown in the following table.

Workers' Compensation Liability Inflation and Discount Rates	December 31, 2010	September 30, 2010	December 31, 2009
Compensation Claims Liability:			
Discount Rate	3.6%	2.9%	5.0%
Wage inflation	2.9%	2.9%	2.9%
Medical Claims Liability:			
Discount Rate	3.6%	3.0%	4.5%
Medical Inflation	7.4%	7.4%	4.4%

At December 31, 2010, the present value of the liability for future workers' compensation payments is $11,027 million, compared to $12,589 million at September 30, 2010, a decrease of $1,562 million. The majority of the decrease is due to the annual payment to the DOL of $1,115 million, which was made in October, 2010. The current portion of the liability is $1,185 million at December 31, 2010, compared to $1,115 million at September 30, 2010.

Including the $820 million and $193 million expense reduction attributable to changes in the discount and inflation rates for the periods ended December 31, 2010 and 2009, workers' compensation expenses are as follows:

Workers' Compensation Expense	Three Months Ended December 31,	
(Dollars in millions)	2010	2009
Impact of discount & inflation rate changes	$ (820)	$ (193)
New cases and actuarial revaluation of existing cases	373	365
Administrative fee	15	14
Total Workers' Compensation Expense	$ (432)	$ 186

In Quarter I, 2011, we experienced a $16 million, or 15.2%, increase in medical claims payments and a $32 million, or 17.8%, increase in compensation claim payments compared to Quarter I, 2010. A portion of the increase in claim payments is due to an initiative to re-evaluate the eligibility of employees injured in past periods for limited duty work assignments. 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 and air transportation costs. Transportation expenses were $1,661 million, an increase of $148 million, or 9.8%, for Quarter I, 2011, compared to $1,513 million in the same period last year.

Transportation Expense (Dollars in millions)	Three Months Ended December 31, 2010	2009
Highway	$ 862	$ 821
Air	713	635
Other	86	57
Total Transportation Expense	$ 1,661	$ 1,513

Highway transportation expenses were $862 million in Quarter I, 2011, an increase of $41 million, or 5.0%, compared to the same quarter last year. The increase in highway transportation expenses is primarily attributable to an increase in the cost of diesel fuel. Diesel fuel, which makes up approximately 93% of fuel purchased for highway contracts, cost an average of $3.15 per gallon during Quarter I, 2011, compared to $2.74 in Quarter I, 2010, an increase of 15.0%. Gasoline prices increased $0.27 per gallon, or 10.3%, compared to the same quarter last year, with the cost of a gallon of gasoline averaging $ 2.88 during Quarter I, 2011, compared to $2.61 during Quarter I, 2010.

Air transportation expenses of $713 million in Quarter I, 2011, increased by $78 million, or 12.3%, from the same quarter last year. Similar to highway transportation, air transportation expenses were highly influenced by rising fuel prices.

Other transportation expenses of $86 million increased $29 million, or 50.9%, from the comparable quarter of the prior year due primarily to increased international expenses, largely attributable to higher settlement costs for foreign transportation and delivery expense.

Operating Expenses – Other Operating Expense

Other operating expenses of $2,270 million for the three months ended December 31, 2010, increased $40 million, or 1.8%, compared to the three months ended December 31, 2009. All categories of other operating expenses increased, with the exception of Depreciation and Amortization expenses, which decreased $54 million, or 8.6%. During the three months ended December 31, 2009, certain operating leases were reclassified to capital leases which increased the depreciation and amortization expense and reduced the rent expense for that period. No comparable adjustment was made in the three months ended December 31, 2010.

Other Operating Expenses (Dollars in millions)	Three Months Ended December 31, 2010	2009
Supplies and Services	$ 573	$ 549
Depreciation and Amortization	573	627
Rent and Utilities	423	414
Vehicle Maintenance Service	223	199
Information Technology and Communications	137	127
Rural Carrier Equipment Maintenance Allowance	146	132
Other	195	182
Total Other Operating Expenses	$ 2,270	$ 2,230

Supplies and services increased $24 million, or 4.4%, for the three months ended December 31, 2010, due mainly to increased costs associated with the Priority Mail flat rate box program. The $24 million, or 12.1%, increase in Vehicle Maintenance Service is due to increased fuel costs as noted in Transportation above and to increased maintenance expenses on our aging delivery vehicles. Information Technology and Communications increased by $10 million, or 7.9%.

