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

# FORM 10-K

**(Mark One)**

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

For the fiscal year ended SEPTEMBER 30, 2014

or

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

For the transition period from ____________ to ____________

Commission file number N/A

# UNITED STATES POSTAL SERVICE

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Washington, D.C.** | **41-0760000** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

**475 L'Enfant Plaza, S.W.**
**Washington, DC 20260**
**(202) 268-2000**
(Address and telephone number, including area code, of registrant's principal executive offices)

**Securities registered pursuant to Section 12(b) of the Act:**

| **Title of each class** | **Name of each exchange on which registered** |
|---|---|
| N/A | N/A |

**Securities registered pursuant to Section 12(g) of the Act:**

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☑

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ☑ No ☐

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. 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 the definitions 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 ☐ Smaller reporting company ☐ Not Applicable ☑

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

The aggregate market value of shares of common stock held by non-affiliates as of September 30, 2014: N/A

The number of shares of common stock outstanding as of December 5, 2014: N/A

Documents Incorporated by Reference: None

# United States Postal Service
## ANNUAL REPORT ON FORM 10-K
## For the Fiscal Year Ended September 30, 2014

# Part I.

## Forward-Looking Statements

From time to time, we make oral and written statements that may constitute "forward-looking statements" rather than historical facts as defined by the Private Securities Litigation Reform Act of 1995. Forward-looking statements contained in this report represent best estimates of known and anticipated trends believed relevant to future operations. However, actual results may differ significantly from current estimates. Certain forward-looking statements are included in this report and use such words as "may," "will," "could," "should," "expect," "believe," "plan," "estimate," "project," "anticipates," "intends" or other similar terminology. These statements reflect current expectations regarding future events and operating performance as of the date of this report.

Important factors that could cause actual results to differ materially from those anticipated in our forward-looking statements include, but are not limited to, those described under *"Risk Factors"* set forth in *Item 1A* of this Annual Report.

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

## Item 1. Business

## General

In accordance with the provisions of the *Postal Reorganization Act*, the United States Postal Service began operations on July 1, 1971, as an "independent establishment of the executive branch of the Government of the United States" with the 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 postal services to our many customers. Within each class of mail service, prices do not vary unreasonably by customer for the level of service provided.

The Postal Service is governed by an eleven-member Board of Governors (the "Board"), of which nine members are independent Governors appointed by the President of the United States with the advice and consent of the U.S. Senate, plus the Postmaster General, who is appointed by the independent members of the Board, and the Deputy Postmaster General, who is appointed by the independent Governors and the Postmaster General.

The Postal Service's governing statute is codified in Title 39 of the United States Code. The *Postal Accountability and Enhancement Act of 2006, Public Law 109-435* ("P.L.109-435") made revisions to the *Postal Reorganization Act* and established the Postal Regulatory Commission ("PRC"), endowing it with regulatory and oversight obligations. In addition, the Postal Service is legally bound by annual *Financial Services and General Government Appropriations* legislation. In accordance with the provisions of this bill, the Postal Service is required to maintain a six-day delivery schedule.

As used herein, except as otherwise indicated by the context, the terms "Postal Service," "USPS," "we" and "us" are used to refer to the United States Postal Service. All references to years in this report, unless otherwise stated, refer to fiscal years beginning October 1 and ending September 30. All references to quarters, unless otherwise stated, refer to fiscal quarters.

## Services

P.L.109-435 classifies postal services into two broad categories: Market-Dominant and Competitive "products;" however, the term "services" is often used in this document for consistency with other descriptions of "services" offered by the Postal Service. Postal Service management uses the following broad service categories to describe and report on the performance of the Postal Service:

> *First-Class Mail* — Letters, postcards or any flat advertisement or merchandise destined for either domestic (up to 13 ounces) or international (up to 4 pounds) delivery. First-Class letters include personal correspondence, bills or statements of account and payments.
>
> *Standard Mail* — Any item, including advertisements and marketing packages, weighing less than 16 ounces that is not required to be sent using First-Class Mail. Standard Mail is typically used for direct advertising to multiple

delivery addresses. Every Door Direct Mail enables customers to prepare direct mailings without names and addresses for distribution to all business and residential customers on individual carrier routes.

*Shipping and Packages* — This category includes: *First-Class Package Service*, a shipping option for high-volume shippers of packages that weigh less than one pound and First-Class Mail parcels for shipment of boxes, thick envelopes or tubes of 13 ounces or less; *Package Services* for merchandise or printed matter, such as library and media mail weighing up to 70 pounds; *Parcels* - Parcel Select, Parcel Return Service and Standard Mail Parcel Services which provide commercial customers with a means of package shipment; *Priority Mail* is offered as a service both within the U.S. and abroad and the domestic offering is a 1–3 day specified (non-guaranteed) delivery service; and *Priority Mail Express* provides an overnight, money-back guaranteed service which includes tracking, proof of delivery and basic insurance up to $100. Priority Mail Express delivery is offered to most U.S. destinations and is available 365 days a year.

*International Mail* — Offered for mail service and the shipping market with individual customer contracts and agreements with other postal administrations. Priority Mail Express International and Priority Mail International services are offered to compete in the eCommerce cross-border business. They provide an affordable option for our retail and business customers for much of their shipping needs to over 180 countries. Global Express Guaranteed is the premier international shipping option that offers reliable, date-certain delivery in 1 to 3 business days to major markets, with a money-back guarantee.

*Periodicals* — Offered for newspaper, magazine and newsletter distribution. This service requires prior authorization by the Postal Service.

*Other services* — This broad category includes: *Post Office Boxes* which provide customers an additional method for mail delivery that is private and convenient. *Money Orders* offer customers a safe, convenient and economical method for the remittance of payments. Postal Service money orders can be purchased at most post offices and can be sent within the U.S. and to some foreign countries. Postal Service money orders are available for any amount up to $1,000 and can be cashed at most post offices or can be deposited or negotiated at financial institutions. *Extra Services* offer a variety of service enhancements that provide security, proof of delivery or loss recovery. These services include: Certified Mail, Registered Mail, Signature Confirmation, Adult Signature and Insurance up to $5,000 and are available online, at post offices or at automated postal centers.

For a discussion of economic and other factors affecting the volume of these services and our actions taken to address these factors, see *Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations- Operating Revenue and Volume*.

## Pricing and Classification

Market-Dominant services include, but are not limited to, First-Class Mail, Standard Mail, Periodicals and certain parcel services. Price increases for these services are generally subject to a price cap by class of mail based on the Consumer Price Index for All Urban Consumers ("CPI-U"). Competitive services, such as Priority Mail, Priority Mail Express, Parcel Select and Parcel Return Service and some types of International Mail have greater pricing flexibility and are commonly referred to as "Shipping and Package Services."

Postal Service prices for Market-Dominant services are set by the Board and reviewed by the PRC for legal compliance. Prices for Market-Dominant services increased an average of 1.7%, 2.6% and 2.1% in January 2014, 2013 and 2012, respectively. Additionally, a temporary exigent price increase of 4.3% was authorized by the PRC effective January 2014, which was assessed as a surcharge. The PRC decision authorizing the 4.3% exigent surcharge dictates that this surcharge shall remain in effect only until an additional $3.2 billion of incremental revenue above what the Postal Service would have otherwise recovered through a CPI-U increase alone is collected. We have filed an appeal with the United States Court of Appeals for the District of Columbia Circuit arguing that the PRC erred in its decision to limit the duration of the exigent increase in the manner that it specified. The outcome of this appeal cannot be determined at this time. Some mailers filed an appeal seeking relief from the PRC's decision to allow any exigent postage increase.

Prices for Competitive services, by law, must cover costs attributable to each service, and must contribute a reasonable share of the institutional costs of the Postal Service, currently 5.5%, as determined by the PRC. Changes in prices for our Competitive market services must be announced at least 30 days prior to the implementation date. Prices for these Competitive services increased an average of 2.4%, 8.1% and 4.6% in January 2014, 2013 and 2012, respectively.

We offer contract prices, rebates, online price reductions and other incentives to encourage customers to increase their volume, which in turn increases Postal Service revenue.

## Reclassification of Certain Postal Services

Periodic reclassifications and expansions of services from Market-Dominant to Competitive, which require approval from the PRC, are necessary to rationalize service offerings. The additional flexibility provided in Competitive services allows us to better offer services that meet customer needs, to increase business for the Postal Service and to allow us to price our products and services competitively within the markets in which we operate.

In 2012, we reclassified certain lightweight commercial parcels previously included in the Market-Dominant category as First-Class Mail Parcels. These parcels were classified as First-Class Package Services and included in Competitive services. In addition, certain Post Office Box services were reclassified from Market-Dominant to Competitive. Also in 2012, Standard Mail parcels used for the fulfillment of customer orders were reclassified as part of Parcel Select which is a Competitive service. The PRC approved the transfer of Standard Post (formerly Parcel Post) and the transfer of First-Class Package International Service from Market-Dominant to Competitive, effective January 27, 2013. In August 2014, additional Post Office Box services were reclassified from Market-Dominant to Competitive.

Information regarding PRC decisions and pending dockets can be obtained on the PRC website: http://www.prc.gov.

## Intellectual Property

We own intellectual property that includes trademarks, service marks, patents, copyrights, trade secrets and other proprietary information and routinely generate intellectual property in the course of developing and improving systems, services and operations. While legal protection for intellectual property and proprietary information is significant to our success, the knowledge, ability and experience of our employees and the timeliness and quality of service we provide are more significant.

## Segment Information

Although P.L.109-435 divides our services into Market-Dominant and Competitive services and we monitor revenue by mail classes and shapes, we operate as a single segment throughout the U.S., its possessions and territories. Operations are conducted primarily in the domestic market, with international mail services representing approximately 4.5% of operating revenue.

## Seasonal Operations

Mail volume and revenue are historically greatest in the first quarter of our fiscal year, which includes the fall holiday mailing season and lowest in the third and fourth quarters of our fiscal year during the spring and summer. In general election years, direct mail may be heavily used by political organizations to reach their targeted audiences, thereby generating temporary volume increases during the months preceding an election.

## Customers

We have a very diverse customer base consisting of households, small business owners and corporate accounts throughout the nation, as well as several countries with which we do business. We are not dependent on a single customer or small group of customers. No single customer or country represents more than 3% of operating revenue.

## Employees

At September 30, 2014, we had approximately 488,000 career employees and 130,000 non-career employees, substantially all of whom reside in the U.S.

Approximately 89% of career employees are covered by collective bargaining agreements. These agreements include provisions for mandatory cost of living adjustments ("COLAs"), which are linked to the Consumer Price Index – Urban Wage Earners and Clerical Workers ("CPI-W"), as well as provisions that limit our ability to reduce the size of the labor force. Our labor force is primarily represented by the National Postal Mail Handlers Union ("NPMHU"), National Association of Letter Carriers ("NALC"), National Rural Letter Carriers' Association ("NRLCA") and American Postal Workers Union ("APWU").

On February 15, 2013, a final award was rendered in the arbitration case between the Postal Service and the NPMHU, resulting in a new NPMHU contract. The contract became effective on November 21, 2011, and extends through May 20, 2016. The NPMHU contract had no retroactive payments, included general wage increases in 2014 through 2016, stipulated that the 2013 COLA be deferred until 2014 and reduced the employer contribution to the funding of health benefits.

On January 10, 2013, a final award was rendered in the arbitration case between the Postal Service and the NALC, resulting in a new NALC contract. The contract with the NALC became effective on November 21, 2011, and extends through May 20, 2016. The NALC contract had no retroactive payments, included general wage increases in 2014 through 2016, stipulated that the 2013 COLA be deferred until 2014 and reduced the employer contribution to the funding of health benefits.

On July 3, 2012, a final award was rendered in the arbitration case between the Postal Service and the NRLCA, resulting in a new NRLCA contract that extends through May 20, 2015. The contract included a 2-year wage freeze, followed by modest increases and a lower wage scale for both new career and non-career employees. There was also a reduction in the employer contribution to the funding of health benefits.

The contract with the APWU became effective May 23, 2011 and extends through May 20, 2015. The contract included a wage freeze for the first two years, with general wage increases over the life of the contract, totaling 3.5%. The agreement also established a new career pay schedule that on average is 10.2% lower than the previous pay schedule.

By law, the Postal Service must consult with management organizations representing most of the employees not covered by collective bargaining agreements. These consultations provide non-bargaining unit employees in the field with an opportunity to participate in the planning, development and implementation of certain programs and policies that affect them. In 2012, we completed the consultation processes with the National Association of Postal Supervisors ("NAPS"), representing supervisory and managerial employees, and with the National Association of Postmasters of the United States ("NAPUS") and the National League of Postmasters of the United States ("NLPM"), representing postmasters.

The Postal Service participates in federal employee benefit programs as provided by statute for retirement, health and workers' compensation benefits. For a discussion of factors affecting these costs and our actions taken to address these factors, see *Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations- Operating Expenses*.

## Information Technology; Cyber Intrusion Incident

We rely extensively on computer systems and technology to manage the delivery of mail, process transactions, summarize results and manage our business. Our operational and administrative information systems are among the largest and most complex systems maintained by any organization in the world. Disruptions in both our primary and back-up systems could harm our ability to run our business and potentially result in significant losses of revenue or additional operating costs. In addition, such disruptions could impair our reputation for reliable service, which would also adversely affect results of operations. During the fourth quarter of 2014 we learned of a cyber intrusion into some of our information systems. We have been working closely with the U.S. Computer Emergency Readiness Team, the Federal Bureau of Investigation, the USPS Office of Inspector General (OIG), the Postal Inspection Service, Carnegie Mellon's Computer Emergency Response Team and private-sector forensic specialists to investigate the matter and to strengthen the security of our systems against future cyber intrusions.

The investigation indicates that the compromised files contained personally identifiable information (PII) of employees and former employees including names, dates of birth, social security numbers, addresses and other information. The potentially affected individuals include persons employed by the Postal Service between May 2012 and the present. In addition, we are investigating a possible compromise of injury claim data involving a smaller number of employees. Individualized letters have and will provide employees with specific information about their particular situation. We are unaware of any evidence that the compromised employee information has been used to engage in malicious activity. Nonetheless, we are making a credit monitoring product available to all potentially affected employees and former employees.

The intrusion also compromised files containing call center data submitted by customers who contacted our customer care center with inquiries via telephone or email between January 1, 2014 and August 16, 2014. This compromised data consists of names, addresses, telephone numbers, email addresses and other information for those customers who may have provided such information.

Our transactional revenue systems in post offices, as well as on usps.com where customers pay for services with credit and debit cards, have not been affected by this incident. There is no evidence that any customer credit or debit card information from retail or online purchases such as Click-N-Ship, the Postal Store, PostalOne!, CAPS, change of address or other services were compromised. As of the date of this report, we do not believe that the cyber intrusion or the costs of responding to it will have a material impact on the financial statements, the system of internal control over financial reporting, results of operations or financial condition.

## Marketing

Our marketing program seeks to capitalize on our industry standing, including our existing relationships and our reputation based on our service delivery performance every day. We have adjusted to changes in customer behaviors and demands to make accessing and using postal services more convenient. We have innovative mobile applications which enable customers to locate a Post Office, find a ZIP Code, track packages and shop online. Online service offerings available through http://www.usps.com have also enhanced the customer experience. We believe that as we work with businesses to equip them with tools to reach our mutual customers, our revenue will grow. Our marketing approach draws attention to the value in the mail piece, our enhanced digital technologies and the linkages between them. Additionally, we seek to maintain our name recognition through the use of media advertising, trade shows, technical seminars and direct mailings.

We have key strategic alliances with large transportation corporations to provide distribution and delivery services allowing us to serve our respective customers' needs. Maintaining these alliances is crucial to sales development and growth and they often provide us with introductions into new markets.

## Competition

A wide variety of communications media compete for the same types of transactions and communications that historically were conducted using our mailing services. These competitors include, but are not limited to, newspapers, telecommunications, television, email, social networking and electronic funds transfers. The package and express delivery businesses are highly competitive. The primary competitors of shipping and package services are FedEx Corporation and United Parcel Service, as well as other regional and local delivery companies. Our shipping and package business competes on the basis of the breadth of our service network, convenience, reliability and economy of the service provided.

## Government Contracts

No material portion of our business is subject to renegotiation of profits or termination of contracts or subcontracts at the election of the U.S. Government.

## Government Regulation

As an "independent establishment of the executive branch of the Government of the United States," the Postal Service continues to align specific objectives with those of the U.S. Government. The PRC, also an independent agency, has regulatory and oversight obligations over the Postal Service. We are subject to numerous federal, state and local regulatory and reporting laws, as well as environmental laws and regulations.

We participate in federal government pension and health and benefits programs for employees and retirees, including the Federal Employees Health Benefit Program ("FEHBP"), the Civil Service Retirement System ("CSRS") and the Federal Employees Retirement System ("FERS"). We have no control or influence over the benefits offered by these plans and make contributions to these plans as specified by law or contractual agreements with our unions (in the case of health benefits for most active employees). We are legally-mandated to participate in the federal workers' compensation program that is managed by the Department of Labor's ("DOL") Office of Workers' Compensation Programs ("OWCP") and governed by the Federal Employees' Compensation Act ("FECA"). For a discussion of factors affecting these costs and our actions taken to address these factors, see *Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations-Compensation and benefits*.

## Strategy

The Postal Service continues to implement the strategies articulated in its five-year business plan released in 2012 and updated in 2013 (the "Business Plan") to achieve financial stability as well as a substantial reduction in debt. The Business Plan includes a four-pronged approach to attain profitability: (1) taking aggressive actions within existing laws to maintain liquidity and reduce the costs of operations to reflect current and future mail volume; (2) maintaining high levels of performance and affordability of services; (3) informing stakeholders during congressional testimony and industry engagement activities about the changes necessary to our legislative and regulatory framework to enable long-term financial sustainability; and (4) identifying and building innovative capabilities that enable future revenue growth opportunities. We have successfully implemented initiatives that have removed billions of dollars of costs from our operations while increasing access to services. The current legislative restrictions on pricing and service diversification and operations restrict our ability to fully implement our Business Plan and cover our costs of providing secure, reliable and affordable universal delivery service to the American public.

As the debate on postal reform legislation continues in the closing days of the 113$^{th}$ Congress, a number of legislative reforms are still urgently needed. Our key legislative requirements include:

- Require within the FEHBP a set of specific health care plans that would fully integrate with Medicare and virtually eliminate the retiree health benefits unfunded liability.
- Adjust the FERS payment amount using Postal Service-specific demographic and salary growth assumptions and refund any existing surplus.
- Adjust delivery frequency (six-day packages/five-day mail).
- Streamline governance model and eliminate duplicative oversight.
- Provide authority to expand products and services.
- Require a defined contribution retirement system for future Postal Service employees.
- Require arbitrators to consider the financial condition of the Postal Service.
- Reform workers' compensation programs.
- Allow the Postal Service the right to appeal the Equal Employment Opportunity Commission ("EEOC") class action decisions to Federal Court.

## Research and Development

We operate a research and development facility in Virginia for design, development and testing of postal equipment and operating systems. We also contract with independent suppliers to conduct research activities. While research and development activities are important to our business, these expenditures are not material to our financial statements.

## Environmental Matters

Although we are required to comply with various federal, state or local environmental laws and regulations, none of these laws or regulations have had a material impact on our financial results or competitive position, or resulted in material capital expenditures. However, the effect of possible future environmental legislation or regulations on operations cannot be predicted. New laws or regulations that regulate greenhouse gas emissions into the environment may increase our operating costs, including the cost of diesel fuel, unleaded gasoline, retrofitting existing vehicles and other petroleum-related products.

## Available Information

The Postal Service is not a reporting company under the *Securities Exchange Act of 1934*, as amended, and is not subject to regulation by the Securities and Exchange Commission ("SEC"). However, we are 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.

Pursuant to Title 39 and PRC regulations, additional disclosures on the organization and finances, including Cost and Revenue Analysis reports, Revenue, Pieces and Weight reports, financial and strategic plans, the *Annual Report to Congress* and the *Comprehensive Statement on Postal Operations* are also filed with the PRC.

These reports are available to the public on our website, *http://about.usps.com*, free of charge, as soon as reasonably practicable after they are filed with the PRC. Information on our website is not incorporated by reference into this report. Requests for copies of our reports may also be sent to the following address: Corporate Communications, United States Postal Service, 475 L'Enfant Plaza, SW, Washington, DC 20260-3100.

## Item 1A. Risk Factors

Our business is subject to various risks and uncertainties that could adversely affect our business, financial condition, results of operations and cash flows. In addition to the risks and uncertainties that are described below, there may be others that we do not yet know of or that we currently think are immaterial that may also impair our business.

***Adverse U.S. and global economic conditions directly impact our business, negatively affecting results of operations.***
The demand for postal services is heavily influenced by the economy. Adverse economic conditions could negatively affect our business and results of operations, primarily through disrupting our customers' businesses. To the extent that the U.S. and other countries continue to experience slow economic growth, our business, financial position and results of operations will continue to be adversely impacted.

***Our ability to generate sufficient cash flows from current and future management actions to increase efficiency, reduce costs and generate revenue may not be sufficient to meet all of our financial obligations or to carry out our strategy.***
Our strategies to increase efficiency and reduce costs by adjusting our network, infrastructure and workforce and to retain and grow revenue are currently constrained by contractual, statutory, regulatory and political restrictions. Accordingly, our ability to react quickly to the changing economic climate and industry conditions is inhibited.

We have proposed legislative changes that are needed to provide the Postal Service with the legal authority to implement additional measures to increase efficiency and cost savings and to grow revenue. Legislation has been introduced in both houses of Congress but has not been passed by either the Senate or the House of Representatives. Further, the proposed legislation does not contain the authority necessary to implement all required actions to increase productivity and realize the cost savings in our Business Plan.

***We are subject to Congressional oversight and regulation by the Postal Regulatory Commission and other government agencies. We have a wide variety of stakeholders whose interests and needs are sometimes in conflict.***
We operate as an independent establishment of the executive branch of the Federal Government of the United States and as a result are subject to a variety of regulations and other limitations applicable to federal agencies. If the Federal Government curtails its spending due to debt ceiling constraints, we may be adversely impacted. Additionally, as an outgrowth of our unique status as a provider of a fundamental service to the American people, we attempt to balance the interests of many parties. Efforts to be responsive to various stakeholders sometimes adversely impact the speed with which we are able to respond to changes in mail volume or other operational needs. Limitations on our ability to take management action could adversely affect operating and financial results.

***Adverse events may call into question our reputation for quality and reliability or our ability to deliver the mail and could diminish the value of the Postal Service brand. This could potentially adversely affect our revenue and results of operations.***
In its latest review of universal postal service providers, Oxford Strategic Consulting ranked the Postal Service as the best postal service within the world's top 20 largest economies for access to services, resource efficiency and public trust. The Postal Service brand represents quality and reliable service; and therefore, is a valuable asset. We use our brand extensively in sales and marketing initiatives and exercise care to defend and protect it. Any event, whether real or perceived, that calls into question our long-term existence, our ability to deliver mail, our quality or our reliability could diminish the value of our brand and reputation and could adversely affect our business operations and operating results.

***Our need to restructure our operations in response to declining mail volume may result in significant costs. It is possible that the measures being considered would be insufficient to reduce our workforce and physical infrastructure to a level commensurate with declining mail volume.***
Our current network optimization plans include the consolidation of certain mail processing operations and reductions in lobby hours of many retail units, post offices and other facilities. Presently, our regular review of the carrying value of our assets has not resulted in significant impairments of our physical assets. However, future changes in business strategy, legislation, government regulations or economic or market conditions may result in material impairment write-downs of our assets. We may, in the future, consider offering financial incentives to encourage employees to voluntarily leave the Postal Service, as has been done in the past. Such impairments, incentives or other related costs would adversely impact our financial results in the short-term, although they are expected to result in long-term savings. In addition, there is no assurance that the mechanisms

available under existing law and contractual arrangements will be sufficient to reduce the workforce or facilities to a level that would allow a return to financial stability.

***Our business and results of operations are significantly affected by competition from both competitors in the marketplace as well as substitute products and channels provided by electronic communication services. If we do not compete effectively, operate efficiently, grow marketing mail and package services and increase revenue and profit margins from other sources, this adverse impact will become more substantial over time.***

Our marketplace competitors primarily include providers of package delivery services. Our competitors have different cost structures and fewer regulatory restrictions than we do and are able to offer differing services and pricing, which may hinder our ability to remain competitive in these service areas. In addition, our competitors have access to public capital markets, which allows them greater freedom in their investments and expansion of their business.

Customer usage of postal services continues to shift to substitute products and channels provided by electronic communication services. Transactional mail, such as the presentment and payment of bills, has been eroded by competition from electronic media, driven by some of our major mailers who actively promote the use of online services. The volume of Periodicals continues to decline as people increasingly use electronic media for news and information. Periodical advertising has also experienced a decline as a result of the move to a lower cost electronic media.

***Existing laws and regulations limit our ability to introduce new products or services, enter new markets, generate new revenue streams or manage our cost structure. These laws and regulations may also prevent us from increasing prices sufficiently, or generating sufficient efficiency improvements, to offset increased costs. This would adversely affect our results of operations.***

In order to offset declining volume and revenue caused by the changing economy and electronic diversion, our ability to sell new products and services in new or existing markets will be a key factor to our return to profitability. However, various laws and regulations significantly limit our ability to enter new markets and/or to provide new services and products as defined by traditional industry definitions. Without legal or regulatory changes that allow us to introduce new products or services to take advantage of our assets, including our strong network and last-mile capabilities, we may be unable to respond adequately to consumers' changing needs and expectations. These limitations have the potential to adversely impact our results of operations and long-term financial viability.

P.L. 109-435 generally limits price increases on our Market-Dominant services to the rate of inflation as measured by the CPI-U. However, our costs are not similarly limited. A large portion of our cost structure cannot be altered expeditiously. Accordingly, we may not be able to increase prices sufficiently to offset increased costs. Because our services are provided primarily through our employees, our costs are heavily concentrated in wages and employee and retiree benefits. These costs are significantly impacted by wage inflation, health benefit premium increases, retirement and workers' compensation programs, COLAs and the continuous growth of our delivery points. Some of these costs have historically tended to increase at a higher rate than inflation as measured by the CPI-U. We believe that continuing productivity improvements alone will not be sufficient to address the challenges presented by declining volume and revenue and the regulatory price cap, nor will revenue enhancements keep pace with increased cost structures.

***Slow market acceptance of new programs or product initiatives would adversely affect our results of operations.***

We cannot be assured that recently launched programs or products, or any new programs or products that we may launch in the future, will be accepted by our customers. We also cannot be certain that we will recover the costs we incurred in developing any new programs or products or that our marketing efforts will be successful.

***An unduly burdensome union contract arrived at either through negotiation or arbitration could have a significant adverse impact on our future results of operations by impacting our control over wages and benefits and/or by limiting our ability to manage our workforce effectively.***

The majority of our labor force is represented by labor unions and covered by collective bargaining agreements, primarily with the APWU, NALC, NPMHU and the NRLCA. The agreements currently in force include provisions for mandatory COLAs, which are linked to the CPI-W. Although the increases in the CPI-W have been relatively low since its 2008 peak when it conferred annual pay increases to employees of nearly $1.1 billion, a resurgence of consumer inflation could have a significant adverse impact on our labor costs. The agreements also contain provisions that limit our ability to reduce the size of the labor force. Reductions in the size and cost of our labor force are necessary to offset the effects of declining volume and revenue.

Our ability to negotiate contracts that control labor costs is essential to maintaining financial stability. We have no assurance that we will be able to negotiate contracts in the future with our unions that will result in a cost structure that is sustainable within current and projected future revenue levels. In addition, if our future negotiations should fail and involved parties proceed to arbitration, we would be deprived of control in the collective bargaining process. The risk of an adverse outcome rises in arbitration, as there is no current statutory mandate requiring an interest arbitrator to consider the financial health of the Postal Service in issuing an award. An unfavorable award in arbitration could have significant adverse consequences on our ability to meet future financial obligations.

***We rely on the terms and conditions of our contracts with vendors and customers to deliver our services. These contracts are renegotiated on a routine and periodic basis. Significant changes in the costs, pricing or terms associated with these contracts could adversely affect our business.***

Some of our suppliers and customers enter into long-term contracts with us to supply goods and services and to procure our services. These contracts are renegotiated from time to time and to the extent that contracts are not renewed, or are renewed with terms that may not sufficiently cover our costs or increase our costs, may have an adverse effect on our business. While no single customer or supplier is material to the Postal Service as a whole, certain vendors and customers are significant to the delivery of certain product lines. Our ability to maintain current or improved terms in our contracts with our customers and suppliers is critical to our initiatives to return to profitability.

***Fuel expenses are a material part of our operating costs. A significant increase in fuel prices could adversely affect costs and results of operations.***

We are exposed to changes in commodity prices, primarily for diesel fuel, unleaded gasoline and aircraft fuel for transportation of mail and natural gas and heating oil for facilities. The price and availability of fuel can be unpredictable and is beyond our control. Unlike commercial entities, we are unable to institute fuel surcharges in our pricing model. Additionally, because we also use contracted carriers to transport the mail, we anticipate that increased operating costs for these independent carriers, including increased costs resulting from rising fuel prices, may ultimately be passed through to the Postal Service.

***We rely extensively on computer systems and technology to manage the delivery of mail, process transactions, summarize results and manage our business. Disruptions in both our primary and back-up systems could harm our ability to run our business and potentially result in significant losses of revenue or additional operating costs. In addition, such disruptions could impair our reputation for reliable service, which would also adversely affect results of operations.***

Our operational and administrative information systems are among the largest and most complex systems maintained by any organization in the world. Any disruption to our infrastructure, including those impacting computer systems that facilitate mail handling and delivery and customer-utilized websites, could adversely impact customer service, mail volume and revenue and result in significant increased cost. Any significant systems failure could cause delays in the processing and delivering of mail or result in the inability to process operational and financial data.

Cyber attacks are a continuing threat to businesses and agencies that maintain data electronically and the Postal Service is not immune to such attacks. A 2013 Government Accountability Office report stated that from 2006 through 2012 the number of cyber incidents reported by federal agencies to the U.S. Computer Emergency Readiness Team increased 782 percent. In addition, reports of cyber incidents affecting national security, intellectual property and individuals have been widespread, with reported incidents involving data loss or theft, economic loss, computer intrusions and privacy breaches. The ability to maintain confidentiality, integrity and availability of information is critical to fulfilling our mission. The source of such threats is wide-ranging and system failures resulting from these threats could damage our reputation, resulting in loss of business and increased costs.

We discovered a data breach in the fourth quarter of 2014, which involved the theft of certain personally identifiable information and customer addresses through unauthorized access to our network. As of the date of the filing of this report, we do not believe there to be any impact to our financial systems or material impact to the financial information presented in this Annual Report.

***Due to our recent and projected cash constraints, our operational performance in the future could be at risk as a result of inadequate capital investment in facilities, transportation equipment, mail processing equipment or information technology infrastructure, all of which are essential for our operations.***

If our operations do not generate the liquidity we require, we may be forced to reduce, delay or cancel investments in technology, facilities and/or transportation equipment, as we have done in the recent past, while our competitors and other businesses are pursuing advanced, competing technologies and equipment. Additionally, our aging facilities, equipment and transportation fleet could inhibit our ability to be competitive in the marketplace, deliver a high-quality service and meet the needs of the American public. The changes in the economic landscape in recent years have made it increasingly important for us to invest in our operations in order to remain competitive. Failure to anticipate or react to our competition, market demands and/or new technology due to inadequate cash reserves is a significant operational risk. An aging or potentially obsolete infrastructure could result in a loss of business and increased costs.

***We have a substantial amount of indebtedness.***

Since 2012, our debt obligations have remained at the statutory $15 billion debt limit. Over the last two years, our cash balances have ranged from $506 million to $5.4 billion. Our significant indebtedness to the Federal Financing Bank ("FFB") has important consequences. For example, it limits our flexibility in planning for, or reacting to, changes in the business environment or competition; it places us at a competitive disadvantage compared to commercial competitors that may have less debt and which have access to public capital markets; and it could require us to dedicate a substantial portion of our cash flow from operations to payments on indebtedness, thus reducing the availability of cash flow to fund working capital, capital expenditures and other general organizational activities.

***Health and pension benefit costs represent a significant expense to us.***

With approximately 488,000 career employees and approximately 490,000 annuitants and survivors participating in the FEHBP as of September 30, 2014, our expenses relating to employee and retiree health and pension benefits are significant. We participate in Federal Government pension and health and benefits programs for employees and retirees, including the FEHBP, the CSRS and the FERS, as required by law. We have no control or influence over the benefits offered by these plans and make contributions to these plans as specified by law or contractual agreements with our unions (in the case of health benefits for most active employees). Several factors including participant mortality rates, return on investment and inflation could require us to make significantly higher future contributions to these plans; and many of these factors are beyond our control.

In recent years, we have experienced significant increases in retiree health benefits costs, primarily as a result of P.L. 109-435, which obligates us to fully fund, on an accelerated time frame, the health benefits of current retirees and current Postal Service employees who have not yet retired. Additionally, we are required to continue contributing to the FERS pension program at the Office of Personnel Management ("OPM") specified rates and will likely be required to resume contributions to the CSRS, beginning in 2017, if OPM determines that a supplemental unfunded liability payment is necessary.

***Workers' compensation insurance and claims expenses could have a material adverse effect on our business, financial condition and results of operations.***

Workers' compensation expense accruals are established for estimates of the cash outlays that we will ultimately incur on reported claims, as well as estimates of the costs of claims that have been incurred but not yet reported. Trends in actual experience and management judgments about the present and expected levels of cost per claim are significant factors in the determination of such accruals. Several other factors which are beyond our control, such as discount and inflation rates, could cause us to incur higher workers' compensation expense. In addition, our workers' compensation program is administered for us by the DOL. As such, we do not have the same level of control over the execution of the program that a private company has with their workers' compensation insurance provider.

We believe our estimated accruals for such claims are adequate, but if actual experience in the number of claims, and/or severity of claims for which we are retaining risk increases, required accruals could materially differ from our estimates and adversely affect our financial condition and results of operations.

***The potential liability associated with existing and future litigation against us could have a material adverse effect on our business, results of operations, financial condition and cash flows.***

In the normal course of operations, we are subject to various legal proceedings and threatened legal proceedings from time to time. Any litigation, regardless of its merits, could result in substantial legal fees and costs being incurred by us. Further, actions that have been or will be brought against us may not be resolved in our favor and, if significant monetary judgments are rendered, we may not have the ability to pay. Such disruptions, legal fees and any losses resulting from these claims could have a material adverse effect on our business, results of operations, financial condition and cash flows.

***A failure to protect the privacy of information we obtain from customers could damage our reputation and result in a loss of business.***

We have invested in and employ a variety of technology security initiatives aimed at protecting organizational information, as well as customer information. As one of the government agencies most trusted by the American public, protecting the confidentiality of data that we obtain is paramount to us. However, should our information technology security initiatives not fully insulate us from a security breach or data loss, our reputation could be damaged resulting in an adverse effect on our operations and financial results. Moreover, unlike other non-governmental entities in our industry, the Postal Service must abide by the *Privacy Act of 1974*, which restricts how we can collect, use, maintain and disseminate personally identifiable information and prescribes civil and criminal penalties for non-compliance.

***International conflicts or terrorist activities and the effects of these events may have adverse impacts on business operations or our financial results. In addition, we are subject to the risk of biohazards and other threats placed in the mail.***

We are exposed to the impacts of international conflicts and terrorist activities on the United States, global economies in general and the transportation industry in particular. In addition, we are subject to the risk of biohazards and other threats placed in the mail. Although we have implemented extensive emergency preparedness measures to keep the mail, employees and customers safe from harm due to biohazards or other threats that could be introduced into the mail, this risk cannot be completely mitigated. If new threats were to arise and measures were not sufficient to contain or mitigate the threat, services could be disrupted. This could adversely affect mail volume and revenue and require substantial expenditures to address new threats, thus adversely affecting our operations and financial results.

***Natural disasters and adverse weather conditions that can damage property and disrupt business operations could have an adverse impact on our business operations and our financial results.***

Natural disasters, such as hurricanes, earthquakes and tsunamis, which have been experienced in recent years, place our employees in harm's way and make it challenging to deliver mail under these unpredictable and dangerous conditions. Damage to Postal Service facilities could also have negative impact on business operations. Significant additional operating costs may be incurred in order to maintain continuity in fulfilling the Postal Service's mission.

***Widespread outbreak of an illness or communicable disease, or any other public health crisis could reduce the demand for our products and services, which may adversely affect our revenue.***

The spread of contagious diseases among our customers and the global population, in general, could significantly impact the demand for our products and services. Additionally, this could impact the availability of our workforce and our ability to continue normal operations.

## Item 1B. Unresolved Staff Comments

Not applicable.

## Item 2. Properties

We own nearly 8,600 and lease over 23,000 Postal Service facilities ranging in size from 60 square feet to 32 acres. Facilities support retail, delivery, mail processing, maintenance, administrative and support activities and are located in numerous communities throughout the U.S. and its territories. We believe our properties are in generally good physical condition with the need for only routine repairs and maintenance and periodic capital improvements. Periodically, we monitor the productive capacity of our properties which have culminated in the consolidation of some of our facilities.

During 2014, 2013 and 2012 we closed 2, 97 and 44 mail processing facilities, respectively, in conjunction with our efforts to adjust our mail processing network to reflect lower volume of mail by consolidating mail processing operations. Not all mail processing consolidations lead to the closure of a facility. In July, 2014 we announced plans to proceed with a second phase of consolidations. It is expected that up to 82 facilities will be impacted by the consolidations which will occur during the course of 2015, leading to approximately 76 mail processing facility closures.

## Item 3. Legal Proceedings

The Postal Service is subject to legal proceedings and claims that arise in the ordinary course of its business.

As previously reported, on January 14, 2010, the EEOC's Office of Federal Operations certified a class action case against the Postal Service in a matter captioned McConnell v. Donahoe (first instituted in 2006 as McConnell v. Potter), with the class consisting of all permanent rehabilitation employees and limited duty employees who have been subjected to the National Reassessment Process ("NRP") from May 5, 2006, through July 1, 2011. The Postal Service used the NRP to ensure that its records were correct and that employees receiving workers' compensation benefits were placed in jobs consistent with their abilities. The case alleges violations of the Rehabilitation Act of 1973 resulting from the NRP's failure to provide a reasonable accommodation, the NRP's wrongful disclosure of medical information, the creation by the NRP of a hostile work environment and the NRP's adverse impact on disabled employees. The class is seeking injunctive relief and damages of an uncertain amount. If the plaintiffs were able to prove their allegations in this matter and to establish the damages they assert, then an adverse ruling could have a material impact on the Postal Service. However, the Postal Service disputes the claims asserted in this class action case and is vigorously contesting the matter.

For further discussion of the legal proceedings affecting the Postal Service, see *Item 8. Financial Statements and Supplementary Data, Note 7- Commitments and Contingencies*.

## Item 4. Mine Safety Disclosures

Not applicable.

# Part II.

## Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Not applicable. As an "independent establishment of the Executive Branch of the Government of the United States," we do not issue stock or other securities.

## Item 6. Selected Financial Data

The selected financial data presented below for each year ended September 30 is derived from our audited financial statements. The selected financial data should be read in conjunction with *Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations* and the related notes to the financial statements *in Item 8. Financial Statements and Supplementary Data*.

| (in millions) | 2014 | 2013 | 2012 | 2011 | 2010 |
|---|---|---|---|---|---|
| **Operating Results** | | | | | |
| Total revenue | $ 67,830 | $ 67,318 | $ 65,223 | $ 65,711 | $ 67,052 |
| Operating expenses | | | | | |
| Compensation and benefits | 46,000 | 46,708 | 47,689 | 48,310 | 48,909 |
| Retiree health benefits* | 8,685 | 8,450 | 13,729 | 2,441 | 7,747 |
| Workers' compensation | 2,554 | 1,061 | 3,729 | 3,672 | 3,566 |
| All other operating expenses | 15,939 | 15,909 | 15,817 | 16,211 | 15,204 |
| **Loss from operations** | **(5,348)** | **(4,810)** | **(15,741)** | **(4,923)** | **(8,374)** |
| **Net loss** | **$ (5,508)** | **$ (4,977)** | **$ (15,906)** | **$ (5,067)** | **$ (8,505)** |
| **Financial Position** | | | | | |
| Cash and cash equivalents | $ 4,906 | $ 2,326 | $ 2,087 | $ 1,321 | $ 991 |
| Property and equipment, net | 16,338 | 17,512 | 18,863 | 20,337 | 21,595 |
| All other assets | 1,718 | 1,803 | 1,661 | 1,755 | 1,740 |
| **Total Assets** | **$ 22,962** | **$ 21,641** | **$ 22,611** | **$ 23,413** | **$ 24,326** |
| Accrued retiree health benefits | $ 22,417 | $ 16,766 | $ 11,205 | $ 7 | $ — |
| Workers' compensation liability | 18,422 | 17,240 | 17,567 | 15,142 | 12,589 |
| Debt | 15,000 | 15,000 | 15,000 | 13,000 | 12,000 |
| All other liabilities | 12,454 | 12,458 | 13,685 | 14,204 | 13,610 |
| **Total Liabilities** | **$ 68,293** | **$ 61,464** | **$ 57,457** | **$ 42,353** | **$ 38,199** |
| **Total Net Deficiency** | **$ (45,331)** | **$ (39,823)** | **$ (34,846)** | **$ (18,940)** | **$ (13,873)** |

*Due to the passage of P.L.112-33 which changed the due date of the $5.5 billion scheduled Postal Service Retiree Health Benefit Fund ("PSRHBF") prefunding payment originally due by September 30, 2011, into 2012, PSRHBF expenses were zero in 2011. PSRHBF expenses in 2012 totaled $11.1 billion which included the previous year's amount of $5.5 billion and the 2012 scheduled amount of $5.6 billion due by September 30. For 2010, there was no accrual at year end because the prefunding payment was made when due at September 30.

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion contains statements that are forward-looking. These statements are based on expectations and assumptions that are subject to risks and uncertainties. Actual results could differ materially because of, among other reasons, factors discussed in *Item 1A. Risk Factors* and elsewhere in this Annual Report. The commentary should be read in conjunction with the consolidated financial statements and related notes included in this Annual Report.

### Overview

The major factors that impact operating results include overall customer demand and the mix of postal services, contribution margins associated with those services, volume of mail and packages processed through our network and our ability to manage our cost structure in line with declining levels of mail volume. In the day-to-day operation of our business, we focus our attention on those costs that are controllable by us which include wages and fuel consumption, to match declining volume levels. We exclude the non-controllable factors from our internal financial analyses in order to focus our attention on relevant expenses that management can control. For example, we include only those workers' compensation costs representing current year payments on behalf of Postal Service claimants. Non-controllable expenses, which greatly impact our financial results, are largely comprised of the annual legally-mandated PSRHBF prefunding expense and non-cash items such as the fluctuations in workers' compensation expense due to changes in discount (interest) rates, changes resulting from the revaluation of the related liability and a one-time change in accounting estimate.

In 2013, we analyzed data that was not previously available regarding consumer behavior and usage patterns related to Forever Stamps, particularly Forever Stamps nearing completion of the stamp's lifecycle. As a result of this analysis, we recorded a $1.3 billion increase in revenue and a decrease in deferred revenue-prepaid postage. This adjustment had no impact on our cash balance nor did it lessen the severity of our liquidity situation.

The table below illustrates the loss from ongoing business activities without the impact of these items, which better reflects the aspects of our financial results that are controllable by management, and reconciles this amount back to accounting principles generally accepted in the U.S. ("U.S. GAAP") net loss. Net financial results for the years ended September 30, 2014, 2013 and 2012 would have been as follows:

| (in millions) | 2014 | 2013 | 2012 |
|---|---|---|---|
| **Net loss** | **$ (5,508)** | **$ (4,977)** | **$ (15,906)** |
| Impact of: | | | |
| Discount rate changes related to workers' compensation liability | 485 | (1,745) | 346 |
| Other non-cash workers' compensation expense | 697 | 1,434 | 1,995 |
| PSRHBF prefunding expense | 5,700 | 5,600 | 11,100 |
| Change in accounting estimate[1] | — | (1,316) | — |
| **Controllable income (loss)*** | **$ 1,374** | **$ (1,004)** | **$ (2,465)** |

[1] The 2013 change in accounting estimate resulting from new data analytics which revised the estimated liability associated with deferred revenue-prepaid postage for Forever stamps.