Cash Flows and Liquidity

CASH FLOW ACTIVITY

Cash and cash equivalents totaled $908 million at December 31, 2010, compared to $1,161 million and $758 million at September 30, 2010 and December 31, 2009, respectively. The following table provides a summary of our cash flows for the three-month periods ended December 31:

(Dollars in millions)	Three Months Ended December 31, 2010	2009
Operating activities:		
Net loss	$ (329)	$ (297)
Noncash depreciation and gains on sales	585	605
Changes in assets and liabilities	(441)	(582)
Cash used by operating activities	(185)	(274)
Investing activities:		
Capital expenditures, net of proceeds	(339)	(369)
Cash used by investing activities	(339)	(369)
Financing activities:		
Net change in notes payable	(100)	(975)
Net change in revolving credit line	400	(1,683)
Other	(29)	(30)
Cash provided (used) by financing activities	271	(2,688)
Net Decrease in Cash and Cash Equivalents	$ (253)	$ (3,331)

Operating Activities: Operating activities used $185 million during the three months ended December 31, 2010, compared to $274 million for the three months ended December 31, 2009, a decrease of $89 million. The decrease is primarily due to the amount of postage collected in Quarter I, 2011, compared to Quarter I, 2010. The Postal Service experienced an increase in postage collections despite a decrease in revenue as the result of our revenue recognition policy. In accordance with our policy, revenue is recognized when services are rendered rather than when cash is collected. See our Form 10-K Report dated September 30, 2010 - *Note 3 — Summary of significant accounting policies* for a discussion of these policies.

Investing Activities: Gross capital expenditures decreased 13.9% during the first three months of 2011, compared to the same period last year, as spending continued to decrease due to efforts to conserve cash.

Financing Activities: In addition to the cash generated by operations, the Postal Service uses credit lines and notes payable to the FFB to help fund operations. During the three months ended December 31, 2010, we increased drawings on our credit lines by $400 million to fund operations and issued $1,800 million of new notes payable to repay the $1,900 million note which matured during the quarter. In contrast, in Quarter I, 2010, we repaid $975 million of floating rate notes and reduced draw downs of the revolving credit line by $1,683 million. We were able to repay more debt in Quarter I, 2010, compared to the same period in 2011, because we started the quarter with $4.1 billion of cash, substantially more than the $1.2 billion this year. This difference is due to the fact that only $1.4 billion was paid for pre-funding Retiree Health Benefits in September 2009, compared to $5.5 billion in September 2010.

LIQUIDITY CHALLENGES

The Postal Service's current financial projections indicate that, as of September 30, 2011, it will have a cash shortfall. In addition, the statutory limit on borrowing will have been exhausted. Without changes in the applicable laws, the Postal Service will be unable to meet all of its financial obligations on September 30, 2011.

The Postal Service had net losses of $329 million and $297 million for the three months ended December 31, 2010 and 2009, respectively. Annual losses were $8,505 million, $3,794 million, and $2,806 million for the years ended September 30, 2010, 2009 and 2008, respectively. The Postal Service had negative cash flow from operations in its first quarter of 2011 and 2010, and also experienced negative cash flow from operations for fiscal years 2010 and

2008. Operating cash flow would have been negative in fiscal year 2009 as well had Public Law 111-68, *Making appropriations for the Legislative Branch for the fiscal year-ending September 30, 2010, and for other purposes* (P.L.111-68), which reduced the required payment to the PSRHBF by $4 billion, not been enacted. P.L. 111-68 did not, however, address future payments to the PSRHBF, including the $5.5 billion pre-funding payment required in September 2011. Even with a continuing mild economic recovery, steps to generate revenue, and stringent cost control efforts, the Postal Service will likely not generate sufficient funds during 2011 to meet all of its projected financial obligations.

By statute, the Postal Service is limited to an annual net increase in debt of $3 billion, and total outstanding debt of $15 billion. The Postal Service has two substantial cash payments scheduled for September and October 2011: $5.5 billion due to the PSRHBF on September 30, 2011; and approximately $1.2 billion due in October 2011 to the DOL for the Postal Service's annual payment on its workers' compensation liability. Based on the cash balance and the remaining borrowing capacity of $2.7 billion at December 31, 2010, along with the projected cash that will be generated by operations in 2011, there will be insufficient cash available to fund these financial obligations absent regulatory and legislative adjustments to some, or all, of these obligations. The legal and/or regulatory consequences to the Postal Service if the PSRHBF or the workers' compensation obligations cannot be fully funded are unknown.