* Controllable income (loss) excludes the impact of certain workers' compensation adjustments, PSRHBF prefunding expense and the 2013 change in accounting estimates from net loss.

### Operating Revenue and Volume

Operating revenue and volume are closely linked to the strength of the U.S. economy and changes in how our customers use the mail. Historically, one of the more significant factors has been the change in the rate of economic growth. However, an additional factor has been the rate at which new communications technology has been introduced and accepted in the marketplace. We have seen the displacement of traditional hard-copy mail, resulting from the introduction and acceptance of this new technology, most significantly consumer hand held devices including smart phones. Our operating revenue growth is also constrained by laws and regulations restricting the types of products and services we can offer, the prices we can charge and the speed with which we can bring them to market. These laws and regulations restrict us from taking necessary steps to enter into new lines of business to generate additional revenue to mitigate the downward trend in traditional First-Class Mail revenue and volume.

We have been proactive in developing mailing and packaging services to better meet our customers' needs. We have improved access to our products and services and facilitated making mail pieces more actionable in terms of enabling speed to purchase. We have enhanced customer's engagement with interactive mail - hard copy to digital that connects consumers to websites, social media, or a purchase point - by embedding technology such as Quick Response codes in mail pieces. Our successful marketing efforts have generated growth in our Shipping and Packages business by offering competitive pricing and innovative services; such as day certain delivery, improved scanning and tracking, text alerts and up to $100 free insurance on most Priority Mail packages. We continue to enhance our mail and packages services and develop new platforms for our services, as well as enter into agreements with our competitors to carry more parcels. Efforts are also underway to increase Sunday and same-day delivery throughout selected geographical markets and cities in the U.S.

However, because Shipping and Packages represents only 20.3% of our 2014 operating revenue, compared to First-Class and Standard Mail, which represents 67.5% of operating revenue, revenue growth in Shipping and Packages, by itself, cannot fully offset the declines in First-Class Mail. Furthermore, the profit margins on both First-Class Mail and Standard Mail are greater than that of Shipping and Packages. As a result, revenue from Shipping and Packages would have to grow at a substantially higher rate than the decline in First-Class Mail revenue in order to replace the lost profit contribution of First-Class Mail.

During 2014, we implemented a price increase on our Market-Dominant and Competitive services. The Market-Dominant price increase included an exigent price increase of 4.3% which was assessed as a surcharge in addition to the 1.7% CPI-U price increase. Together, the CPI-U and exigent price increases were expected to generate $2.7 billion in incremental annual operating revenue for the Postal Service in the first full year. The PRC decision authorizing the 4.3% exigent surcharge dictates that this surcharge shall remain in effect only until an additional $3.2 billion of incremental operating revenue above what the Postal Service would have otherwise recovered through a CPI-U increase alone is collected. The exigent price increase has generated approximately $1.4 billion in incremental operating revenue for the Postal Service through September 30, 2014.

We have filed an appeal with the United States Court of Appeals for the District of Columbia Circuit arguing that the PRC erred in its decision to limit the duration of the exigent increase in the manner that it specified. The outcome of this appeal cannot be determined at this time. Some mailers filed an appeal seeking relief from the PRC's decision to allow any exigent postage increase. The expected outcome of these appeals cannot be estimated at this time.

The following table presents details of our operating revenue and volume for the years ended September 30, 2014, 2013 and 2012 by each service:

| (in millions) | 2014 | 2013 | 2012 |
|---|---|---|---|
| **Operating Revenue:** | | | |
| First-Class Mail[1] | $ 28,335 | $ 28,110 | $ 28,856 |
| Standard Mail[2] | 17,428 | 16,915 | 16,428 |
| Shipping and Packages[3] | 13,743 | 12,597 | 11,592 |
| International Mail | 3,024 | 3,016 | 2,816 |
| Periodicals | 1,625 | 1,658 | 1,731 |
| Other[4] | 3,609 | 3,583 | 3,656 |
| Total operating revenue before change in accounting estimate | $ 67,764 | $ 65,879 | $ 65,079 |
| Deferred operating revenue-change in accounting estimate[5] | — | 1,316 | — |
| **Total operating revenue** | **$ 67,764** | **$ 67,195** | **$ 65,079** |
| **Volume:** | | | |
| First-Class Mail[1] | 63,603 | 65,754 | 68,674 |
| Standard Mail[2] | 80,311 | 80,806 | 79,496 |
| Shipping and Packages[3] | 4,015 | 3,715 | 3,501 |
| International Mail | 899 | 902 | 926 |
| Periodicals | 6,045 | 6,359 | 6,741 |
| Other[6] | 502 | 686 | 497 |
| **Total volume** | **155,375** | **158,222** | **159,835** |

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

[1]Excludes First-Class Mail Parcels.

[2]Excludes Standard Mail Parcels.

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

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

[5]The 2013 change in accounting estimate resulting from new data analytics which revised the estimated liability associated with deferred revenue-prepaid postage for Forever stamps.

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

In 2014, total operating revenue increased $569 million, or 0.8%, compared to 2013. Operating revenue growth year-over-year, excluding a one-time adjustment in 2013, would have been $1.9 billion, or 2.9%. The growth was primarily due to the price increase implemented for Market-Dominant and Competitive services and the growth in Shipping and Packages. In 2013, total operating revenue growth was $2.1 billion, or 3.3%, compared to 2012. Operating revenue growth year-over-year, excluding the one-time adjustment in 2013, would have been $800 million, or 1.2%. First-Class Mail and Standard Mail provided the vast majority of our revenue, despite consumer trends away from hard copy mail to electronic media. Combined, these two mail categories totaled $45.8 billion in 2014 and represented approximately 68% of operating revenue. In 2013, First-Class Mail and Standard Mail revenue totaled $45.0 billion and represented 68% of our operating revenue, before the change in accounting estimate. With consideration of the change in accounting estimate, the categories represent approximately 67% of operating revenue for 2013. In 2012, these categories represented 70% of operating revenue.

We anticipate that total mail volume will continue to decline in future years due to the continued decline of First-Class Mail volume. To compensate for the loss of one piece of First-Class Mail, Standard Mail must increase by approximately three pieces. Shipping and Packages, International Mail and other categories are not expected to grow significantly enough to replace the profit contribution lost due to the decline of First-Class Mail.

**First-Class Mail**

In 2014, the long-term decline in First-Class Mail volume continued, albeit at a slower pace than previous years, with a decrease of 3.3% from 2013. In 2014, First-Class Mail represented 42% of operating revenue, as compared to 43% of revenue in 2013 before the change in accounting estimate, and 44% in 2012.

The decline in volume of First-Class Mail in 2014, our most profitable service, was offset by the exigent price increase which became effective in January 2014.

Price increases for all services in the First-Class Mail category are generally capped at the rate of inflation because these services are classified, by law, as Market-Dominant.

**Standard Mail**

Standard Mail generated the greatest volume, at 51.7% of the total, but represented only 25.7% of operating revenue in 2014. Standard Mail revenue increased by $513 million, or 3.0% to $17.4 billion in 2014 compared to 2013, on a volume decrease of 495 million pieces, or 0.6%. Increases in Standard Mail revenue were a result of the exigent price increase implemented in January 2014. While volume remained relatively flat, mail is proving to be an especially resilient marketing channel and its value to America’s businesses is increasing due to better data and technology integration.

Standard Mail represented 25.2% of operating revenue in 2013 after consideration of the change in accounting estimate. Political mail volume coupled with a modest improvement in the economy resulted in an increase in Standard Mail revenue by 3% in 2013 compared to 2012, on a volume increase of 1.6%. Political mail revenue of $263 million from October and November, 2012 mailings are included in our results for the year ended September 30, 2013.

Price increases for all services in the Standard Mail category are generally capped at the rate of inflation because they are classified, by law, as Market-Dominant.

**Shipping and Packages**

Shipping and Packages revenue continues to show strong year-over-year growth. Shipping and Packages are predominantly Competitive services which can be priced to reflect current market conditions, although some Market-Dominant services subject to price caps such as First-Class Parcels and certain other package services are also included in this category. Responding to the opportunity created by the growth in packages shipped for consumer purchases made online, we have been able to capture an increasing share of this newly created volume. We continue to capitalize on the competitive advantage we have in providing “last mile” service for e-commerce fulfillment markets. Ground shipping services have proven to be very popular in e-commerce fulfillment, as companies push to keep their costs down. In addition, new postal services and successful marketing campaigns have helped fuel this growth. Shipping and Packages revenue grew 9.1% in 2014 and 8.7% in 2013, when compared to the previous year. Additionally, in order to further grow revenue, to accommodate the surge in volume and to avoid service disruptions, we implemented Sunday delivery service in some U.S. markets during the first quarter of 2014 and are currently serving seventeen major U.S. cities with Sunday package delivery.

The following table presents detailed operating revenue and volume for Shipping and Packages for the years ended September 30, 2014, 2013 and 2012 by each service:

| (in millions) | 2014 | 2013 | 2012 |
|---|---|---|---|
| **Shipping and Packages Revenue:** | | | |
| Priority Mail[1] | $ 7,376 | $ 7,020 | $ 6,662 |
| Parcel Select, Parcel Return, Standard Parcels | 2,736 | 2,202 | 1,759 |
| Package Services | 818 | 810 | 846 |
| First-Class Packages[2] | 2,053 | 1,771 | 1,523 |
| Priority Mail Express | 760 | 794 | 802 |
| **Total Shipping and Packages revenue** | **$ 13,743** | **$ 12,597** | **$ 11,592** |
| **Shipping and Packages Volume:** | | | |
| Priority Mail[1] | 956 | 924 | 892 |
| Parcel Select, Parcel Return, Standard Parcels | 1,606 | 1,418 | 1,290 |
| Package Services | 549 | 542 | 575 |
| First-Class Packages[2] | 868 | 792 | 704 |
| Priority Mail Express | 36 | 39 | 40 |
| **Total Shipping and Packages volume** | **4,015** | **3,715** | **3,501** |

[*]Note: The totals for certain mail categories for the prior year have been reclassified to conform with classifications used in the current year. These reclassifications did not impact total Shipping and Packages revenue for the prior year.

[1]Includes Standard Post which is a retail-only product classified as Market-Dominant. Standard Post is priced identically to Priority Mail for Zones 1-4 and is functionally equivalent to Priority for those Zones.

[2]Includes First-Class Mail Parcels and First-Class Package Services.

In 2014, Shipping and Packages, which includes premium services, such as Priority Mail and Priority Mail Express and business-oriented services, such as Parcel Select and Parcel Return Services, represented 2.6% of volume and generated approximately 20.3% of operating revenue, as compared to 2.3% of volume and 19.1% of operating revenue before the change in accounting estimate in 2013. Similarly, in 2012, Shipping and Packages represented 2.2% of volume but generated approximately 17.8% of operating revenue.

Shipping and Packages operating revenue of $13.7 billion increased $1.1 billion, or 9.1%, in 2014 on a volume increase of 300 million pieces, or 8.1% when compared to the prior year. In January 2014, Postal Service customers experienced an overall average price increase of 2.4% in Shipping and Package services.

In 2013, Shipping and Packages operating revenue of $12.6 billion increased $1.0 billion, or 8.7% on a volume increase of 214 million pieces, or 6.1% compared to 2012.

In 2012, Shipping and Packages operating revenue of $11.6 billion increased $0.9 billion, or 8.6% on a volume increase of 7.5% from the prior year.

***Priority Mail***

Priority Mail, including Standard Post, is the Postal Service's flagship Shipping Services product accounting for 53.7% of total Shipping and Packages revenue in 2014 and 55.7% in 2013. This service is a convenient and fast way to send documents and packages requiring expedited transportation and handling.

Priority Mail revenue of $7.4 billion increased 5.1% in 2014 when compared to the prior year. In 2013, Priority Mail revenue of $7.0 billion increased 5.4% when compared to the prior year.

In September 2014, the Postal Service changed Priority Mail prices, including a reduction in prices on average for businesses and other customers who use Commercial Plus and Commercial Base online shipping services for heavier weight packages. The price change includes a modest increase of 1.7% on average for Priority Mail prices at post offices and other postal retail outlets. The changes are intended to offer more competitive pricing and build on Priority Mail's popularity with customers.

***Parcel Services***

Parcel Services includes Parcel Select, Parcel Returns and Market-Dominant Standard Parcels. These services have continued to show strong revenue and volume growth over the last three years; however, they represent one of our lowest priced services. As a result, they provide a relatively lower level of contribution than many of our other services. In 2014, Parcel Services revenue of $2.7 billion increased $534 million, or 24.3%, from $2.2 billion in 2013.

***First-Class Packages***

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

First-Class Packages revenue and volume performance continues to experience strong increases for the past three years, as demand increased for this competitively priced, reliable shipping option. For 2014, First-Class Packages revenue of $2.1 billion increased $282 million, or 15.9%, when compared to the prior year. For 2013, First-Class Packages revenue of $1.8 billion increased $248 million, or 16.3%, when compared to 2012.

**International Mail**

International Mail revenue, primarily for outbound services, were 4.5%, 4.6% and 4.3%, of total operating revenue for 2014, 2013 (before the change in accounting estimate) and 2012, respectively. For 2014, a weak global economy continued to be the primary factor contributing to the decline in international mail revenue and volume year-over-year. In January 2013, we implemented a price increase, accounting for the increase in revenue over 2012.

**Periodicals**

Due to the ongoing adoption of electronic communications and digital publishing, the volume of mailed periodicals has declined for the last several years, and likely will continue to do so for the foreseeable future. As advertisers continue to shift away from printed materials, periodicals will remain a depressed medium. In 2014, periodicals revenue of $1.6 billion, declined $33 million, or 2.0%, compared to $1.7 billion in 2013. This year's volume has declined 4.9% to 6.0 billion pieces from 2013 volume of 6.4 billion pieces. In 2013, periodicals revenue declined 4.2% from $1.7 billion in 2012; while volume declined 5.7% from 6.7 billion pieces.

**Other**

Other revenue includes ancillary services such as Certified Mail, P.O. Box services, Return Receipts and Delivery Confirmation. In addition, revenue generated from items such as the sales of money orders and passport services are also included into this category.

In 2013, we recognized an additional $1.3 billion in non-cash revenue related to a one-time change in accounting estimate for deferred revenue-prepaid postage. This accounted for approximately 2% of our operating revenue and did not affect our liquidity.

## Operating Expenses

In an effort to align Postal Service resources with anticipated types of services and volume, during the year ended September 30, 2014, the Postal Service has continued its network realignment plans that have included a reduction in both capital expenditures and operating expenditures which are under management's control.

**Compensation and Benefits**

The following table provides the components of compensation and benefits expense for current employees as of September 30, 2014, 2013 and 2012:

| (in millions) | 2014 | 2013 | 2012 |
|---|---|---|---|
| Compensation | $ 35,113 | $ 35,639 | $ 36,279 |
| Retirement | 5,758 | 5,738 | 5,854 |
| Employee health benefits | 4,804 | 4,951 | 5,187 |
| Other | 325 | 380 | 369 |
| **Total compensation and benefits expense** | **$ 46,000** | **$ 46,708** | **$ 47,689** |

Total compensation and benefits expense decreased $708 million, or 1.5%, from 2013 to 2014 and $981 million, or 2.1%, from 2012 to 2013. The decreases experienced in total compensation and benefits over the last two years were driven primarily by continued effective utilization of non-career employees, a flexibility gained through recent changes in our collective bargaining agreements and our effective management of work hours and staffing levels. This transition in our workforce composition has yielded significant cost savings, resulting in decreases of 1.2% and 0.7% in average hourly compensation rates in 2014 and 2013, respectively.

Our continued efforts to manage work hours have resulted in 3 million, 12 million and 27 million work hour reduction in 2014, 2013 and 2012, respectively. These work hour reductions were achieved primarily due to significant operational initiatives to improve efficiency and reduce costs. These initiatives included adjustments to our mail processing and transportation networks; adjustments to the hours of operation of retail units; and delivery changes, such as the consolidation of delivery units and adjustments to delivery routes.

Partially offsetting these savings were contractual wage increases and COLAs which are discussed further in conjunction with our collective bargaining agreements, as well as increases in the number of deliveries and growth in packages, which are more costly to process and deliver.

***Workforce Composition***

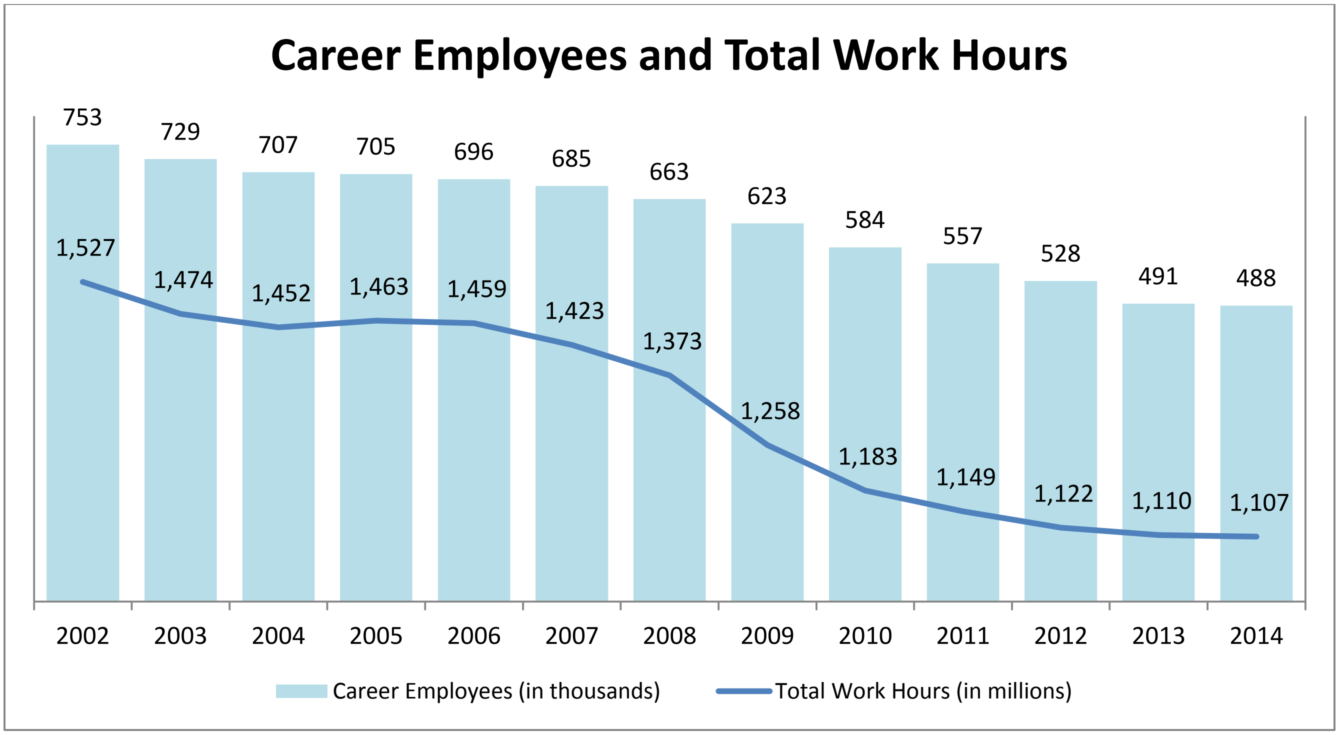
The most significant component of the decrease in compensation expense in 2014 and 2013 has been the change in our staffing composition, which utilized a greater number of non-career employees. Beginning in 2013, our labor contracts permitted greater numbers of non-career employees. This has allowed us to reduce career employee work hours and substitute non-career work hours at a reduced expense. We make every effort to utilize non-career employees to the maximum extent allowed by our collective bargaining agreements.

As of September 30, 2014, the number of career employees has decreased by approximately 40,000, or 7.6% from 2012, while the number of non-career employees has risen by approximately 29,000, or 29%, as shown in the table below:

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| Career employees | 488,000 | 491,000 | 528,000 |
| Non-career employees | 130,000 | 127,000 | 101,000 |
| **Total employees** | **618,000** | **618,000** | **629,000** |

These reductions in the career employee workforce have been accomplished almost exclusively through attrition and incentives to retire or resign.

The following graph details the decline in the number of our career employees and the decline in total work hours (career and non-career) since 2002:




***Work Hours***

Work hours are an important factor of compensation expense. As illustrated in the chart above, since 2002, work hour reductions have been the single largest contributor to the ongoing achievement of savings targets. Over that period of time, we have eliminated approximately 420 million work hours, or 27.5%, yielding over $17 billion in annual savings.

Influencing work hours are growth in the number of delivery points and the variations in products and services sold. The number of delivery points increased by approximately 972,000 in 2014 and 774,000 in 2013, although the rate of increase is still below pre-recession levels. The growth in our Shipping and Packages volume, 15% since 2012, places additional upward pressure on work hours, due to the more labor intensive activity of handling and delivering packages. Despite both an increase in delivery points and package volume, total work hours continued to decrease in 2014 and 2013.

***Collective Bargaining Agreements***

Approximately 89% of career employees are covered by collective bargaining agreements. The contracts with the four labor unions representing the majority of our employees include provisions granting annual increases and COLAs, which are linked to the CPI-W. In 2014, all major bargaining units received general wage increases of 1.0% or 1.5% and COLA adjustments. Employees represented by the APWU and NRLCA received a 1.5% general wage increase and 2014 COLAs. Employees represented by the NALC and NPMHU received a 1.0% general wage increase, 2014 COLAs, and COLAs deferred from 2013. Employees represented by the NALC and NPMHU received neither a COLA or general wage increase in 2013, although the 2013 COLA was earned and deferred until 2014.

Non-bargaining unit employee salary rates were frozen in 2012 and 2013. Most non-bargaining employees received a 1% pay increase in Calendar Year 2014. These employees did not receive COLAs or locality pay.

***Separation Incentives***

We have periodically offered targeted separation incentives to employees who agreed to retire or resign within a specified time period. These separation incentives encourage attrition and help us to reduce our career complement to better match workload and reduce costs. Since 2012, these incentives have targeted postmasters, clerks, mail handlers and administrative employees.

The Postal Service recorded an expense of $15 million, $351 million and $135 million for separation incentives during the years ended September 30, 2014, 2013 and 2012, respectively.

The table below outlines the impact of incentives which have been offered since 2012:

| Year Initiated | Impacted Employee Class | Monetary Incentive | | Employees Accepted | Charge Recorded |
|---|---|---|---|---|---|
| 2014 | Postmasters | $ 10,000 | (a) | 1,380 | $ 15 million |
| 2013 | APWU employees | $ 15,000 | (b) | 22,842 | $ 351 million |
| 2012 | Postmasters | $ 20,000 | (c) | 4,275 | $ 135 million |
| | Mail handlers | $ 15,000 | (c) | 2,925 | |

(a) Payment will be made December 5, 2014.
(b) A payment of $5,000 per employee was made on May 23, 2013 and $10,000 per employee was paid on May 23, 2014.
(c) Made in two equal installments on December 21, 2012 and December 20, 2013.

In July 2014, a Voluntary Early Retirement ("VER") was offered to approximately 3,000 eligible postmasters and accepted by 1,380 postmasters. The offer included a $10,000 incentive payment with an effective date of September 30, 2014. Remaining postmasters who were impacted by the organizational changes, but that did not accept a VER, received a reduction-in-force separation letter in October 2014 with an effective date of January 9, 2015.

On September 7, 2013, we announced a VER option for approximately 15,600 eligible managers, supervisors and local postmasters that did not include a financial incentive. This option was accepted by 1,223 employees. There was no impact to the financial results for the year ended September 30, 2013 as a result of this VER.

**Retirement Expense** - Postal Service employees participate in one of three retirement programs of the U.S. Government, based on their starting date of employment with the Federal Government. These programs are the CSRS, Dual CSRS/Social Security System ("Dual CSRS") and FERS. These programs are administered by the OPM. The funding requirements and timing of employer and employee contributions to the programs can be altered at any time with the enactment of a new law or regulation, or an amendment of existing law or regulation. For additional information, see *Item 8. Financial Statements and Supplementary Data, Note 8- Retirement Benefit Plans*. Employees may also participate in the Thrift Savings Plan ("TSP"), a defined contribution retirement savings and investment plan, administered by the Federal Retirement Thrift Investment Board.

All expenses of the retirement programs, except for retiree health benefits, are included in compensation and benefits expense. Retirement expenses for current employees consist of employer contributions to FERS, the TSP and Social Security. P.L. 109-435 suspends until 2017 the employer contributions to CSRS that would otherwise have been required under Title 5, Section 8334(a)(1) of the United States Code. In 2017, the OPM will determine whether additional funding is required for the benefit of Postal Service CSRS retirees. As a result of P.L. 109-435, the Postal Service made no contributions to the CSRS and Dual CSRS in 2014, 2013 and 2012.

The required agency contribution to the FERS retirement plan was 11.9% of wages for most employees for 2014, 2013 and 2012. Retirement expense increased by $20 million or 0.3%, to $5.8 billion in 2014 primarily due to contractual wage increases and COLAs received by bargaining employees in accordance with their collective bargaining agreements, partially offset by lower career complement levels throughout much of the year. In 2013, retirement expense of $5.7 billion was $116 million, or 2.0%, less than the 2012 expense of $5.9 billion, reflecting the 37,000 reduction in the number of career employees during 2013.

During 2014, the OPM announced that the FERS employer contribution rate for 2015 will be increased to 13.2% for most FERS employees. This is a government-wide increase based on government-wide demographics and projected salary increases. This underscores the need for legislative change which would allow for the use of Postal Service-specific demographic and projected salary increases, as management believes that the use of these assumptions would result in a more accurate, and likely lower, cost to the Postal Service.

**P.L. 109-435 Required Reporting**

As described in *Item 8. Financial Statements and Supplementary Data, Note 1- Organization and Summary of Significant Accounting Policies*, we account for participation in the retirement programs of the U.S. Government under multiemployer plan accounting rules. Although the Civil Service Retirement and Disability Fund ("CSRDF") is a single fund and does not maintain separate accounts for individual agencies, P.L. 109-435 requires certain disclosures regarding obligations and changes in net assets as if the funds were separate. The following information is provided by the OPM and represents the most recent actual data available, which is as of September 30, 2013, with projections to September 30, 2014.

***Funding Status***

As required by P.L. 109-435, the Postal Service discloses OPM-provided information regarding the costs and changes in obligations related to the FERS and CSRS retirement programs. We have reported this information based on OPM-provided actuarial valuations, the same valuations that are used by the Civil Service Retirement System Board of Actuaries to establish the normal cost and funding requirements for these retirement programs. The OPM actuarial valuations utilize the long-term economic assumptions established by the Civil Service Retirement System Board of Actuaries. These assumptions are not specific to the Postal Service; rather they are prepared for the Federal Government as a whole.

The Postal Service's portion of the FERS liability had been overfunded from 1992 to 2012. The OPM's most recent calculation estimates a FERS deficit of $0.1 billion at September 30, 2013, the latest actual data available. The OPM had previously estimated that we had overfunded our FERS obligations by approximately $0.9 billion at September 30, 2012. This change from a surplus to a deficit resulted primarily from actual 2013 experience. The OPM currently estimates the FERS deficit will increase to approximately $0.6 billion by September 30, 2014.

The Postal Service believes that, as a matter of equity, its FERS obligation should be estimated using the best available data that most accurately reflects Postal Service-specific demographics and expected pay increases. Instead of using government-wide salary growth and demographic data to calculate the Postal Service's FERS liability, which unfairly increases our present and future costs, actual Postal Service salary and demographic data should be used. The FERS liability would be reduced if the OPM calculated the amount using available postal data, as experience over the last decade demonstrates that average Postal Service salary increases are lower than what is currently being used in calculating the liability. The Postal Service has reduced its workforce and instituted cost reductions, yet the OPM calculation neglects these initiatives. Instead, government-wide factors are used where the Postal Service cannot manage these costs and workforce trends. We continue to request the OPM to reconsider its use of such government-wide factors and apply Postal Service-specific assumptions, which we believe would have resulted in a surplus of $1.4 billion as of September 30, 2013.

Under current law, there is no mechanism for addressing a FERS surplus once it has occurred, nor is there a mechanism for appealing the OPM's valuation of our FERS liability, or the normal cost percentage used to determine required contributions. However, in the event that the OPM publishes new government-wide contribution percentages, an agency may appeal to the OPM to use agency-specific data, if the agency estimates that its normal cost percentage is at least 10% lower than the OPM calculation. Legislation returning the OPM-estimated surplus and requiring use of Postal Service-specific economic and demographic assumptions is being considered in Congress, but has not reached the floor of either the House of Representatives or the Senate.

The following table provides the OPM's estimation of the funded status of the CSRS and FERS programs for Postal Service participants projected as of September 30, 2014 and as of September 30, 2013 and 2012. As allowed by law, the amounts included in the following table have been estimated based upon assumptions from Federal Government employee demographics, rather than the demographics of the Postal Service's workforce.

| (in billions) | Projected* 2014 | Actual 2013 | Actual 2012 |
|---|---|---|---|
| **CSRS** | | | |
| Actuarial Liability 9/30 | $ 202.9 | $ 204.4 | $ 209.5 |
| Current Fund Balance | 184.1 | 186.6 | 190.7 |
| **Unfunded** | **$ (18.8)** | **$ (17.8)** | **$ (18.8)** |
| **FERS** | | | |
| Actuarial Liability 9/30 | $ 103.2 | $ 96.6 | $ 90.8 |
| Current Fund Balance | 102.6 | 96.5 | 91.7 |
| **(Unfunded) Surplus** | **$ (0.6)** | **$ (0.1)** | **$ 0.9** |
| **Total CSRS and FERS** | | | |
| Actuarial Liability 9/30 | $ 306.1 | $ 301.0 | $ 300.3 |
| Current Fund Balance | 286.7 | 283.1 | 282.4 |
| **Unfunded** | **$ (19.4)** | **$ (17.9)** | **$ (17.9)** |

*9/30/13 is the latest available data.

***Net Periodic Costs***

Information about the net periodic costs for the CSRS and FERS pension plans, which is prepared by the OPM, is as follows:

| (in billions) | Projected* 2014 | Actual 2013 |
|---|---|---|
| **CSRS** | | |
| Actuarial liability as of October 1 | $ 204.4 | $ 209.5 |
| + Contributions** | 0.2 | 0.3 |
| - Benefit disbursements | (12.1) | (11.7) |
| + Interest expense | 10.4 | 10.7 |
| + Total actuarial loss | — | (4.4) |
| **Actuarial liability as of September 30** | **$ 202.9** | **$ 204.4** |
| **FERS** | | |
| Actuarial liability as of October 1 | $ 96.6 | $ 90.8 |
| + Normal cost | 3.5 | 3.5 |
| - Benefit disbursements | (2.0) | (1.8) |
| + Interest expense | 5.1 | 4.8 |
| + Total actuarial loss | — | (0.7) |
| **Actuarial liability as of September 30** | **$ 103.2** | **$ 96.6** |
| **Total actuarial liability as of September 30** | **$ 306.1** | **$ 301.0** |

*9/30/13 is the latest actual data available.
**Contributions for CSRS consist of employee contributions only.

***Cost Methods and Assumptions***

The CSRS is a defined benefit pension plan while FERS has a defined benefit component.

The following table outlines the long-term economic assumptions recommended by the CSRS Board of Actuaries in July 2012. The CSRS Board of Actuaries recommended revisions to certain demographic assumptions including additional future mortality improvement, effective for the September 30, 2013 valuation.

| | **2014** | | **2013** | |
|---|---|---|---|---|
| | **CSRS** | **FERS** | **CSRS** | **FERS** |
| Rate of Inflation | 3.00% | 3.00% | 3.00% | 3.00% |
| Long-term COLA | 3.00% | 2.40% | 3.00% | 2.40% |
| Actual COLA applied | 1.50% | 1.50% | 1.70% | 1.70% |
| Long-term salary increase | 3.25% | 3.25% | 3.25% | 3.25% |
| Actual salary increase | 1.00% | 1.00% | 0.00% | 0.00% |
| Long-term interest rate | 5.25% | 5.25% | 5.25% | 5.25% |

***Components of Net Change in Plan Assets***

The following table prepared by the OPM shows the components of the net change in plan assets for the CSRS and FERS programs:

| (in billions) | **Actual 2013*** | **Actual 2012** |
|---|---|---|
| **CSRS** | | |
| Net assets as of October 1 | $ 190.7 | $ 193.0 |
| + Contributions | 0.3 | 0.3 |
| - Benefit disbursements | (11.8) | (11.4) |
| + Investment income | 7.4 | 8.8 |
| **CSRS net assets as of September 30** | **$ 186.6** | **$ 190.7** |
| **FERS** | | |
| Net assets as of October 1 | $ 91.7 | $ 86.6 |
| + Contributions | 3.1 | 3.1 |
| - Benefit disbursements | (1.7) | (1.5) |
| + Investment income | 3.5 | 3.5 |
| **FERS net assets as of September 30** | **$ 96.6** | **$ 91.7** |

*9/30/13 is the latest actual data available.

As noted previously, CSRDF is a single fund and does not maintain separate accounts for individual employer agencies. The actual securities of the CSRDF are not allocated separately to CSRS or FERS, or to Postal Service and non-Postal Service beneficiaries. The assets of the CSRDF are composed entirely of special-issue U.S. Treasury securities with maturities of up to 15 years. The long-term securities bear interest rates ranging from 1.38% to 6.50%, while the short term securities bear interest rates of 2.13%.

The assumed rates of return on the CSRS fund balance for 2013 and 2012 were 5.25% and 5.75%, respectively; and the actual rates of return were 4.01% and 4.70%, respectively. For the FERS fund, the assumed rates of return for 2013 and 2012 were 5.25% and 5.75%, respectively; while the actual rates of return were 3.82% for 2013 and 4.00% for 2012. The projected long-term rate of return on the CSRS and FERS fund balances for 2014 was 5.25%.

The OPM estimates the contributions and benefit payments for the next five years as follows:

| (in billions) | CSRS | | FERS | |
|---|---|---|---|---|
| | Contributions | Total Benefit Payments | Contributions | Total Benefit Payments |
| 2014 | 0.2 | 12.1 | 3.0 | 2.0 |
| 2015 | 0.2 | 12.4 | 3.3 | 2.2 |
| 2016 | 0.2 | 12.7 | 3.4 | 2.5 |
| 2017 | 0.1 | 13.0 | 3.3 | 2.8 |
| 2018 | 0.1 | 13.2 | 3.3 | 3.2 |

**Health Benefits** - Postal Service employees and retirees may participate in the FEHBP, which is administered by the OPM. The Postal Service accounts for current employee and retiree health benefit costs as an expense in the period in which the contribution is due.

***Current Employees***

Health care expense is most significantly impacted by the number of employees electing coverage and the premium costs of the selected plans. The employer contribution rate for the majority of our employees is subject to collective bargaining agreements. On average, the Postal Service paid 76% of the premium costs in 2014, and 78% of the premium costs in 2013 and 2012. Our employees paid the remainder. In September 2014, the OPM announced average premium increases of 3.2% for Calendar Year 2015. Previous increases were 3.7% in 2014, 3.4% in 2013 and 3.8% in 2012.

Total employee health benefit expenses were $4.8 billion for the year ended September 30, 2014, a decrease of $147 million, or 3.0% from the 2013 expense of $5.0 billion. The decrease in 2014 primarily resulted from the lower career complement levels throughout much of the year. The 2013 expense decreased by $236 million, or 4.5%, when compared to $5.2 billion of expense in 2012. The 2013 decrease resulted from a reduction in the number of career employees during that year. Employee health benefits expense was 10.4%, 10.6% and 10.9% of total compensation and benefits expense in 2014, 2013 and 2012, respectively.

***Retirees***

Eligible employees, defined as having at least five consecutive years of participation in the FEHBP immediately preceding retirement, are entitled to continue to participate in FEHBP after retirement. Our total cost for retiree health benefits consists of two components: 1) the PSRHBF prefunding payments which are set by law and 2) our portion of the current premium expense for retirees. These amounts are recognized as an expense when due.

Retiree health benefit premium expense, which excludes prefunding payments to the PSRHBF, has grown every year due to premium increases and the increased number of retirees. Retiree health benefits premium expense increased 4.8% in 2014, 8.4% in 2013 and 7.7% in 2012. The number of Postal Service annuitants and survivors participating in FEHBP as of September 30 of each year was approximately 490,000 in 2014, compared to 491,000 in 2013 and 471,000 in 2012.

The following table shows the components of retiree health benefits expense for 2014, 2013 and 2012:

| (in millions) | 2014 | 2013 | 2012 |
|---|---|---|---|
| Retiree health benefits premiums | $ 2,985 | $ 2,850 | $ 2,629 |
| P.L. 109-435 payment to PSRHBF | 5,700 | 5,600 | 11,100 |
| **Total retiree health benefits** | **$ 8,685** | **$ 8,450** | **$ 13,729** |

With the passage of P.L. 109-435 in 2006, the PSRHBF was established and the law initially directed that we make annual prefunding payments through 2016 into the fund. Although P.L. 109-435 specifies the funding requirements through 2016, the amounts to be funded and the timing of the funding can be changed at any time with enactment of a new law or upon amendment of an existing law.

As of September 30, 2014, we have defaulted on total prefunding amounts due of $22.4 billion for the years 2012 – 2014 because we had insufficient funds to make the payments. Prior to the defaults, we notified key stakeholders, including the Administration and Congress, of the imminent default. Although we defaulted on the payments due in each year 2012, 2013 and 2014, $11.1 billion, $5.6 billion and $5.7 billion, respectively, were recorded as an expense under "Retiree health benefits" in the respective years' *Statements of Operations* and is a current liability in "*Retiree health benefits*" on the respective year's *Balance Sheets*.

Current law obligates us to make additional payments of $5.7 billion in 2015 and $5.8 billion in 2016, due by September 30 of each year. We have advised the Administration and Congress that we do not see any means by which to satisfy these future prefunding obligations. Given the low levels of our cash resources, we may be forced to prioritize payments to our employees and our suppliers to ensure that we continue to be able to fulfill our other statutory obligations, including our obligation to provide universal mail service to the nation. Refer to *Item 7. Management's Discussion and Analysis, Liquidity and Capital Resources.* The statutory requirement establishing the payment schedule in P.L. 109-435 contains no provisions addressing a payment default. As of the filing date of this report, no penalties have resulted.

Under current law, not later than 2017, the OPM will conduct an actuarial valuation and determine whether any further payments into the PSRHBF are required. If additional payments are required, the OPM will design an amortization schedule to fully amortize the remaining liability by 2056. Beginning in 2017, the PSRHBF will begin to pay the Postal Service's portion of the retiree health premiums. Also beginning in 2017, we will be required to fund the actuarially determined normal cost, plus any required amortization of the unfunded liability.

**P.L. 109-435 Required Reporting - PSRHBF**

P.L. 109-435 requires that the OPM provide, and that we report, certain information concerning the obligations, costs and funded status of the PSRHBF. The following table presents information provided by the OPM and shows the funded status and components of net periodic costs:

| (in millions) | **2014** | **2013** | |
|---|---|---|---|
| Beginning actuarial liability at October 1 | $ 95,614 | $ 93,575 | |
| - Actuarial gain | (1,542) | (1,923) | |
| + Normal costs | 2,605 | 2,673 | |
| + Interest @ 4.4% and 4.7%, respectively | 4,044 | 4,033 | |
| Subtotal net periodic costs | 5,107 | 4,783 | |
| - Premium payments | (2,981) | (2,744) | |
| Actuarial liability at September 30 | 97,740 | 95,614 | |
| - Fund balance at September 30 | (48,850) | (47,312) | * |
| **Unfunded obligations at September 30** | **$ 48,890** | **$ 48,302** | * |

*Updated to reflect an additional $20M in interest earned but not received as a result of the government's debt issuance suspension period and not reported by the OPM with last year's earnings and fund balance.

The OPM valuation of post-retirement health liabilities and normal costs was prepared in accordance with Federal Accounting Standards Advisory Board Statement of Federal Financial Accounting Standards ("SFFAS") No. 5 and SFFAS No. 33, which require the use of the aggregate entry age normal actuarial cost method.

Demographic assumptions and an interest rate assumption of 4.3% are consistent with the pension valuation assumptions and decrements are based upon counts or numbers rather than dollars.

The normal cost, which is on a per-participant basis, is computed to increase annually by a variable medical inflation rate which is assumed to be 4.2% per annum as of the valuation date, increasing to 5.6% in 2021 and then trending down to an ultimate value of 4.2%. Past-year medical inflation was assumed to be 5.3%. Normal costs are derived from the current FEHBP on-rolls population with an accrual period from entry into FEHBP to assumed retirement. Entry into the FEHBP is generally later than entry into the retirement systems.

The accrued liability is equal to the total liability less future normal cost payments. The amounts used in these valuations use the same methodology and assumptions as the OPM's financial statements, except that the average government share of premium payments for annuitants is substituted for annuitant medical costs less annuitant premium payments. This amount is assumed to increase at 4.3% per year as of the valuation date. For current Postal Service annuitants, the government share of premium payments is adjusted to reflect the pro-rata share of civilian service to total service for which the Postal Service is responsible. The pro-rata adjustment is made by applying calculated factors based upon actual payments that vary by the age and Medicare status of enrollees. For active Postal Service employees, the pro-rata share in retirement is assumed to be 93% of the total.

Assets of the PSRHBF are comprised entirely of long-term, special-issue U.S. Treasury securities with maturities of up to 15 years. The long-term securities bear interest rates ranging from 1.38% to 5.00%.

The following table shows the net assets of the PSRHBF as reported by the OPM:

| (in millions) | 2014 | 2013 | |
|---|---|---|---|
| Beginning balance at October 1 | $ 47,312 | $ 45,744 | |
| Contributions and transfers | — | — | |
| Earnings at 3.4% and 3.6%, respectively | 1,538 | 1,568 | * |
| Net increase | 1,538 | 1,568 | |
| **Fund balance at September 30** | **$ 48,850** | **$ 47,312** | * |

*Updated to reflect an additional $20M in interest earned but not received as a result of the government's debt issuance suspension period and not reported by the OPM with last year's earnings and fund balance.

Because calculation of the PSRHBF liability involves several areas of judgment, estimates of the liability could vary significantly depending on the assumptions used. Utilizing the same underlying data that was used in preparing the estimate in the table above, the September 30, 2014, unfunded obligation could range from $33 billion to $68 billion, solely by varying the inflation rate by plus or minus 1% and the 2013 unfunded obligation would range from $35 billion to $64 billion.

Although P.L. 109-435 dictates the annual prefunding requirements through 2016, these amounts and the timing of funding could change at any time with enactment of a new law or an amendment of existing law. At September 30, 2014, scheduled prefunding payments to the PSRHBF are as follows:

| (in millions) | P.L. 109-435 Requirement |
|---|---|
| 2015* | $ 28,100 |
| 2016 | 5,800 |
| 2017** | — |
| 2018** | — |
| 2019** | — |
| **Total PSRHBF commitment** | **$ 33,900** |

*The 2015 commitment includes the $22.4 billion of payments previously defaulted on and $5.7 billion which is due no later than September 30, 2015.
**Effective in 2017, the unfunded liability will be calculated by the OPM. We are obligated to fund the actuarially determined normal cost and the amortized portion of the unfunded liability.