Mail volume has declined by almost 20% since its peak of 213 billion pieces in 2006.The current Postal Service projection indicates that 2011 mail volume will increase by approximately 1.1% over the 2010 volume of 170.6 billion pieces. However, the volume of First-Class Mail, the Postal Service's most profitable product, is expected to decline by 3.0 billion pieces, or 3.8%, in 2011 compared to 2010. First-Class Mail volume decreased by 1.2 billion pieces, or 5.7%, in Quarter 1, 2011, compared to the same quarter for 2010.

In January 2011, the Postal Service filed new Mailing Services prices with the PRC. Price increases are limited to the Consumer Price Index cap, consistent with the *2006 Postal Accountability and Enhancement Act, Public Law 109*-435 (P.L. 109-435) and PRC regulations. The increase, which will become effective in April 2011, is the first increase in Mailing Services prices in almost two years. The price changes, which do not impact the cost of a First-Class stamp, are expected to generate approximately $340 million of revenue in the current fiscal year. In addition, prices for Shipping Services increased by an average of 3.6% in January 2011. If the economic recovery is weaker than anticipated, the rate of diversion from traditional postal services to electronic media accelerates, or other adverse factors impact customers' usage of postal services and products, mail volume and revenues could be less than currently projected.

Personnel costs including compensation and benefits, retiree health benefits (including the PSRHBF requirement), and workers' compensation costs represent approximately 78% of total operating costs. As a result of management initiatives, work hours were reduced 6.4 million hours in the first quarter. This is in addition to reductions of 75 million, 115 million and 50 million work hour reductions in fiscal years 2010, 2009, and 2008, respectively. Although significant actions have been implemented to decrease these personnel costs, many are fixed by statute, regulation, or contract and, therefore, beyond the sole control of management. Wage rates and work rules affecting bargaining employees are contractually negotiated and are fixed for the duration of the labor contract; retirement benefits are determined by law, rather than by management; and health care premium costs continue to rise well above the rate of inflation.

To further reduce costs, in January 2011 the Postal Service announced plans to significantly redesign administrative functions within the organization by reducing the number of Area and District Offices and further decrease the number of administrative, supervisor, and Postmaster positions by approximately 7,500. The redesign, which is expected to be completed by the end of 2011, is anticipated to capture annualized savings of over $700 million starting in 2012.

Despite these efforts, 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. Given these restrictions, Postal Service efforts to positively impact cash flow will likely not be, either individually or in the aggregate, sufficient to avoid a cash shortfall in 2011. Absent significant changes in the economy and regulatory environment, the $15 billion debt ceiling will be reached in September 2011, thereby exhausting the Postal Service's external funding ability. No assurance can be given that Postal Service efforts to secure legislative changes will be successful, or that Congress will enact restructuring legislation in time to impact 2011, or at all.

Even if legislation is enacted to address shorter-term liquidity matters such as the PSRHBF pre-funding payment schedule, the Postal Service still faces longer-term financial stability concerns. To begin the process of addressing these issues, in March 2010 the Postal Service issued its action plan for the next decade, *Ensuring a Viable Postal Service for America*. In this plan, the Postal Service estimated that during the next decade, there could be cumulative financial losses of approximately $238 billion, absent significant operational and legislative changes. The Postal Service further estimated that approximately $123 billion of the projected losses could be addressed and resolved by aggressive management actions within the existing statutory and regulatory structure, assuming the full cooperation of all Postal Service stakeholders. Addressing the remaining projected deficit will require additional legislation and the cooperation of a range of stakeholders, and include changes in the following areas: reduction of retiree health benefits funding; reassessment of the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS) obligations; delivery frequency; modernized access to postal services; workforce flexibility; pricing flexibility; expansion of products and services; and oversight.

The Postal Service's status as a self-supporting entity within the federal government presents unique requirements and restrictions, but also 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 government service and 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 contract 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 it faces and the legislative changes that would help ensure the availability of sufficient liquidity on September 30, 2011, and beyond. There can be no assurance that the requested adjustments to the PSRHBF payment schedule, or any other legislative changes, will be made in time to impact 2011, or at all.