**Workers' Compensation** - Postal Service employees injured on the job are covered by the FECA, administered by the DOL's OWCP. We are legally-mandated to participate in the federal workers' compensation program. We reimburse the DOL for all workers' compensation benefits paid to or on behalf of Postal Service employees, plus an administrative fee. Refer to *Item 8. Financial Statements and Supplementary Data, Note 10- Workers' Compensation.*

Under FECA, many types of workers' compensation claims cannot be settled through lump-sum payments, rather, compensation must be paid over many years. The FECA benefit structure is often superior to benefits available under normal federal retirement and these more lucrative payments will, in some cases, be for the rest of the lives of the claimants. This, compounded by the COLA granted by Federal Law to those claims, and no mandatory retirement age, results in substantially higher costs to the Postal Service than would likely be the case if claims management decisions were made by the Postal Service. In addition to the constraints imposed due to the legally-mandated FECA program, actuarial estimations, new compensation and medical cases, the progression of existing cases and projected cash payments that will be paid well into the future also have substantial impact on our reported liability. Future cash payments must be converted to present-day dollars, or discounted, by applying the current rates at which the liability could theoretically be settled. Discount rates can fluctuate significantly from period to period with changes in the economic and interest rate environment.

The following table presents the components of workers' compensation expense for the years ended September 30, 2014, 2013 and 2012:

| (in millions) | 2014 | 2013 | 2012 |
|---|---|---|---|
| Impact of discount rate changes | $ 485 | $ (1,745) | $ 346 |
| Actuarial revaluation of existing cases | 45 | 949 | 1,602 |
| Costs of new cases | 1,956 | 1,789 | 1,714 |
| Administrative fee | 68 | 68 | 67 |
| **Total workers' compensation expense** | **$ 2,554** | **$ 1,061** | **$ 3,729** |
| Less cash payments made on behalf of workers' compensation obligations | 1,372 | 1,372 | 1,388 |
| **Total non-cash workers' compensation expense** | **$ 1,182** | **$ (311)** | **$ 2,341** |

For the year ended September 30, 2014, workers' compensation expense increased $1.5 billion, or 140.7%, compared to 2013. The increase was primarily due to the impact of lower interest rate changes from the prior period, which accounted for $2.2 billion of the increase and by the costs of new cases, which increased by $167 million. These increases were offset by a reduction of $904 million for the actuarial revaluation of existing cases. During 2014, the Postal Service experienced a $23 million, or 2.8% decrease in compensation claim payments and a $26 million, or 5.5% increase in medical claims payments compared to the year ended September 30, 2013.

For the year ended September 30, 2013, workers' compensation expense decreased $2.7 billion, or 71.5%, compared to 2012. The decrease was primarily due to higher interest rates in 2013 and a lower actuarial revaluation of existing claims, compared to 2012. During 2013, the Postal Service experienced a $40 million, or 4.7%, decrease in compensation claim payments and a $28 million, or 6.2%, increase in medical claims payments compared to the year ended September 30, 2012. The bulk of compensation payments are due to claims on the periodic roll, with benefit payments being made every 28 days. In 2012, there were 14 such payments, while a typical year has 13. For this reason, compensation payments in 2012 were higher than they were in 2013.

In 2012, workers' compensation increased $361 million due to a change in the estimate of the workers' compensation liability. This change was considered a change in accounting estimate under U.S. GAAP, and accordingly, the impact of the change was reflected in the results of operation for 2012.

**Transportation** - Transportation expenses are primarily comprised of contracted highway, air and international transportation costs. Variations in the volume and weight of mail being transported and the mode of transportation used have significant impact on transportation expenses.

The decline in air transportation expenses in 2014 is primarily attributable to two factors: a new air cargo contract with a major supplier at lower rates effective October 2013 and the shift of some mail to less expensive ground transportation. This shift from air to ground transportation was the primary contributing factor to the increase in ground transportation expense in 2014. Changes in the prices of jet and diesel fuel also contribute to changes in our transportation costs. In 2014, the reduction in jet fuel prices which are passed through to us under the terms of our air cargo contract accounted for approximately $150 million of the air transportation expense decrease from 2013.

In 2013, growth in our shipping and packaging business was the primary driver behind the 5.3% increase in air transportation expense over 2012. Highway transportation expense remained relatively flat in 2013, reflecting stable prices for diesel fuel through most of the year.

The following table presents the components of transportation expense for the years ended September 30, 2014, 2013 and 2012:

| (in millions) | 2014 | 2013 | 2012 |
|---|---|---|---|
| Highway | $ 3,531 | $ 3,410 | $ 3,378 |
| Air | 2,092 | 2,378 | 2,259 |
| International | 934 | 906 | 950 |
| Other | 29 | 41 | 43 |
| **Total transportation expenses** | **$ 6,586** | **$ 6,735** | **$ 6,630** |

**Other Operating Expenses** - The following table provides a summary of our other operating expenses for the periods ended September 30, 2014, 2013 and 2012:

| (in millions) | 2014 | 2013 | 2012 |
|---|---|---|---|
| Supplies and services | $ 2,550 | $ 2,400 | $ 2,263 |
| Depreciation and amortization | 1,843 | 1,901 | 2,075 |
| Rent and utilities | 1,613 | 1,582 | 1,623 |
| Vehicle maintenance service* | 1,108 | 1,040 | 995 |
| Information technology and communications | 791 | 720 | 695 |
| Rural carrier equipment maintenance | 556 | 558 | 579 |
| Miscellaneous other | 892 | 973 | 957 |
| **Total other operating expenses** | **$ 9,353** | **$ 9,174** | **$ 9,187** |

* Includes fuel costs for delivery routes.

Total other operating expenses include all operating expenses other than compensation and benefits, retiree health benefits, workers' compensation and transportation. Other operating expenses increased $179 million, or 2.0% in 2014. The growth of our package business has increased our supplies and services costs. Additionally, increases in mobile communications, IT services and higher costs of maintenance of our aging vehicle fleet also contributed to the increase. These were partially offset by a decrease in depreciation expense as management continued to limit non-essential capital spending.

In 2013, total other operating expenses decreased by $13 million, or 0.1% from 2012. This resulted from continued efforts to control costs and limits on non-essential spending.

In 2012, total other operating expenses decreased by $635 million, or 6.5%, form 2011. The decrease was primarily due to lower depreciation and amortization, rent and utilities and legal expenses.

## Liquidity and Capital Resources

We continue to suffer from a lack of liquidity. Cash balances remain insufficient to support an organization with approximately $73 billion in annual operating expenses as the present cash balance can fund less than one month of operating activity and was insufficient to cover the legally required retiree health benefits prefunding payment of $5.7 billion that was due by September 30, 2014. We held cash and cash equivalents of $4.9 billion and $2.3 billion as of September 30, 2014 and 2013, respectively, and had no remaining borrowing capacity. See *Item 8. Financial Statements and Supplementary Data, Note 6-Debt* for additional information.

Although cash increased from last year's balance, the increase is largely attributable to the temporary exigent price increase on Market-Dominant services implemented in January 2014. We do not have sufficient cash balances to meet all of our existing legal obligations, make reductions in our debt and make important investments in our infrastructure. Our cash balance was not sufficient to pay the legally mandated PSRHBF payments that were due totaling $22.4 billion as of September 30, 2014. As of the date of this report, we have incurred no penalties or negative consequences resulting from our inability to make these payments.

Annual capital expenditures have declined from approximately $2.7 billion in 2007 to approximately $781 million in 2014 to conserve cash. The present level of capital expenditures is not sustainable. Our delivery fleet includes approximately 140,000 vehicles that are at least 20 years old and nearing the end of their useful life. Repair and maintenance costs for these vehicles have risen significantly in recent years. Some facilities maintenance has been deferred in recent years to save cash and the backlog needs to be addressed. Investments in package sorting and handling equipment are needed to fully capitalize on business opportunities in the growing package delivery market and other letter sorting equipment must be updated. Further, the existing level of cash could be insufficient to support operations in the event of another significant downturn in the U.S. economy. Absent legislative change, current projections indicate that we will continue to have a low level of liquidity throughout the foreseeable future.

We incurred a net loss of approximately $5.5 billion for the year ended September 30, 2014. The loss included $5.7 billion of expense accrued for the legally mandated prefunding payment for retiree health benefits. The requirement of P.L. 109-435 to prefund retiree health benefit obligations, a requirement not imposed on other federal agencies or private sector businesses, the ongoing decline in First-Class Mail volume caused by changes in consumers' and businesses' uses of mail resulting from the Great Recession and the continuing migration toward electronic communication and transactional alternatives, have been major factors contributing to our losses. Without structural change to our business model, we will continue to be negatively impacted by these factors and, absent legislative change, anticipate continuing losses for the foreseeable future.

In addition to the requirement to prefund $5.7 billion of retiree health benefits for 2014, we continue to pay our share of health insurance premiums for our retirees. This cost was $3.0 billion in 2014 and is projected to increase to $3.1 billion for 2015. In the past eight fiscal years, since the enactment of the Congressionally-mandated prefunding, we have incurred $51.7 billion of net losses, including $43.3 billion of expenses for prefunding retiree health benefits. Through 2014, we paid $20.9 billion of cash into the PSRHBF for prefunding, plus an additional $17.1 billion that was transferred in 2007 from the then-overfunded CSRS fund.

Additionally, our liquidity could be challenged if the temporary exigent rates expire. Diversion of hard copy mail continues to reduce revenue and the effects of contractually-granted inflation based COLAs and general wage increases exert constant pressure on expenses.

In the event that circumstances leave us with insufficient cash, we would be required to implement contingency plans to ensure that mail deliveries continue. These measures may require us to prioritize payments to our employees and suppliers ahead of some payments to the Federal Government, as has been done in the past.

### Postal Service Actions Taken to Improve Liquidity

In 2013, we implemented a realignment of our operations to further reduce costs and strengthen our finances. These operational realignments included reductions in the number of mail processing operations, realignment of retail office hours to match demand, reductions in the number of delivery routes and consolidations of delivery offices. In June 2014, the Postal Service announced that a second phase of mail processing realignments would begin in January 2015, culminating in a consolidation impacting up to 82 more processing operations. Additionally, we continue to leverage employee attrition, VER and utilization of non-career employees to the maximum extent permitted by our labor contracts. In July 2014, we offered a VER to approximately 3,000 postmasters who were impacted by reductions in retail hours at certain Postal Service facilities which was accepted by 1,380 postmasters.

We continue to pursue strategies within our control to increase operational efficiency and to improve liquidity. In April 2014, we revised certain service standards for Standard Mail as part of an efficiency improvement effort known as "load leveling." With this change, delivery volume became more evenly balanced across the delivery days, which improved efficiency and reduced overtime pay and operating costs.

On January 26, 2014, we implemented price increases on Market-Dominant and Competitive services. The Market-Dominant increases included a 1.7% price increase based on the CPI-U plus a temporary 4.3% increase approved by the PRC in December 2013 as an exigent rate change. The exigent rate change was approved as a surcharge to be collected only until we recover a total amount of $3.2 billion of incremental revenue above what would otherwise have been recovered through a CPI-U increase alone. As of September 30, 2014, the Postal Service has collected $1.4 billion in such incremental revenue. We have filed an appeal with the United States Court of Appeals for the District of Columbia Circuit arguing that the PRC erred in its decision to limit the duration of the exigent increase in the manner that it specified. Some mailers have also filed an appeal seeking relief from the PRC's decision to allow any exigent rate increase. Additionally, we increased prices an average of 2.4% for Competitive services.

We have conserved capital by spending only what we believed essential to maintain our existing facilities and service levels. However, an increase of capital investment is necessary to upgrade our facilities, existing fleet of vehicles and processing equipment in order to remain operationally competitive.

We continue to pursue legislation to transition to a new delivery schedule that would include package delivery Monday through Saturday (and on Sundays in some instances) and mail delivery Monday through Friday; however, changing the delivery schedule to eliminate Saturday delivery of mail is only possible with a change in existing law. We also continue to seek reforms that would establish a set of health care plans within the FEHBP that would fully integrate with Medicare for current and future Postal Service retirees, largely eliminating the current unfunded liability and the necessity for the prefunding requirement.

**Mitigating Circumstances**

Our status as an independent establishment of the executive branch that does not receive tax dollars for its operations presents unique requirements and restrictions, but also potentially mitigates some of the financial risk that would otherwise be associated with a cash shortfall. With annual revenue of nearly $68 billion, generated almost entirely through the sale of Postal Service products and services, a financially sound Postal Service continues to be vital to American commerce. The U.S. economy benefits greatly from the Postal Service and the many businesses that provide the printing and mailing services that support it. Disruption of the mail would cause undue hardship to businesses and consumers. Therefore, it is unlikely that in the event of a cash shortfall, the Federal Government would allow us to significantly curtail or cease operations. We continue to inform the Administration, Congress, the PRC and other stakeholders of the immediate and long-term financial challenges we face and the legislative changes that are required to restore financial stability. However, there can be no assurances that the requests to restructure the pension and benefit payment schedules, or any other legislative changes, will be made in the foreseeable future.

The following table summarizes future cash requirements as of September 30, 2014:

| (in millions) | Total | Less than 1 Year | 1-3 Years | 3-5 Years | After 5 Years |
|---|---|---|---|---|---|
| Debt[1] | $ 15,000 | $ 9,800 | $ 300 | $ 2,700 | $ 2,200 |
| Interest on debt[1] | 1,727 | 177 | 486 | 206 | 858 |
| Federal Employees' Retirement System supplemental liability | 201 | 7 | 13 | 13 | 168 |
| PSHRBF[2] | 33,900 | 28,100 | 5,800 | — | — |
| Workers' compensation[3] | 26,280 | 1,372 | 2,620 | 2,232 | 20,056 |
| Capital lease obligations | 472 | 91 | 167 | 113 | 101 |
| Operating leases | 6,761 | 731 | 1,287 | 1,061 | 3,682 |
| Capital commitments[4] | 770 | 705 | 65 | — | — |
| Purchase obligations[4] | 4,634 | 869 | 1,511 | 1,501 | 753 |
| Employees' leave[5] | 2,102 | 129 | 225 | 286 | 1,462 |
| **Total commitments** | **$ 91,847** | **$ 41,981** | **$ 12,474** | **$ 8,112** | **$ 29,280** |

(1) For overnight and short-term debt, the table assumes the balance as of period end remains outstanding for all periods presented.
(2) The 2015 commitment includes default amounts of $11.1 billion from 2012, $5.6 billion from 2013, $5.7 billion from 2014 and $5.7 billion which will be due September 30, 2015. Effective in 2017, the unfunded liability will be calculated by the OPM. We are obligated to fund the actuarially determined normal cost and the amortized portion of the unfunded liability.
(3) Assumes no new cases in future years. This amount represents the undiscounted expected future workers' compensation payments plus $69 million in administrative fees due October 15, 2014. We will also be obligated to pay administrative fees in future years as determined by DOL.
(4) Capital commitments pertain to purchases of equipment, building improvements, and vehicles for legally binding obligations. 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 Sheets*.
(5) Employees' leave includes both annual and holiday leave.

## Capital Investments

Given the financial and liquidity challenges facing the Postal Service, management first implemented a capital commitment plan that was below historical average levels in 2009. Discretionary capital spending limitations to conserve cash have continued since that time through the current year. Priority has been given to projects: 1) needed for safety and/or health or legal requirements; 2) required to provide service to our customers; and 3) initiatives with a high return on investment and a short payback period. The source of funds needed to fulfill these commitments was generated from our operating activities.

At the beginning of 2014, eleven major projects were in progress (i.e., major being defined as greater than $25 million approved capital), representing $2.5 billion in approved capital funding. During the year, seven new projects were approved, which totaled $0.6 billion in additional capital funding. During the year, a total of five projects representing $1.7 billion in approved capital funding were completed. The year ended with thirteen open projects that amounted to $1.4 billion in approved capital.

While the funding for a project is authorized in one year, the commitment or contract to purchase or build, including cash outlay, may take place over several years. By year-end, approximately $0.9 billion had been committed to these thirteen open projects. Through the end of 2014, approximately $0.6 billion has been disbursed for these projects.

New capital commitments in 2014 (including the major projects mentioned above), consisting of building improvements, equipment and maintenance of infrastructure investments, totaled $0.9 billion.

At the beginning of 2013, eleven major projects were in progress, representing $3.1 billion in approved capital funding. During the year, three new projects were approved, which totaled $0.2 billion in additional capital funding. During the year, a total of three projects representing $0.8 billion in approved capital funding were completed. The year ended with eleven open projects that amount to $2.5 billion in approved capital.

## Cash Flow

Cash and cash equivalents, which exclude restricted cash, totaled $4.9 billion, $2.3 billion and $2.1 billion at September 30, 2014, 2013 and 2012, respectively.

***Operating Activities*** - Cash flows provided by operating activities increased $2.4 billion in 2014 primarily due to implementing price increases on our Market-Dominant and Competitive services which became effective in January 2014 as well as increased volume in our Shipping and Packages service offerings. We continue to focus on areas to improve operating cash flows by implementing cost reduction programs and improvements to our processing operations. See *Item 8. Financial Statements and Supplementary Data, Note 2- Liquidity* for additional information.

Cash flows provided by operating activities increased $1.4 billion in 2013 primarily due to increased volume in our Shipping and Packages and Standard Mail service offerings. Additional non-cash items included $1.9 billion in depreciation and $5.6 billion in PSRHBF offset by $1.3 billion in deferred revenue primarily due to a change in accounting estimate for prepaid postage.

Cash flows used in operating activities were $431 million in 2012. The increase in cash used was due to $911 million repayment of the FERS employer contributions that were withheld from June 2011 through November 2011. Partially offsetting the FERS payment impact on cash flows was an increase in cash received for stamps that had not yet been used, otherwise known as deferred revenue - prepaid postage, which increased by $517 million in 2012.

***Investing Activities*** - Net cash used in investing activities for the periods ended September 30, 2014, 2013 and 2012 were $586 million, $588 million and $585 million, respectively. Cash flows used in investing activities were primarily due to the purchase of property and equipment, net of proceeds. We continued to employ a discretionary capital expenditure plan for priority projects that are essential to conserve cash.

***Financing Activities*** - As an "independent establishment of the Executive Branch of the Government of the United States," the Postal Service receives no tax dollars for ongoing operations and has not received an appropriation for operational costs since 1982. We fund operations chiefly through cash generated from operations and by borrowing from the FFB.

The amount borrowed is largely determined by three major factors: (1) cash flow from operations, (2) capital cash outlays, which include funds invested for new facilities, new automation equipment and new services and (3) the annual increase in debt, which is limited by statute to $3 billion. See *Item 8. Financial Statements and Supplementary Data, Note 6- Debt* for additional information.

Net cash used in financing activities for the periods ended September 30, 2014 and 2013 were $148 million and $107 million, respectively. Net cash provided by financing activities was $1.8 billion for 2012, primarily due to issuances of new debt.

## Interest and Investment Income

The majority of our interest and investment income comes from the imputed interest we recognize on the funds owed to us under the *Revenue Forgone Reform Act of 1993*. Under the Act, Congress agreed to reimburse the Postal Service $1,218 million in 42 annual installments of $29 million through 2035 for services performed in prior years. Although Congress did not appropriate the funds for these payments in 2014, 2013 and 2012, we continue to make these appropriation requests and recognize the imputed interest due on the original amortization schedule. Imputed interest for Revenue Forgone was $22 million in 2014 and $23 million for each of the years ended September 30, 2013 and 2012. See *Item 8. Financial Statements and Supplementary Data*, *Note 12- Revenue Forgone* for additional information.

Investment income was not material for the years ended September 30, 2014, 2013 and 2012, respectively.

## Interest Expense

Interest expense was $184 million, $191 million and $190 million, in 2014, 2013 and 2012, respectively. Although long-term debt carries higher interest rates than prevailing rates for short-term debt, financing a portion of debt at fixed rates decreases our interest rate risk and interest expense volatility now and in future years. At September 30, 2014, $5.2 billion of long-term obligations remain outstanding.

## Legal Matters and Contingent Liabilities

We are subject to various legal proceedings and claims in the normal course of conducting our operations. Contingent liabilities are difficult to measure, as their measurements are subject to a multitude of factors that are not easily predicted or projected about the future. An estimated loss contingency is accrued in our financial statements when we deem the outcome is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. We regularly review loss contingencies to determine the adequacy of our accruals and related disclosures. The amount of the actual losses may differ significantly from our estimates.

A material claim, in a matter captioned McConnell v. Donahoe, has been outstanding since 2010 (first instituted in 2006 as McConnell v. Potter). For a description of the pending proceedings, see *Item 3. Legal Proceedings*.

## Fair Value Measurements

In 2014 and 2013 our financial statements contain fair value disclosures required by U.S. GAAP. We did not have any recognized gains as a result of these valuation measurements in the years 2014, 2013 and 2012. All recognized losses have been incorporated into our financial statements and the unrecognized gains and losses are not considered to have a significant impact upon our operations. See *Item 8. Financial Statements and Supplementary Data*, *Note 11- Fair Value Measurement* for additional information.

## Significant Accounting Estimates

The preparation of financial statements in accordance with U.S. GAAP requires management to make significant judgments and estimates to develop certain amounts reflected and disclosed in the financial statements. In many cases, there are alternative policies or estimation techniques that could be used. We maintain a thorough process to review the application of accounting policies and to evaluate the appropriateness of the many estimates that are required to prepare the financial statements. Management discusses the development and selection of these accounting policies and estimates with the Audit and Finance Committee of the Board. However, even under optimal circumstances, estimates routinely require adjustment based on changing circumstances and new or better information.

The three accounting policies that are considered either the most judgmental, or involve the selection or application of alternative accounting policies, and are material to the financial statements, are those related to the recording of workers' compensation costs, deferred revenue-prepaid postage and contingent liabilities.

*Workers' compensation costs* are highly sensitive to discount and inflation rates and the length of time recipients are expected to stay on the compensation rolls. However, the total annual cash payment for claims is relatively stable and predictable. The workers' compensation costs reflected on our *Statements of Operations* are subject to actuarial estimates of future claim payments based upon past claim payment experience. Changes in the actuarial and inflation rate estimates and discount rates can significantly impact reported results from period to period. Inflation and discount rates are updated on a quarterly basis.

The discount rate reflects the current rate at which the workers' compensation liabilities could be effectively settled at the measurement date (e.g., the end of the accounting period). In setting the discount rates, we use the current yield, as of the measurement date, on U.S. Treasury securities that is matched to the expected duration of both the medical and compensation payments. Expected inflation in compensation claim obligations is estimated using the CPI-U as forecasted by IHS Global Insight. For medical claims, we use the average rate of medical cost increases experienced by our workers' compensation claimants over the past five years as an estimate for future medical inflation. Workers' compensation liabilities are recorded in the *Balance Sheets* as *"Workers' compensation costs"* with both current and noncurrent components.

*Deferred revenue-prepaid postage* is an estimate of postage that has been sold, but not yet used by customers. Revenue is recognized only when services are rendered. Because payments for postage are collected in advance of services being performed, revenue is deferred and reflected in the *Balance Sheets* as *"Deferred revenue-prepaid postage."* The deferred revenue estimate is developed and validated through complex mathematical and statistical methods, including regression analysis of stamp usage trends. Small differences in inputs can lead to significant differences in the estimate of the liability. Two categories of postage sales account for the majority of deferred revenue-prepaid postage: stamp sales and metered postage.

*Contingent liabilities* require significant judgment in estimating potential losses for legal and other claims. Each quarter, significant new claims and litigation are evaluated for the probability of an adverse outcome. Liabilities are recorded in the *Balance Sheets* in *"Trade payables and accrued expenses"* and *"Other non-current liabilities"* when amounts are deemed both probable and estimable. In addition, any prior claims and litigation are reviewed and, when necessary, the liability balances are adjusted for resolutions or revisions to prior estimates. Estimates of loss can therefore change as individual claims develop and additional information becomes available. We disclose the range of amounts for pending claims and litigations that are deemed to be reasonably possible of an unfavorable outcome. No provisions for these reasonably possible losses are accrued for or included in the financial statements.

For further information, see *Item 8. Financial Statements and Supplementary Data*, *Note 1- Organization and Summary of Significant Accounting Policies, Note 10- Workers' Compensation* and *Note 7- Commitments and Contingencies.*

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

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

## Legislative Update

This legislative update section provides ongoing insights into the legislative and policy decisions that may affect the Postal Service and its operations. Following are significant legislative actions which occurred during 2014:

<u>**Appropriations**</u>
On September 19, 2014, the President signed into law the *Continuing Appropriations Resolution, 2015* ("P.L. 113-164"). The law provides funding for the Federal Government to continue operations at current levels through December 11, 2014. The Postal Service's appropriation for free mail for the blind and overseas voters remains the same at $70.8 million. The law contains no provisions related to the *Revenue Forgone Reform Act of 1993*, which authorizes the Postal Service to receive $29 million annually through 2035 as reimbursement for services it provided from 1991 through 1998. The provision requiring six-day delivery frequency remains in effect.

<u>**Administration Proposals**</u>

***President's Fiscal Year 2015 Budget Proposal***
On March 4, 2014, the President released his Fiscal Year 2015 Budget Proposal for the U.S. Government. The President's proposal is one component of the budgeting process and includes a comprehensive postal reform package that would:

- Refund to the Postal Service, over a period of two years, the FERS surplus, and require that the OPM calculate future costs using factors specific to the demographics and salary assumptions of the Postal Service workforce.
- Defer the 2014 RHB prefunding payment, and reduce the fixed payments due in 2015 and 2016 by one half.
- Shift to paying an estimate of how much the Postal Service needs to set aside annually to fund retirement health care benefits for current employees, normal cost, beginning in 2014 rather than 2017 as in current law. The missed RHB payments in 2012 of $11.1 billion and 2013 of $5.6 billion would be incorporated into the 40-year amortization schedule for the remaining unfunded liability starting in 2017.

In addition, the Budget proposes reforms to reduce Postal Service costs and improve its revenue, including:

- Authorizing the Postal Service to adjust mail delivery frequency from six days to five days per week upon enactment.
- Allowing the Postal Service to leverage its resources by increasing collaboration with state and local governments.
- Allowing the Postal Service to begin shifting to centralized and curbside delivery where appropriate.
- Codifying the current administrative plan (POST Plan) to avoid small and rural Post Office closures.
- Permanently extending the January 2014 exigent price increase beyond two years, as limited by the Postal Regulatory Commission.

The President's Budget Proposal reflects reimbursement to the Postal Service in the amount of $70.8 million for free mail for the blind and overseas voting; however, it contained no provisions related to the *Revenue Forgone Reform Act of 1993*, which authorizes the Postal Service to receive $29 million annually through 2035 as reimbursement for services it provided from Fiscal Year 1991 through Fiscal Year 1998.

***Comprehensive Postal Reform Legislation***

Two significant postal reform bills were introduced in 2013 during the First Session of the 113th Congress. Both bills remained under consideration during the Second Session of the 113th Congress, which encompassed 2014.

***Postal Reform Act of 2014, S. 1486***

On August 2, 2013, the *Postal Reform Act of 2014* ("S. 1486"), was introduced in the Senate. The bill proposes to reform the Postal Service by addressing a number of financial issues, including: assessments of the FERS and the CSRS pension fund liabilities, requiring that the calculation of pension fund liabilities use Postal Service-specific economic and demographic assumptions, and returns up to $6 billion of the calculated surplus to the Postal Service within 10 days of a transfer request. The bill also grants authority for the Postal Service to negotiate retirement benefits for new employees, restructures payments for retiree health benefits, and authorizes implementation of a Postal Service health benefits plan within FEHBP that would coordinate retiree benefits with Medicare. The bill also requires arbitrators to consider the financial condition of the Postal Service when rendering decisions.

S. 1486 addresses Postal Service operations in several ways, including: requiring the Postal Service to maintain for two years the existing service standards for First-Class Mail and Periodicals, requiring a two-year moratorium on the closure or consolidation of mail processing facilities, permitting the establishment of a five-day mail delivery schedule if total mail volume during any four consecutive quarters drops below 140 billion pieces, but not before 2017. S. 1486 also allows for delivery point modernization, authorizes the Postal Service Governors to establish a system of classes and rates for Market-Dominant products, work share discounts and negotiated service agreements, gives the Postal Service the authority to introduce new non-postal and governmental services and permits the Postal Service to ship beer, wine and distilled spirits.

S. 1486 would make changes to the current governance structure, including: modifying the make-up of the Board, establishing an Advisory Committee to develop and oversee implementation of strategies to ensure the Postal Service's long-term financial solvency, appointment of a Chief Innovation Officer and creating a plan to reduce the total number of area and district offices. The bill also reforms the FECA, which is applicable to the entire Federal Government, and includes provisions related to federal property management, including co-location with other federal agencies and the disposal of real property.

On February 6, 2014, the Senate Homeland Security and Governmental Affairs Committee passed S. 1486, as amended, by a bipartisan margin of 9-1. The bill was reported favorably to the full Senate.

***Postal Reform Act of 2013, S. 2748***

On July 19, 2013, the *Postal Reform Act of 2013, ("*H.R. 2748") was introduced in the House. H.R. 2748 would allow the Postal Service to establish a five-day mail delivery schedule while temporarily mandating six-day package delivery for domestic competitive products. It would allow the Postal Service to forgo past-due payments to prefund retiree health benefits and would eliminate the past due 2013 and 2014 payments. Starting in 2015, required payments to prefund retiree health benefits would be based on an actuarial calculation designed to achieve full funding by 2056, while current retiree health benefits premiums would be paid out of the PSRHBF. H.R. 2748 would replace the current Board with a panel of five full-time executives. Once the Postal Service met certain specified financial requirements, the panel would be dissolved and replaced with a smaller Board that would initially be comprised of the panel members.

H.R. 2748 would begin to phase out door delivery of mail, except in cases where eliminating door delivery is infeasible, where customers pay for continued door delivery or where customers have a significant hardship requiring that they receive door delivery. The bill would also require above-CPI price increases for postal products for which costs exceed revenue and would not permit political committees to use the non-profit Standard mail rate. The bill would require postal workers to pay the same health and life insurance premiums as paid by other federal workers and seeks to clarify the compensation parity currently required between Postal Service and private sector workers. H.R. 2748 would allow the Postal Service to offer state and local government services. The bill creates a mechanism to allow any FERS surplus to be transferred to the PSRHBF to the extent that it exceeds any unfunded liability in CSRS and would allow the use of Postal Service-specific economic assumptions to calculate liabilities and annual payments for both the FERS and the CSRS pension systems. It also specifies that, in the future, postal employees would be subject to the same reduction-in-force authority as the rest of the federal workforce.

H.R. 2748 would limit the closure of rural post offices and require the Postal Service to consider broadband penetration, cellular phone service and the distance to the closest alternate access point when determining whether to close a post office. It would create a Chief Innovation Officer position responsible for identifying and growing new postal and authorized non-postal products and would also raise the current revenue limit on experimental product market tests.

The House Oversight and Government Reform Committee amended and passed the bill by a margin of 22-17 at its July 24, 2013 meeting. In 2014, however, no legislative action took place on H.R. 2748.

***U.S. Postal Service Board of Governors***

On July 30, 2014, the Senate Homeland Security and Governmental Affairs Committee held a meeting to consider the nominations of James C. Miller III, Stephen D. Crawford, David Michael Bennett and Victoria Reggie Kennedy, to be named Governors of the United States Postal Service. The Committee ordered the nominations reported favorably. The nominations now await consideration by the full Senate.

On September 17, 2014, the Senate Homeland Security and Governmental Affairs Committee held a hearing to consider the nomination of Chairman Mickey D. Barnett to serve an additional term on the U.S. Postal Service Board of Governors. The nomination now awaits consideration by the full Committee.

On October 8, 2014, President Obama announced his nomination of David S. Shapira to serve on the Board of Governors of the United States Postal Service for a term expiring on December 8, 2019. This nomination brought to six the total number of Board of Governors nominations pending before the Senate.

On November 12, 2014, the Senate Homeland Security and Governmental Affairs Committee held a meeting to consider the nomination of Chairman Mickey D. Barnett to serve an additional term on the U.S. Postal Service Board of Governors. The Committee ordered the nomination reported favorably. The nomination now awaits consideration by the full Senate.

***Postal Regulatory Commission***

On May 21, 2014, the Senate Homeland Security and Governmental Affairs Committee considered the nominations of Tony Hammond, of Missouri, to be a Commissioner of the Postal Regulatory Commission for a term expiring October 14, 2018, and Nanci E. Langley, of Hawaii, to be a Commissioner of the Postal Regulatory Commission for a term expiring November 22, 2018. Both nominations were reported favorably by the Committee. The nominations were sent to the full Senate for consideration.

On January 7, 2014, the PRC announced the designation of Commissioner Mark Acton as Vice Chairman of the PRC. PRC regulations provide that the Commissioners elect a member to serve as Vice Chairman for a term of one year.

**<u>Other Noteworthy Legislation</u>**

On July 17, 2014, the *Savings, Accountability, Value and Efficiency III Act of 2014* ("H.R. 5152"), a bill to save the Federal Government money by reducing duplication and increasing efficiency was introduced in the House. H.R. 5152 requires the Postal Service to reduce petroleum consumption by two percent every year over the next 10 years, and sets minimum fuel efficiency and emission standards for all new fleet vehicles. It also requires the Postal Service to incorporate new technologies that increase fuel economy or reduce emissions, and directs it to conduct a cost-benefit analysis to determine if the cost to maintain vehicles outweighs the benefit of replacement. The bill was referred to the House Oversight and Government Reform and the House Energy and Commerce Committees.

On July 23, 2014, H.R. 5179, the *Providing Opportunities for Savings, Transactions, and Lending (POSTAL) Act of 2014*, was introduced in the House. The bill would amend Title 39, United States Code, to provide that the Postal Service may offer certain basic financial services. The services would include small-dollar loans, checking accounts and interest-bearing savings accounts, services related to international money transfers, and other services determined by the Postal Service to be appropriate and in the public interest. The bill was referred to the House Oversight and Government Reform Committee.

On July 31, 2014, H.R. 5377, the *Postal Facilities Preservation and Sales Reform Act,* was introduced in the House. The bill would provide for certain safeguards with respect to the sale of Postal Service facilities listed or eligible to be listed in the National Register of Historic Places. The bill prohibits the Postal Service from entering into any contract or agreement to sell, relocate, or cease services at any historic postal facility pending review in accordance with Section 106 of the *National Historic*

*Preservation Act*. Additionally, a Federal agency, the state in which the facility is located, and city, town or local government (in order of priority) would have a right of first refusal to purchase any postal facility offered for sale by the Postal Service. The bill was referred to the House Oversight and Government Reform Committee.

On August 1, 2014, H. Res. 711, a resolution expressing the sense of the House of Representatives that the United States Postal Service should take all appropriate measures to ensure the continuation of door deliveries for all business and residential customers, was introduced in the House. The resolution is in opposition to a provision in H.R. 2748, the *Postal Reform Act of 2013*, which would phase out door delivery of mail. The measure was referred to the House Oversight and Government Reform Committee.

On September 10, 2014, the *Postal Jobs Protection Act of 2014 (*"H.R. 5445"), was introduced in the House. The measure would impose a temporary moratorium on the closure or consolidation of any mail processing facility. The bill provides that notwithstanding any other provision of law, no mail processing facility operating as of September 1, 2014 may be closed or consolidated prior to December 31, 2015. The bill was referred to the House Oversight and Government Reform Committee.

**Legislation and Nomination Expiration**

All above-mentioned pending legislation and nominations will expire if required final Congressional action does not take place before the 113th Congress adjourns.

## Item 7A. Quantitative and Qualitative Disclosures About Market Risk

The market rate risks we encounter are primarily related to foreign currency exchange rate fluctuations, interest rates and commodity prices. Historically we have not entered into derivatives for trading or speculative purposes, nor leveraged financial instruments to manage market risks, or entered into commodity instruments to manage risk of changes in energy prices.

### Foreign Exchange Risk

While we operate outside of the U.S. markets, we believe that the potential change in foreign exchange rates is not a material risk to us as a large majority of our business transactions are denominated in U.S. dollars. However, currency exchange rate fluctuations may favorably or unfavorably impact our reported earnings.

We estimate that a 1% increase or decrease in foreign exchange rates would not have a material impact on our financial statements due to the small percentage of our receipts and disbursements denominated in foreign currencies.

### Interest Rate Risk

We are impacted by changes in interest rates in the normal course of our business operations as a result of our ongoing investing and financing activities which include our revolving credit line facilities as well as our cash and cash equivalents. We assess our interest rate risks on a regular basis. We estimate that a 1% increase in interest rates would have resulted in a $43 million increase in interest expense.

We have interest rate risk associated with our workers' compensation liability, see *Item 8. Financial Statements and Supplementary Data, Note 10- Workers' Compensation,* which is highly sensitive to changes in discount (interest) rates. An increase of 1% in the interest rates would decrease the September 30, 2014 liability and 2014 expense by approximately $1.9 billion. A decrease of 1% would increase the September 30, 2014 liability and 2014 expense by approximately $2.3 billion.

We currently have no significant exposure to changing interest rates on our noncurrent debt as interest rates are fixed on such debt. As disclosed in the accompanying notes to the financial statements, see *Item 8. Financial Statements and Supplementary Data, Note 11- Fair Value Measurements*, the fair value of our noncurrent debt, exclusive of capital leases, was $5.6 billion for the year ended September 30, 2014. The underlying fair value of our noncurrent debt was estimated using prices provided by the FFB.

### Commodity Prices Risk

We currently have market risk for changes in fuel and natural gas costs. As of September 30, 2014, we estimated that a 1% increase in fuel and natural gas would have resulted in a $27 million increase in expense.

# Item 8. Financial Statements and Supplementary Data

## Report of Independent Registered Public Accounting Firm

The Board of Governors of the United States Postal Service

We have audited the United States Postal Service's internal control over financial reporting as of September 30, 2014, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) (the COSO criteria). The United States Postal Service's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the United States Postal Service's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the United States Postal Service maintained, in all material respects, effective internal control over financial reporting as of September 30, 2014, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the balance sheets of the United States Postal Service as of September 30, 2014 and 2013, and the related statements of operations, changes in net deficiency, and cash flows for each of the three years in the period ended September 30, 2014 of the United States Postal Service and our report dated December 5, 2014 expressed an unqualified opinion thereon that included an explanatory paragraph regarding the United States Postal Service's ability to generate sufficient cash flow to meet all of its financial obligations throughout their fiscal year ending September 30, 2015.

/s/ Ernst & Young LLP

McLean, Virginia
December 5, 2014

## Report of Independent Registered Public Accounting Firm

The Board of Governors of the United States Postal Service

We have audited the accompanying balance sheets of the United States Postal Service as of September 30, 2014 and 2013, and the related statements of operations, changes in net deficiency, and cash flows for each of the three years in the period ended September 30, 2014. These financial statements are the responsibility of the United States Postal Service's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the United States Postal Service at September 30, 2014 and 2013, and the results of its operations and its cash flows for each of the three years in the period ended September 30, 2014, in conformity with U.S. generally accepted accounting principles.

As discussed more fully in Note 2 to the financial statements, the United States Postal Service, an independent establishment of the executive branch of the Government of the United States, is dependent upon future actions of the Government to continue its operations in the ordinary course as a result of continuing operating losses and statutory funding requirements for employee benefit obligations. The Postal Service has incurred recurring losses from its operations primarily due to sustained declines in mail volume and statutory and regulatory restrictions have constrained the ability of the Postal Service to implement strategies to improve efficiency, reduce costs and increase revenue. Due to these conditions, during fiscal year 2014, the Postal Service defaulted on a $5.7 billion prefunding payment required to be paid to the Postal Service Retiree Health Benefits Fund by Public Law (P.L.) 109-435, the Postal Accountability and Enhancement Act, by September 30, 2014 and has not satisfied $16.7 billion of required prefunding payments due in previous years. The Postal Service does not expect to have sufficient cash to satisfy these obligations or to satisfy the related additional prefunding payment due by September 30, 2015 for $5.7 billion. The statutory requirement establishing the payments required by P.L. 109-435 contains no provisions addressing a payment default. The Postal Service does not, at this time, anticipate any legal consequences, under current law, from its inability to make the required payments. Management expects, but no assurances can be given, that additional legislation will be enacted to address the short-term funding requirements of the United States Postal Service and to address regulatory restrictions that have not allowed the Postal Service to adjust its operations to levels commensurate with its current revenue base.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the United States Postal Service's internal control over financial reporting as of September 30, 2014, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) and our report dated December 5, 2014 expressed an unqualified opinion thereon.

In accordance with *Government Auditing Standards*, we also have issued our report dated December 5, 2014 on our consideration of the United States Postal Service's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

/s/ Ernst & Young LLP

McLean, Virginia
December 5, 2014

# United States Postal Service
# Statements of Operations

| (in millions) | Year Ended September 30, 2014 | 2013 | 2012 |
|---|---|---|---|
| **Revenue** | | | |
| Operating revenue | $ 67,764 | $ 67,195 | $ 65,079 |
| Other revenue | 66 | 123 | 144 |
| **Total revenue** | **67,830** | **67,318** | **65,223** |
| **Operating expenses** | | | |
| Compensation and benefits | 46,000 | 46,708 | 47,689 |
| Retiree health benefits | 8,685 | 8,450 | 13,729 |
| Workers' compensation | 2,554 | 1,061 | 3,729 |
| Transportation | 6,586 | 6,735 | 6,630 |
| Other operating expenses | 9,353 | 9,174 | 9,187 |
| **Total operating expenses** | **73,178** | **72,128** | **80,964** |
| **Loss from operations** | **(5,348)** | **(4,810)** | **(15,741)** |
| Interest and investment income | 24 | 24 | 25 |
| Interest expense | (184) | (191) | (190) |
| **Net loss** | **$ (5,508)** | **$ (4,977)** | **$ (15,906)** |

*See accompanying notes to the financial statements.*

## United States Postal Service
## Balance Sheets

| (in millions) | September 30, 2014 | September 30, 2013 |
|---|---|---|
| **Assets** | | |
| **Current Assets:** | | |
| Cash and cash equivalents | $ 4,906 | $ 2,326 |
| Restricted cash | 246 | 312 |
| Receivables, net | 930 | 984 |
| Supplies, advances and prepayments | 122 | 122 |
| **Total current assets** | **6,204** | **3,744** |
| Property and equipment, net | 16,338 | 17,512 |
| Other assets | 420 | 385 |
| **Total assets** | **$ 22,962** | **$ 21,641** |
| **Liabilities and Net Deficiency** | | |
| **Current Liabilities:** | | |
| Compensation and benefits | $ 1,506 | $ 1,529 |
| Retiree health benefits | 22,417 | 16,766 |
| Workers' compensation costs | 1,320 | 1,322 |
| Payables and accrued expenses | 2,023 | 1,913 |
| Deferred revenue-prepaid postage | 3,064 | 2,993 |
| Customer deposit accounts | 1,191 | 1,229 |
| Other current liabilities | 1,221 | 1,131 |
| Current portion of debt | 9,800 | 9,800 |
| **Total current liabilities** | **42,542** | **36,683** |
| Workers' compensation costs, noncurrent | 17,102 | 15,918 |
| Employees' accumulated leave, noncurrent | 1,982 | 1,982 |
| Other noncurrent liabilities | 1,467 | 1,681 |
| Noncurrent portion of debt | 5,200 | 5,200 |
| **Total liabilities** | **68,293** | **61,464** |
| **Net Deficiency:** | | |
| Capital contributions of the U.S. Government | 3,132 | 3,132 |
| Deficit since 1971 reorganization | (48,463) | (42,955) |
| **Total net deficiency** | **(45,331)** | **(39,823)** |
| **Total liabilities and net deficiency** | **$ 22,962** | **$ 21,641** |

*See accompanying notes to the financial statements.*

## United States Postal Service
## Statements of Changes in Net Deficiency

| (in millions) | Capital Contributions of U.S. Government | Accumulated Deficit Since Reorganization | Total Net Deficiency |
|---|---|---|---|
| **Balance, September 30, 2011** | **$ 3,132** | **$ (22,072)** | **$ (18,940)** |
| Net loss | — | (15,906) | (15,906) |
| **Balance, September 30, 2012** | **$ 3,132** | **$ (37,978)** | **$ (34,846)** |
| Net loss | — | (4,977) | (4,977) |
| **Balance, September 30, 2013** | **$ 3,132** | **$ (42,955)** | **$ (39,823)** |
| Net loss | — | (5,508) | (5,508) |
| **Balance, September 30, 2014** | **$ 3,132** | **$ (48,463)** | **$ (45,331)** |

*See accompanying notes to the financial statements.*

## United States Postal Service
## Statements of Cash Flows

| (in millions) | Years Ended September 30, 2014 | 2013 | 2012 |
|---|---|---|---|
| **Cash flows from operating activities:** | | | |
| Net loss | $ (5,508) | $ (4,977) | $ (15,906) |
| Adjustments to reconcile net loss to cash provided by (used in) operations: | | | |
| Depreciation and amortization | 1,843 | 1,901 | 2,075 |
| Loss (gain) on disposals of property and equipment, net | 43 | (53) | (5) |
| (Increase) decrease in other assets | (35) | — | 17 |
| Increase (decrease) in noncurrent workers' compensation | 1,184 | (312) | 2,343 |
| (Decrease) increase in noncurrent deferred appropriations and other revenue | (5) | 13 | (3) |
| (Decrease) increase in other noncurrent liabilities | (53) | 141 | (97) |
| Changes in current assets and liabilities: | | | |
| Receivables, net | 54 | (66) | 108 |
| Other assets | — | 4 | (6) |
| Retiree health benefits | 5,651 | 5,561 | 11,198 |
| Payables, accrued expenses and other | 1 | (252) | (615) |
| Deferred revenue-prepaid postage, prepaid box rents and other | 139 | (1,026) | 460 |
| **Net cash provided by (used in) operating activities** | **3,314** | **934** | **(431)** |
| **Cash flows from investing activities:** | | | |
| Change in restricted cash | 66 | (79) | (28) |
| Purchases of property and equipment | (781) | (667) | (705) |
| Proceeds from sales of property and equipment | 129 | 158 | 148 |
| **Net cash used in investing activities** | **(586)** | **(588)** | **(585)** |
| **Cash flows from financing activities:** | | | |
| Issuance of notes payable | 5,800 | 5,500 | 5,300 |
| Payments on notes payable | (5,800) | (5,500) | (4,100) |
| Net change in revolving credit line | — | — | 800 |
| Payments on capital lease obligations | (58) | (59) | (51) |
| U.S. Government appropriations | (90) | (48) | (129) |
| **Net cash (used in) provided by financing activities** | **(148)** | **(107)** | **1,820** |
| Net increase in cash and cash equivalents | 2,580 | 239 | 804 |
| Cash and cash equivalents at beginning of year | 2,326 | 2,087 | 1,283 |
| **Cash and cash equivalents at end of period** | **$ 4,906** | **$ 2,326** | **$ 2,087** |
| **Supplemental cash flow disclosures:** | | | |
| Cash paid for interest | $ 184 | $ 190 | $ 188 |

*See accompanying notes to the financial statements.*

## Note 1- Organization and Summary of Significant Accounting Policies

## Organization

The United States Postal Service (the "Postal Service") began operations on July 1, 1971, in accordance with the provisions of the *Postal Reorganization Act,* which established it as an "independent establishment of the executive branch of the Government of the United States." Governing decisions are made by a Board of Governors (the "Board"), which consists of independent members who are appointed by the President with the advice and consent of the Senate. The Board also includes the Postmaster General, who is appointed by the independent members of the Board, and the Deputy Postmaster General, who is appointed by the independent Governors and the Postmaster General.