Contractual Obligations

The following table illustrates contractual cash flow obligations in 2011 and future years:

Contractual Obligations	Payments Due by Calendar Year				
(Dollars in millions)	Total	Less than 1 Year	1-3 Years	3-5 Years	After 5 Years
Debt (1)	$ 12,300	$ 7,800	$ -	$ 300	$ 4,200
Interest on debt (1)	2,193	199	308	616	1,070
PSRHBF	33,900	5,500	11,200	11,400	5,800
Capital lease obligations	822	101	196	248	277
Operating leases	7,712	773	1,389	2,163	3,387
Capital commitments (2)	1,150	394	335	175	246
Purchase obligations (2)	4,181	1,757	2,419	5	-
Workers' compensation (3)	18,548	1,185	2,246	2,344	12,773
Employees' leave	2,412	487	203	206	1,516
Total Contractual Obligations	$ 83,218	$ 18,196	$ 18,296	$ 17,457	$ 29,269

(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 $11,027 million is reflected in our Balance Sheet at December 31, 2010.

Fair Value Measurements

As required by authoritative accounting literature, certain fair value disclosures for the quarter ended December 31, 2010 are contained in the Notes to the Financial Statements. We did not recognize gains as a result of valuation measurements during Quarter I, 2011. All recognized losses have been incorporated into our financial statements as of December 31, 2010, and for the three months then ended. See Note 10, *Fair Value Measurements*.

Legislative Update

APPROPRIATIONS

On December 22, 2010, the President signed into law H.R. 3082 (P.L. 111-322), the *Continuing Appropriations Act for fiscal year ending September 30, 2011*. The measure funds the government through March 4, 2011. The law has provided the Postal Service with $102 million for free mail and reduced mail rate for the blind and overseas voters. In addition, it also carries forward the language used since 1983 that requires the Postal Service to provide mail delivery six days a week.

U.S. POSTAL IMPROVEMENT ACT OF 2010

On December 2, 2010, S. 4000, the *U.S. Postal Service Improvements Act of 2010* was introduced in the Senate. The measure addresses a number of areas, including requiring OPM to revalue the Postal Service's surplus in CSRS through 2043 and, between 2011 and 2016, allowing the Postal Service to use any surplus to pay the annual PSRHBF pre-funding requirement. After 2017, the surplus could be used to pay either remaining PSRHBF liability amounts or reduce the Postal Service debt. These actions would be at the discretion of the Postal Service Board of Governors. S. 4000 also directs OPM to determine if a surplus exists in the FERS pension plan. Surplus amounts could be used in ways similar to the CSRS surplus, pursuant to Board approval. The bill requires that an arbitrator consider the financial condition of the Postal Service when making decisions regarding collective bargaining agreements. It encourages increased use of negotiated Service Agreements. It also requires the Postal Service to report, within 90 days of enactment, a strategic plan for consolidation of area and field offices. The Postal Service, in consultation with the PRC, must prepare a report on a plan for co-location of Post Offices at retail facilities. The plan must consider any effects on rural communities when co-locating and seek public input prior to making decisions. The bill also requires the Postal Service and the PRC to appoint a Competition Advocate to oversee contracting issues. It would add new contracting provisions to Title 39 and impose new requirements for delegation of contracting authority, publicizing non-competitive contracts, ethical reviews, and a ban on selected contracts. The Postal Service has concerns about the procurement provisions, which impose Federal Acquisition Regulation (FAR)-like requirements on the Postal Service, which does not follow FAR. In addition, S. 4000 addresses workers' compensation issues for federal and postal retirement eligible employees receiving workers' compensation. The measure was referred to the Senate Committee on Homeland Security and Governmental Affairs. Although this bill expired at the end of the 111th Congress, we expect it to be reintroduced in a similar form in the 112th Congress which began in January 2011.

FEDERAL EMPLOYEES' COMPENSATION REFORM ACT OF 2011

On February 2, 2011, S.261, the *Federal Employees' Compensation Reform Act of 2011,* was introduced. The bill would apply to all Federal and Postal employees currently covered by the Federal Employees' Compensation Act (FECA). S. 261 would require employees receiving FECA benefits to transition to the applicable retirement system when the recipient reaches the retirement age. The bill was referred to the Homeland Security and Governmental Affairs Committee.

Outlook

The financial outlook for the Postal Service remains closely linked to the outlook for the U.S. economy. In the past several years, the American economy experienced its worst economic downturn since the Great Depression and mail revenue and volume fell precipitously.

Economic indicators suggest that the worst is over in terms of the precipitous volume decline the Postal Service has experienced and that revenue and volume should see slight growth in 2011.

In January 2011 the Postal Service announced plans to streamline postal management, improve customer service, and redesign operations. This will continue our efforts to increase service levels, improve Postal Service flexibility and speed, control costs, and meet ever-changing customer needs in the communications marketplace. In addition, we continue to announce new revenue generating initiatives.

However, the financial outlook remains clouded by continuing uncertainty of congressional action regarding the $5.5 billion PSRHBF pre-funding contribution required in 2011, and the continuing need for structural reform.

REVENUE OUTLOOK

While new sales initiatives and price increases may help augment future growth, the economy and electronic diversion continue to be the driving factors determining future revenue and volume. Total mail volume is expected to see slight growth in 2011 and will not likely return to the peak 2006 levels. In 2011, we project that revenue will have slight growth compared to 2010, as Standard Mail and Shipping Services sales increases will be offset by First-Class Mail revenue declines.

In January 2011, the Postal Service filed new Mailing Services prices with the PRC to take effect in April 2011. Price increases are limited to the Consumer Price Index cap, consistent with the P.L. 109-435 and PRC regulations. This is the first pricing increase in Mailing Services in almost two years, but the price changes will not impact the cost of a First-Class stamp. Also on January 2, 2011, prices for Shipping Services increased by an average of 3.6%. In addition, several new initiatives including such items as expansion of simplified addressing for businesses, Priority Mail Regional Rate Boxes, Reply Rides Free, customized cards and the sale of gift cards, have been introduced and are expected to increase revenues.

First-Class Mail volume is expected to continue its long-term decline through 2011, and beyond. Even when employment, consumer spending and capital investment recover, the price increase and the expanding use of the Internet and other electronic means of communication will continue to suppress mail volume growth rates. First-Class single-piece letters have been in decline for more than a decade and are expected to continue to decline in both the short- and long-term.

The outlook for Standard Mail is more positive; however, it may never reach its peak 2007 volume level. We expect growth in Standard Mail revenue and volume over the next few years; however, the profit contribution rate for this service is approximately one-third the contribution rate of First-Class Mail.

Shipping Services revenues and volume, which represent approximately 14% of Postal Service revenue, are expected to increase by several percent in 2011. This entire group is influenced by competitors' prices, which may include fuel surcharges.

EXPENSE OUTLOOK

The Postal Service is aggressively pursuing a plan to reduce total expenses. This includes savings initiatives in operations, administrative, and non-personnel expenses. We are targeting approximately $2 billion in cost savings, including a reduction of over 40 million work hours across the organization in 2011. These work hour reductions will be accomplished by implementing initiatives in mail processing operations to compress mail processing schedules, plant consolidations and the reduction of allied labor. In addition, there are plans to implement Flat Sequencing Systems for City Routes, to standardize the customer service process, and to improve the utilization of highway contract routes for surface transportation.

The benefits obtained from these initiatives, however, may be partially offset by rising fuel prices. Prices have increased more than expected since the beginning of the fiscal year and are now expected to rise at an accelerated rate for the remainder of the year.

In addition, the outlook for the non-cash portion of workers' compensation expenses, which do not impact our operational abilities, cannot be predicted because these changes are largely dependent on the level of interest rates. A 1% increase or decrease in interest rates could decrease or increase workers' compensation expense by approximately $1 billion.

Finally, we are still negotiating new contracts with the APWU and the NRLCA, as the most recent labor agreements expired on November 20, 2010. The financial impact of any new APWU or NRLCA labor contract cannot be determined at this time.

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, such as hedging, 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 2010 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, 2010. 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, 2010, 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

None.

Item 1A – Risk Factors

There were no changes in risk factors from those disclosed in our Annual Report on Form 10-K for the year ended September 30, 2010.

Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds

Not applicable to the United States Postal Service. As an “independent establishment of the executive branch of the United States government” we do not issue stock or other securities.

Item 3 – Defaults Upon Senior Securities

Not applicable to the United States Postal Service. As an “independent establishment of the executive branch of the United States government” we do not issue stock or other securities.

Item 4 – (Removed and Reserved)

Item 5 – Other Information

None.

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, 2011

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

Date: February 9, 2011

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, 2011

/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, 2011

/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, 2010, (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, 2011

/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, 2010 (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, 2011

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