The *Postal Accountability and Enhancement Act*, Public Law 109-435 ("P.L. 109-435"), made further revisions to the *Postal Reorganization Act*. P.L. 109-435 created the Postal Regulatory Commission ("PRC"), endowing the PRC with regulatory and oversight obligations and classified postal services into two broad categories: Market-Dominant and Competitive services. Price increases for those services classified as Market-Dominant are subject to a price cap based on the Consumer Price Index for All Urban Consumers ("CPI-U"). The regulations for Competitive services place no upper limit on price changes but do set a price floor. The Postal Service's governing statute is codified in Title 39 of the United States Code.

While there are distinct legal and regulatory classifications of postal services known as either Market-Dominant or Competitive "products," Postal Service management uses the following broad service categories to describe and report on the performance of the business:

> *First-Class Mail* — Letters, postcards or any flat advertisement or merchandise destined for either domestic (up to 13 ounces) or international (up to 4 pounds) delivery. First-Class letters include personal correspondence, bills or statements of account and payments.
>
> *Standard Mail* — Any item, including advertisements and marketing packages, weighing less than 16 ounces that is not required to be sent using First-Class Mail. Standard Mail is typically used for direct advertising to multiple delivery addresses. The Every Door Direct Mail options enable customers to prepare direct mailings without names and addresses for distribution to all business and residential customers on individual carrier routes.
>
> *Shipping and Packages* — This category includes: *First-Class Package Service is* a shipping option for high-volume shippers of packages that weigh less than one pound and First-Class Mail parcels for shipment of boxes, thick envelopes or tubes of 13 ounces or less; *Package Services* is for merchandise or printed matter, such as library and media mail weighing up to 70 pounds; *Parcels* includes Parcel Select, Parcel Return Service and Standard Mail Parcel Services which provide commercial customers with a means of package shipment; *Priority Mail* is offered as a service both within the U.S. and abroad and the domestic offering is a 1–3 day specified (non-guaranteed) delivery service; and *Priority Mail Express* provides an overnight, money-back guaranteed service which includes tracking, proof of delivery and basic insurance up to $100. Priority Mail Express delivery is offered to most U.S. destinations and is available 365 days a year.
>
> *International Mail* — Offered for mail service and the shipping market with individual customer contracts and agreements with other postal administrations. Priority Mail Express International and Priority Mail International services are offered to compete in the eCommerce cross-border business. They provide an affordable option for the Postal Service's retail and business customers for much of their shipping needs to over 180 countries. Global Express Guaranteed is the premier international shipping option that offers reliable, date-certain delivery in 1–3 business days to major markets, with a money-back guarantee.
>
> *Periodicals* — Offered for newspaper, magazine and newsletter distribution. This service requires prior authorization by the Postal Service.
>
> *Other Services* — This broad category includes: *Post Office Boxes* which provide customers an additional method for mail delivery that is private and convenient; *Money Orders* offer customers a safe, convenient and economical method for the remittance of payments. Postal Service money orders can be purchased at most post offices and can be sent within the U.S. and to some foreign countries. Postal Service money orders are available for any amount up to $1,000 and can be cashed at most post offices or can be deposited or negotiated at financial institutions; *Extra Services* offer a

variety of service enhancements that provide security, proof of delivery or loss recovery. These services include: Certified Mail, Registered Mail, Signature Confirmation, Adult Signature and Insurance up to $5,000 and are available online, at Post Offices or at automated postal centers.

Products and services are sold through approximately 32,000 post offices, stations and branches, plus a large network of Contract Postal Units, Community Post Offices, Village Post Offices, commercial outlets which sell stamps on the Postal Service's behalf and on the Postal Service website http://www.usps.com. The Postal Service has a very diverse customer base and is not dependent on a single customer or small group of customers. No single customer represents more than 3% of operating revenue. Operations are conducted primarily in the domestic market, with international mail services representing approximately 4.5% of revenue.

Approximately 89% of career employees are covered by collective bargaining agreements and are 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"). By law, the Postal Service also consults with management organizations representing most of the employees not covered by collective bargaining agreements. These consultations provide an opportunity for non-bargaining unit employees in the field to participate directly in the planning, development and implementation of programs and policies affecting managerial employees.

The Postal Service is not a reporting company under the *Securities Exchange Act of 1934*, as amended, and is not subject to regulation by the Securities and Exchange Commission ("SEC"). However, it is required under P.L.109-435 to file with the PRC certain financial reports containing information prescribed by the SEC under Section 13 of the *Securities Exchange Act of 1934*. These reports include the annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K.

Pursuant to Title 39 and PRC regulations, additional disclosures on the organization and finances, including Cost and Revenue Analysis reports, Revenue, Pieces and Weight reports, financial and strategic plans, the *Annual Report to Congress* and the *Comprehensive Statement on Postal Operations* are also filed with the PRC.

All references to years in this report, unless otherwise stated, refer to fiscal years beginning October 1 and ending September 30. All references to quarters, unless otherwise stated, refer to fiscal quarters.

Subsequent events have been evaluated through the date the Postal Service filed its Form 10-K for the year ended September 30, 2014, with the PRC.

## Summary of Significant Accounting Policies

The preparation of financial statements in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, management evaluates its estimates which are based on historical experience and various other assumptions that management believes are reasonable under the circumstances, the results of which form a basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions; however, management believes that its estimates are reasonable and that the actual results will not vary significantly from the estimated amounts.

**Cash and Cash Equivalents**

Cash and cash equivalents consist of cash and short-term, highly liquid investments with maturities of 90 days or less.

**Restricted Cash**

Restricted cash includes funds received by the Postal Service which are restricted by agreement with the U.S. Department of Justice. They are not available for immediate and general use. These amounts are comprised of consumer fraud and forfeiture funds received and amounts recovered for the victims of a large mail and wire fraud case.

**Receivables, net of allowances**

Receivables are recorded at the amount invoiced, net of allowances. Allowances for potential credit losses are recognized at each balance sheet date. These estimates are determined based on historical collection experience, trends in customer payment frequency and judgments about the probable effects on observable data, including present economic conditions and the financial health of specific customers and market sectors.

**Property and Equipment**

Property and equipment is recorded at cost, which includes the interest on borrowings used to pay for the construction of major capital additions, less accumulated depreciation. Depreciation expense is recorded using the straight-line method over the estimated useful lives, which range from 3 - 40 years. Depreciation expense is included in *"Other operating expenses"* in the *Statements of Operations*. The costs and accumulated depreciation of assets sold or retired are removed from balance sheet accounts in the period in which the transaction occurred. General maintenance and repair costs are charged to expense as incurred.

**Impaired Assets**

Impairment losses on long-lived assets are recorded when events or circumstances indicate that the assets' fair value is less than the carrying value. When such a determination is made, the carrying values of the assets are written down to fair value. Fair value is determined by independent appraisals for real property. Due to the absence of a market for most types of mailing equipment, impaired equipment assets are typically assigned a fair value of zero. Impairment charges included in *"Other operating expenses"* in the *Statements of Operations* were $62 million, $26 million and $80 million for the years ended September 30, 2014, 2013 and 2012, respectively.

**Deferred Revenue–Prepaid Postage**

Deferred revenue–prepaid postage is an estimate of postage that has been sold, but not yet used by customers. Revenue is recognized when mail is delivered. Because payments for postage are collected in advance of services being performed, revenue is deferred and reflected in the *Balance Sheets* as *"Deferred revenue–prepaid postage."* Two categories of postage sales account for the majority of deferred revenue–prepaid postage: stamp sales and metered postage.

Deferred revenue for stamp sales is developed and validated through complex mathematical and statistical sampling methods for estimating usage, including regression analysis of stamp usage trends. Small differences in inputs can lead to significant differences in the estimate of the liability. The estimated stamp usage is subtracted from stamp sales with the difference representing the Postal Service's obligation to perform future services. That obligation is reduced by recognizing a provision for stamps sold that may never be used; either through loss, damage or collecting activity.

Metered postage is primarily used by businesses. Deferred revenue related to meters is estimated by monitoring the actual usage of all postage meters that had postage added during the month preceding the financial measurement date. The information from the two most recent meter readings is used to derive a deferral percentage, which is applied to all postage meter receipts for the month.

Included in the estimate of deferred revenue–prepaid postage is an estimate for mail that is in-transit within the postal system. The following table summarizes deferred revenue–prepaid postage by category as of September 30, 2014 and 2013:

| (in millions) | 2014 | 2013 |
|---|---|---|
| Forever stamps | $ 2,272 | $ 2,179 |
| Non-forever stamps | 72 | 96 |
| Meters | 392 | 403 |
| Mail in-transit | 279 | 265 |
| Other | 49 | 50 |
| **Total deferred revenue-prepaid postage** | **$ 3,064** | **$ 2,993** |

**Contingent Liabilities**

The Postal Service is a party to various legal proceedings and claims in the normal conduct of its operations. Contingent liabilities require significant judgment in estimating potential losses for legal and other claims. Each quarter, significant new claims and litigation are evaluated for the probability of an adverse outcome. Any prior claims and litigation are also reviewed, and when necessary, the liability balance is adjusted for resolutions or revisions to prior estimates. Estimates of loss can therefore change as additional information becomes available. See *Note 7- Commitments and Contingencies* for additional information.

**Employees' Accumulated Leave, net**

Employees earn annual leave based on the number of creditable years of service with the Postal Service. The Postal Service advances annual leave to employees at the beginning of each calendar year for the value of leave they will earn for the current year. Leave taken by employees before it is earned is considered an advance. Advances were $155 million and $152 million at September 30, 2014 and 2013, respectively. Employees' accumulated leave, net represents leave earned as of the balance sheet date and is recorded net of advances.

**Retiree Benefits**

Employees are eligible to participate in the Federal Government pension and retiree health benefits programs. The Postal Service is required to provide funding for these plans as determined by the Office of Personnel Management ("OPM"), the administrator of the plans. The Postal Service cannot direct the costs, benefits or funding requirements of the plans. Accordingly, the plans are accounted for using multiemployer plan accounting rules, and expense is recorded in the period in which the contribution is due and payable. These amounts can fluctuate significantly from year to year, if changes in funding requirements are made. See *Note 8- Retirement Benefit Plans* and *Note 9- Health Benefit Plans* for additional information.

**Workers' Compensation**

Postal Service employees are covered by the Federal Employees' Compensation Act ("FECA"), administered by the Department of Labor ("DOL") Office of Workers' Compensation Programs ("OWCP"). The Postal Service uses an estimation model to forecast and record workers' compensation expense for the present value of estimated future payments. See *Note 10- Workers' Compensation* for additional information.

**Leases**

The Postal Service leases over 23,000 real properties. As the lessee, the Postal Service classifies a lease which has substantially all the risks and rewards of ownership as a capital lease. These leases are capitalized on the commencement date of the lease at the lower of the fair value of the leased assets and the present value of the minimum lease payments. The discount rate used to determine the present value is based on the average Treasury rates. The property acquired under a financing lease is depreciated over the lease term. Other lease arrangements in which substantially all risks and rewards of ownership are retained by the lessor are classified as operating leases. Rent expense for operating leases is included in *"Other operating expenses"* in the *Statements of Operations* on a straight-line basis over the term of the lease.

**Revenue Forgone Appropriation**

Revenue forgone is an appropriation from Congress which covers the cost of providing mailing services to certain groups at no cost or at reduced rates. The costs incurred for these services are estimated by the Postal Service and submitted to Congress annually. Congress subsequently approves or alters the amount and funds the necessary appropriation. See *Note 12- Revenue Forgone* for additional information.

**Emergency Preparedness Appropriation**

Emergency preparedness appropriations were received from Congress to help pay the costs of keeping mail, Postal Service employees and Postal Service customers safe and are restricted for such use. These funds were accounted for as deferred revenue upon receipt and were generally used to procure capital equipment. The majority of these funds were received in 2001. Revenue for emergency preparedness appropriations is recognized when depreciation expense for the purchased equipment is recorded and consumables incurred to support the operation of the equipment. The emergency preparedness appropriations revenue recognized was $90 million, $48 million and $129 million for the years ended September 30, 2014, 2013 and 2012, respectively. The majority of the amount recorded in 2012 reflects the revenue recognized to offset the impairment expense related to equipment originally funded by appropriations that was taken out of service as a result of a process improvement.

Deferred revenue at September 30, 2014 and 2013 related to emergency preparedness appropriations was $93 million and $184 million, respectively. Deferred revenue from appropriations is included on the *Balance Sheets in "Other current liabilities"* and *"Other noncurrent liabilities."*

**Advertising**

Advertising costs are expensed as incurred and are included in *"Other operating expenses"* in the *Statements of Operations*. Advertising expenses were $175 million, $140 million and $125 million for the years ended September 30, 2014, 2013 and 2012, respectively.

**Foreign Currency Translation**

Foreign currency translation risk can arise from international mail transactions related to settlements of receivables and payables with foreign postal administrations. The majority of international accounts are denominated in special drawing rights ("SDRs"). SDRs exchange rate fluctuates daily based on a group of currencies comprised of the Euro, Japanese yen, British pound sterling and the U.S. dollar. Changes in the relative value of these currencies will increase or decrease the value of the settlement accounts and result in a gain or loss that is included in operating results. The impact of foreign currency translation on operating results was not material for the years ended September 30, 2014, 2013 and 2012.

**Segment Information**

The Postal Service operates as one segment throughout the U.S., its possessions and territories.

**Reclassifications**

Certain prior year amounts have been reclassified to conform to the current year's presentation. Specifically, certain revenue have been reclassified from *"Operating revenue"* to *"Other revenue"* on the *Statements of Operations*. These reclassifications had no effect on previously reported total revenue, operating loss or net loss.

**Related Parties**

The Postal Service has significant transactions with other U.S. government agencies, as disclosed throughout this report. For the years ended September 30, 2014, 2013 and 2012, revenue from other U.S. Government agencies was $771 million, $777 million and $852 million, respectively, and is included in *"Operating revenue"* in the *Statements of Operations*. Expenses incurred for transactions with other U.S. Government agencies are included in *"Operating expenses,"* in the *Statements of Operations.*

**Recent Accounting Standards**

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

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

## Note 2- Liquidity

The Postal Service continues to suffer from a lack of liquidity. Cash balances remain insufficient to support an organization with approximately $73 billion in annual operating expenses as the present cash balance can fund less than one month of operating activity and was insufficient to cover the legally required retiree health benefits prefunding payment of $5.7 billion that was due by September 30, 2014. The Postal Service held cash and cash equivalents of $4.9 billion and $2.3 billion as of September 30, 2014 and 2013, respectively, and had no remaining borrowing capacity. See *Note 6- Debt* for additional information.

Although cash increased from last year's balance, the increase is largely attributable to the temporary exigent price increase on Market-Dominant services implemented in January 2014. The Postal Service does not have sufficient cash balances to meet all of its existing legal obligations, make reductions in debt and make important investments in its infrastructure. The Postal Service's cash balance was not sufficient to pay the legally mandated PSRHBF payments that were due totaling $22.4 billion as of September 30, 2014. As of the date of this report the Postal Service has incurred no penalties or negative consequences resulting from its inability to make these payments.

Annual capital expenditures have declined from approximately $2.7 billion in 2007 to approximately $781 million in 2014 to conserve cash. The present level of capital expenditures is not sustainable. The Postal Service's delivery fleet includes approximately 140,000 vehicles that are at least 20 years old and nearing the end of their useful life. Repair and maintenance costs for these vehicles have risen significantly in recent years. Some facilities maintenance has been deferred in recent years to save cash and the backlog needs to be addressed. Investments in package sorting and handling equipment are needed to fully capitalize on business opportunities in the growing package delivery market and other letter sorting equipment must be updated. Further, the existing level of cash could be insufficient to support operations in the event of another significant downturn in the U.S. economy. Absent legislative change, current projections indicate that the Postal Service will continue to have a low level of liquidity throughout the foreseeable future.

The Postal Service incurred a net loss of $5.5 billion for the year ended September 30, 2014. The loss included $5.7 billion of expense accrued for the legally mandated PSRHBF prefunding payment for retiree health benefits. The requirement of P.L. 109-435 to prefund retiree health benefit obligations, a requirement not imposed on other federal agencies or private sector businesses, the ongoing decline in First-Class Mail volume caused by changes in consumers' and businesses' uses of mail resulting from the Great Recession and the continuing migration toward electronic communication and transactional alternatives, have been major factors contributing to Postal Service losses. Without structural change to the Postal Service's business model, it will continue to be negatively impacted by these factors and, absent legislative change, it anticipates continuing losses for the foreseeable future.

In addition to the requirement to prefund $5.7 billion of retiree health benefits for 2014, the Postal Service continues to pay its employer share of health insurance premiums for Postal Service's retirees, which was $3.0 billion in 2014. In the past eight fiscal years, since the enactment of the Congressionally-mandated prefunding, the Postal Service has incurred $51.7 billion of net losses, including $43.3 billion of expenses for prefunding retiree health benefits. Through 2014, the Postal Service has paid $20.9 billion of cash into the PSRHBF for prefunding, plus an additional $17.1 billion that was transferred in 2007 from the then-overfunded Civil Service Retirement System ("CSRS") fund.

Additionally, the Postal Service's liquidity could be challenged if the temporary exigent rates expire. Diversion of hard copy mail continues to reduce revenue and the effects of contractually-granted inflation based cost of living adjustments ("COLAs") and general wage increases exert constant pressure on expenses.

In the event that circumstances leave the Postal Service with insufficient cash, it would be required to implement contingency plans to ensure that mail deliveries continue. These measures may require the Postal Service to prioritize payments to its employees and suppliers ahead of some payments to the Federal Government, as has been done in the past.

## Postal Service Actions Taken to Improve Liquidity

In 2013, the Postal Service implemented a realignment of its operations to further reduce costs and strengthen its finances. These operational realignments included reductions in the number of mail processing operations, realignment of retail office hours to match demand, reductions in the number of delivery routes and consolidations of delivery offices. In June 2014, the Postal Service announced that a second phase of mail processing realignments would begin in January 2015, culminating in a consolidation impacting up to 82 more processing operations. Additionally, the Postal Service continues to leverage employee attrition, Voluntary Early Retirement ("VER") and utilization of non-career employees to the maximum extent permitted by its labor contracts. In July 2014, the Postal Service offered a VER to approximately 3,000 postmasters who were impacted by reductions in retail hours at certain postal facilities which was accepted by 1,380 postmasters.

The Postal Service continues to pursue strategies within its control to increase operational efficiency and to improve liquidity. In April 2014, the Postal Service revised certain service standards for Standard Mail as part of an efficiency improvement effort known as “load leveling.” With this change, delivery volume became more evenly balanced across the delivery days, which improved efficiency and reduced overtime pay and operating costs.

On January 26, 2014, the Postal Service implemented price increases on Market-Dominant and Competitive services. The Market-Dominant increases included a 1.7% price increase based on the CPI-U plus a temporary 4.3% increase approved by the PRC in December 2013 as an exigent rate change. The exigent rate change was approved as a surcharge to be collected only until the Postal Service recovers a total amount of $3.2 billion of incremental revenue above what it would otherwise have recovered through a CPI-U increase alone. As of September 30, 2014, the Postal Service collected $1.4 billion in such incremental revenue. The Postal Service has filed an appeal with the United States Court of Appeals for the District of Columbia Circuit arguing that the PRC erred in its decision to limit the duration of the exigent increase in the manner that it specified. Some mailers have also filed an appeal seeking relief from the PRC’s decision to allow any exigent rate increase. Additionally, the Postal Service increased prices an average of 2.4% for Competitive services.

The Postal Service has conserved capital in recent years by spending only what it believed essential to maintain its existing facilities and service levels. However, an increase of capital investment is necessary to upgrade its facilities, existing fleet of vehicles and processing equipment in order to remain operationally competitive.

The Postal Service continues to pursue legislation to transition to a new delivery schedule that would include package delivery Monday through Saturday (and on Sundays in some instances) and mail delivery Monday through Friday; however, changing the delivery schedule to eliminate Saturday delivery of mail is only possible with a change in existing law. The Postal Service also continues to seek reforms that would establish a set of health care plans within the Federal Employees’ Health Benefits Program (“FEHBP”) that would fully integrate with Medicare for current and future Postal Service retirees, largely eliminating the current unfunded liability and the necessity for the prefunding requirement.

### Mitigating Circumstances

The Postal Service’s status as an independent establishment of the executive branch that does not receive tax dollars for its operations presents unique requirements and restrictions, but also potentially mitigates some of the financial risk that would otherwise be associated with a cash shortfall. With annual revenue of nearly $68 billion, generated almost entirely through the sale of postal products and services, a financially sound Postal Service continues to be vital to American commerce. The U.S. economy benefits greatly from the Postal Service and the many businesses that provide the printing and mailing services that support it. Disruption of the mail would cause undue hardship to businesses and consumers. Therefore, it is unlikely that in the event of a cash shortfall, the Federal Government would allow the Postal Service to significantly curtail or cease operations. The Postal Service continues to inform the Administration, Congress, the PRC and other stakeholders of the immediate and long-term financial challenges it faces and the legislative changes that are required to restore financial stability. However, there can be no assurances that the requests to restructure the pension and benefit payment schedules, or any other legislative changes, will be made in the foreseeable future.

## Note 3- Receivables and Major Customers

The following table summarizes current receivables, net of allowances as of September 30, 2014 and 2013:

| (in millions) | 2014 | 2013 |
|---|---|---|
| Foreign countries | $ 595 | $ 618 |
| U.S. Government | 90 | 118 |
| Other | 302 | 302 |
| Receivables before allowances | 987 | 1,038 |
| Less: Allowances | 57 | 54 |
| **Receivables, net** | **$ 930** | **$ 984** |

Receivables from foreign countries were 60% of the total receivables before allowances for the years ended September 30, 2014 and 2013. The largest receivable was from China, which was 28% of the total foreign balance outstanding in each year.

Total U.S. Government receivables consist primarily of appropriations receivables of $50 million and $68 million and military and official mail receivables of $37 million and $47 million for the years ended September 30, 2014 and 2013, respectively.

Total provisions for allowances charged to expense for the years ended September 30, 2014, 2013 and 2012 were $11 million, $23 million and $11 million, respectively. These expenses are recorded in the *Statements of Operations* in *"Other operating expenses."*

Postal services are sold through a network of post offices and retail establishments that sell postage stamps, shipping and other services, as well as on the Postal Service's website. The Postal Service's sales to its three largest domestic, non-related mail owners for the year ended September 30, 2014, 2013 and 2012 represented approximately 4.1%, 4.2% and 3.2% of total revenue, respectively.

## Note 4- Property and Equipment, net

The following table summarizes property and equipment, net as of September 30, 2014 and 2013:

| (in millions) | Estimated Life in Years | 2014 | 2013 |
|---|---|---|---|
| Buildings | 3 - 40 | $ 24,593 | $ 24,452 |
| Equipment | 3 - 20 | 15,761 | 16,014 |
| Vehicles | 5 - 24 | 3,614 | 3,615 |
| Land | - | 2,886 | 2,895 |
| Leasehold improvements | 2 - 40 | 1,357 | 1,290 |
| **Property and equipment, at cost** | | **48,211** | **48,266** |
| Less: Accumulated depreciation and amortization | | 32,288 | 31,156 |
| Construction in progress | | 415 | 402 |
| **Property and equipment, net** | | **$ 16,338** | **$ 17,512** |

In 2013, the Postal Service implemented a realignment of its operations to further reduce costs and strengthen its finances. These operational realignments included reductions in the number of mail processing operations and consolidations of delivery offices. In June 2014, the Postal Service announced that a second phase of mail processing realignments would begin in January 2015, culminating in a consolidation impacting up to 82 more processing operations. As a result, an assessment was performed on both the real estate and equipment associated with the proposed realignment efforts to determine if any impairment should be recognized. Any facility lacking continued utility to the network will be identified for disposal. Once a facility is identified for disposal, determination of impairments, if any, will be made. For the year ended September 30, 2014, there were no significant impairment charges related to this plan.

Assets classified as held for sale, were approximately $97 million and $78 million as of September 30, 2014 and 2013, respectively, and are included as components of both *"Land"* and *"Buildings."*

Gains recognized on the sale of property and equipment are reported in *"Other revenue"* in the *Statement of Operations.* Total gains were $59 million, $109 million and $65 million for the years ended September 30, 2014, 2013 and 2012, respectively.

Gains are deferred when the Postal Service enters into any lease-back arrangements or other contractual obligations requiring continuing involvement with the property. Deferred gains on the sale of property are recorded in the *Balance Sheets* in *"Other noncurrent liabilities"* in the amount of $301 million and $308 million as of September 30, 2014 and 2013, respectively. Deferred gains recognized as *"Other revenue"* were $8 million, $14 million and $79 million for the years ended September 30, 2014, 2013 and 2012, respectively.

The Postal Service operates one of the largest vehicle fleets in the United States. These vehicles are primarily used for the delivery and collection of mail; however, some are also used for mail transport and maintenance and inspection services.

## Note 5- Payables and Accrued Expenses

The following table summarizes total payables and accrued expenses as of September 30, 2014 and 2013:

| (in millions) | 2014 | 2013 |
|---|---|---|
| Trade payables | $ 1,042 | $ 898 |
| Foreign countries | 553 | 564 |
| U.S. Government | 89 | 112 |
| Other accrued expenses | 339 | 339 |
| **Total payables and accrued expenses** | **$ 2,023** | **$ 1,913** |

## Note 6- Debt

### Debt Limits

Under the *Postal Reorganization Act*, as amended by Public Laws 101-227 and 109-435, the Postal Service can issue debt obligations. The Postal Service is limited by statute to net annual debt increases of $3.0 billion. Total debt cannot exceed $15.0 billion.

### Revolving Credit Facilities

The Postal Service has two revolving credit line facilities, renewable annually, with the Federal Financing Bank ("FFB"), a government-owned corporation under the general supervision of the Secretary of the Treasury, both of which have been extended until April 2015. One facility, a short-term credit line, enables the Postal Service to draw up to $3.4 billion 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 line, 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. The interest rates for borrowings under these credit facilities are determined by the U.S. Treasury each business day. As of September 30, 2014, these two revolving credit facilities were fully drawn.

### Note Purchase Agreement

In addition, under the provisions of a note purchase agreement with the FFB ("Note Purchase Agreement"), the Postal Service can use a series of other notes with varying provisions to draw upon with two days prior notice. The Note Purchase Agreement, renewable annually, was extended to September 30, 2015.

These credit line facilities and note arrangements provide the flexibility to borrow short or long-term, using floating or fixed-rate notes. Fixed-rate notes can be either callable or non-callable at the option of the Postal Service.

Debt, all of which is unsecured and not subject to sinking fund requirements, can be repaid at any time at a price determined by the Secretary of the Treasury, based on prevailing interest rates in the Treasury Security market at the time of repayment. As of September 30, 2014, the premium associated with a prepayment of all debt was $368 million based on prevailing interest rates.

The following table summarizes total debt as of September 30, 2014 and 2013:

(in millions)

| | 2014 | | 2013 | |
|---|---|---|---|---|
| **Maturity** | **Balance** | **Rate %** | **Balance** | **Rate %** |
| **Floating rate notes - current** | | | | |
| October 17, 2013 | $ — | | $ 700 | 0.166 |
| December 17, 2013 | — | | 700 | 0.135 |
| June 18, 2014 | — | | 500 | 0.145 |
| September 17, 2014 | — | | 600 | 0.145 |
| October 23, 2014 | 700 | 0.155 | — | |
| December 17, 2014 | 700 | 0.145 | — | |
| June 18, 2015 [1] | 500 | 0.145 | — | |
| September 23, 2015 [2] | 600 | 0.135 | — | |
| **Fixed rate notes - current** | | | | |
| November 14, 2013 | — | | 1,300 | 0.293 |
| January 31, 2014 | — | | 300 | 2.035 |
| May 1, 2014 | — | | 1,200 | 0.242 |
| September 18, 2014 | — | | 500 | 0.226 |
| November 13, 2014 | 1,300 | 0.247 | — | |
| January 8, 2015 | 300 | 0.219 | — | |
| April 30, 2015 | 1,200 | 0.206 | — | |
| September 17, 2015 | 500 | 0.221 | — | |
| **Current revolving credit line** | | | | |
| October 1, 2014 | 3,400 | 0.135 | 3,400 | 0.166 |
| **Overnight revolving credit line** | | | | |
| October 1, 2014 | 600 | 0.145 | 600 | 0.155 |
| **Total current portion of debt** | **9,800** | | **9,800** | |
| **Fixed rate notes - noncurrent** | | | | |
| May 2, 2016 | 300 | 2.844 | 300 | 2.844 |
| November 15, 2018 | 500 | 3.048 | 500 | 3.048 |
| February 15, 2019 | 700 | 3.296 | 700 | 3.296 |
| May 15, 2019 | 1,000 | 3.704 | 1,000 | 3.704 |
| May 15, 2019 | 500 | 3.513 | 500 | 3.513 |
| August 16, 2021 | 1,000 | 2.066 | 1,000 | 2.066 |
| May 17, 2038 | 200 | 3.770 | 200 | 3.770 |
| February 15, 2039 | 1,000 | 3.790 | 1,000 | 3.790 |
| **Total noncurrent portion of debt** | **5,200** | | **5,200** | |
| **Total debt** | **$ 15,000** | | **$ 15,000** | |

[1] Floating Rate Note - Repurchasable at par on each interest rate reset date and the interest rate resets on December 18, 2014 and March 18, 2015.

[2] Floating Rate Note - Repurchasable at par on each interest rate reset date and the interest rate resets on December 23, 2014, March 23, 2015, and June 23, 2015.

At September 30, 2014 scheduled repayments of debt principal by fiscal year, exclusive of capital leases, was as follows:

| (in millions) | |
|---|---|
| 2015 | $ 9,800 |
| 2016 | 300 |
| 2017 | — |
| 2018 | — |
| 2019 | 2,700 |
| Thereafter | 2,200 |
| **Total debt maturities** | **$ 15,000** |

## Note 7- Commitments and Contingencies

The Postal Service leases premises and equipment under operating and capital leases having terms from 3 to 20 years with options to renew. Certain non-cancellable real estate leases have purchase options at prices specified in the leases. Future minimum lease payments for all non-cancellable leases with original lease terms greater than one year are set forth in the following table:

| (in millions) | Operating | Capital |
|---|---|---|
| 2015 | $ 731 | $ 91 |
| 2016 | 677 | 88 |
| 2017 | 610 | 79 |
| 2018 | 558 | 64 |
| 2019 | 503 | 49 |
| Thereafter | 3,682 | 101 |
| **Total lease obligations** | **$ 6,761** | **$ 472** |
| Less: Interest | | 117 |
| **Total capital lease obligations** | | **$ 355** |
| Less: Current portion of capital lease obligations | | 61 |
| **Noncurrent portion of capital lease obligations** | | **$ 294** |

Capital leases are included in *"Property and equipment, net",* at historical cost, at September 30, 2014 and 2013 were $812 million and $855 million, respectively. Total accumulated amortization related to capital leases was $577 million and $576 million at September 30, 2014 and 2013, respectively. Amortization expense for assets recorded as capital leases is included in *"Other operating expense"* in the *Statements of Operations*.

The following table summarizes total rental expense for the years ended September 30, 2014, 2013 and 2012:

| (in millions) | 2014 | 2013 | 2012 |
|---|---|---|---|
| Non-cancellable real estate leases[1] | $ 918 | $ 915 | $ 938 |
| GSA facilities leases[2] | 35 | 37 | 41 |
| Equipment and other short-term rentals | 139 | 153 | 176 |
| **Total rental expense** | **$ 1,092** | **$ 1,105** | **$ 1,155** |

[1]Sublease income was not material to the financial statements for the years ended September 30, 2014, 2013 and 2012.

[2]General Services Administration leases subject to 120-day cancellation notice.

Capital commitments consist primarily of equipment and building construction and improvements. The following table summarizes financial commitments for approved capital projects in progress at September 30, 2014 and 2013:

| (in millions) | 2014 | 2013 |
|---|---|---|
| Mail processing equipment | $ 278 | $ 316 |
| Building improvements, construction and building purchase | 265 | 329 |
| Postal support equipment | 123 | 50 |
| Vehicles and other | 104 | 13 |
| **Total Capital Commitments** | **$ 770** | **$ 708** |

Contingent liabilities of the Postal Service consist primarily of claims and lawsuits resulting from labor, employment, environmental matters, property damage claims, and injuries on Postal Service properties, issues arising from Postal Service contracts, personal claims and traffic accidents. Each quarter, significant new claims and litigation are evaluated for the probability of an adverse outcome. If the claim is deemed probable of an unfavorable outcome and the amount of the potential resolution is reasonably estimable, a liability for the loss is recorded. Any pre-existing claims and litigation are reviewed and adjusted for resolutions or revisions to prior estimates.

As previously reported, on January 14, 2010, the Equal Employment Opportunity Commission's ("EEOC") Office of Federal Operations certified a class action case against the Postal Service in a matter captioned McConnell v. Donahoe (first instituted as McConnell v. Potter in 2006). The class currently consists of all permanent rehabilitation employees and limited duty employees who were subjected to the National Reassessment Process ("NRP") from May 5, 2006 to July 1, 2011. The Postal Service used the NRP to ensure that its records were correct and that employees receiving workers' compensation benefits were placed in jobs consistent with their abilities. The case alleges violations of the Rehabilitation Act of 1973 resulting from the NRP's failure to provide a reasonable accommodation, the NRP's wrongful disclosure of medical information, the creation by the NRP of a hostile work environment and the NRP's adverse impact on disabled employees. The class is seeking injunctive relief and damages of an uncertain amount. If the plaintiffs were able to prove their allegations in this matter and to establish the damages they assert, then an adverse ruling could have a material adverse impact on the Postal Service. However, the Postal Service disputes the claims asserted in this class action case and is vigorously contesting the matter. There was no material change in the status of this case during the twelve months ended September 30, 2014.

Based on currently available information, adequate provision has been made for probable losses arising from all claims and lawsuits. The current portion of the contingent liability is $158 million and $108 million at September 30, 2014 and 2013, respectively and is included on the *Balance Sheets* in *"Payables and accrued expenses."* The noncurrent portion of this liability is $775 million at September 30, 2014 and $831 million at September 30, 2013 and is included in *"Other noncurrent liabilities"* on the *Balance Sheets*.

As of September 30, 2014, contingent liabilities consisted of $839 million associated with labor and employment matters, $48 million with asset retirement obligations, $45 million with tort matters and $2 million with contractual matters, for a total of

$934 million. As of September 30, 2013, contingent liabilities consisted of $809 million associated with labor and employment matters, $48 million with asset retirement obligations, $49 million with tort matters and $33 million with contractual matters, for a total of $939 million.

In addition to the amounts accrued in the financial statements, the Postal Service also has claims and lawsuits which it deems reasonably possible of an unfavorable outcome which ranged from $325 million to $925 million at September 30, 2014 and 2013. No provisions for these reasonably possible losses are accrued for or included in the financial statements.

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

## Note 8- Retirement Benefit Plans

### Pension Programs

Employees participate in one of three U.S. Government pension programs based on the starting date of their employment with the Federal Government. These programs are the CSRS, the Dual Civil Service Retirement System/Social Security ("Dual CSRS"), or the Federal Employees Retirement System ("FERS"), all of which are administered by the OPM. The pension plans generally provide for retirement, death and/or termination benefits for eligible employees, based on specific eligibility/participation requirements, vesting periods and benefit formulas. As government-sponsored benefit plans, the CSRS, Dual CSRS and FERS are not subject to the provisions of the *Employee Retirement Income Security Act of 1974*, as amended. Employees may also participate in the Thrift Savings Plan ("TSP"), a defined contribution retirement savings and investment plan, administered by the Federal Retirement Thrift Investment Board.

CSRS provides a basic annuity plan benefit to employees hired before January 1, 1984. Dual CSRS provides a basic annuity plan and Social Security benefits to employees hired between January 1, 1984 and January 1, 1987. Effective January 1, 1987, FERS covers employees hired since December 31, 1983. FERS provides a basic annuity plan, Social Security and TSP benefits. The Postal Service and its employees contribute to the basic annuity plan and Social Security at rates prescribed by law. Employees who participate in the CSRS and Dual CSRS do not receive TSP matching contributions from the Postal Service.

The Postal Service participates in these multiemployer defined benefit pension plans with other related entities. The Postal Service is required to provide funding and records an expense within "*Compensation and benefits*" expense in the *Statements of Operations* for these plans based on the allocations to the Postal Service provided by the OPM. Annual funding requirements can fluctuate significantly due to changes in federal law or regulation by the OPM. The Postal Service cannot direct the costs, benefits, or funding requirements of the plans.

The risks of participating in these federal retirement plans are different from single-employer retirement plans in the following aspects:

- Assets contributed to the plans by one agency may be used to provide benefits to employees of other participating agencies.
- If a participating agency stops contributing to the plans, the unfunded obligations of the plan may be borne by the remaining participating agencies.
- Postal Service participation in the federal retirement plans is required by law. If the Postal Service were permitted by a change in law to discontinue participation in some of the federal retirement plans, it may be required to pay those plans an amount based on the underfunded status of the plan, referred to as a withdrawal liability, if such a liability exists at that time.

As of September 30, 2013, the latest actual data available, the CSRS plan for the Federal Government, taken as a whole, is less than 65% funded. The Postal Service made no contribution to the CSRS plan in 2014, 2013 or 2012, in accordance with P.L. 109-435. As of September 30, 2013, the latest actual data available, the FERS plan is greater than 80% funded, for the Federal Government as a whole. For 2014, 2013 and 2012, the Postal Service provided more than 5% of the total plan contributions for FERS from all employers (as disclosed in the OPM's *Civil Service Retirement and Disability Fund Annual Report*). Because these government-sponsored retirement plans are not subject to the rules and regulations of the *Pension Protection Act of 2006*, typical plan measurements such as zone status and financial improvement plan status, or rehabilitation plan status are not available for these plans.

## Employee / Employer Contributions

As required by law, the Postal Service contribution rate was 11.9% of base salary for current FERS employees for the twelve months ended September 30, 2014, 2013 and 2012. For employees covered by the FERS system, the Postal Service is also required to contribute to the TSP a minimum of 1% per year of the employee's basic pay and to match voluntary employee's contribution up to 3% of the employee's basic pay and 50% of an employee's contribution of between 3% and 5% of basic pay.

P.L. 109-435 suspends employer contributions to the CSRS that would otherwise have been required under Title 5, Section 8334(a)(1) of the United States Code, until 2017. At that time the OPM will determine whether additional funding is required for the benefit of Postal Service retirees. As a result, the Postal Service made no contributions to the CSRS and Dual CSRS in 2014, 2013 and 2012.

The Postal Service recognizes expense for the legally required contribution for each period and records a liability for any contributions due and unpaid at the end of a reporting period.

## Expense Components

The following table summarizes the components of total retirement expenses included in "*Compensation and benefits*" expense in the *Statements of Operations* for the years ended September 30, 2014, 2013 and 2012:

| (in millions) | 2014 | 2013 | 2012 |
|---|---|---|---|
| FERS | $ 2,888 | $ 2,891 | $ 2,980 |
| Social security | 1,881 | 1,860 | 1,853 |
| TSP | 989 | 987 | 1,021 |
| **Total retirement expense** | **$ 5,758** | **$ 5,738** | **$ 5,854** |

The following table summarizes the number of employees enrolled in each of the retirement plans at the end of September 30, 2014, 2013 and 2012:

| (actual numbers) | 2014 | 2013 | 2012 |
|---|---|---|---|
| CSRS | 43,887 | 50,932 | 67,224 |
| Dual CSRS | 2,877 | 3,232 | 3,942 |
| FERS | 441,546 | 436,891 | 457,292 |
| **Total enrollment** | **488,310** | **491,055** | **528,458** |

Employer cash contributions to retirement plans were $3.9 billion in 2014, $3.9 billion in 2013 and $4.0 billion in 2012. These amounts do not include Social Security contributions. The OPM announced that employer contributions as a percentage of employees basic pay for FERS will increase to 13.2% in 2015.

Employee contributions for the past three years, as a percentage of employee basic pay, were 7.0% for CSRS and 0.8% for most Dual CSRS and FERS. New hires participate in FERS with higher contribution rates than employees with greater tenure due to changes made effective for employees hired on or after January 1, 2013.

The OPM's most recent calculation estimates a FERS deficit of $0.1 billion at September 30, 2013, the latest actual data available. They had previously estimated that the Postal Service had overfunded its FERS obligations by approximately $0.9 billion at September 30, 2012. This change from a surplus to a deficit resulted primarily from changes to government-wide economic and demographic assumptions made by the OPM. As a result, OPM has calculated an amortization schedule to pay down the deficit over 30 years and, accordingly, billed the Postal Service $6.7 million. This amount has been included in *"Payables and accrued expenses"* in the September 30, 2014 *Balance Sheets*. The OPM currently estimates that the FERS deficit will increase to approximately $0.6 billion by September 30, 2014. The Postal Service is requesting that the OPM calculate FERS liabilities utilizing Postal Service-specific assumptions.

## Note 9- Health Benefit Plans

Substantially all career employees are covered by the FEHBP. This plan covers both active and retired employees. Health care benefits are available to all participants who meet certain eligibility requirements.

### Current Employees

The OPM administers the program and allocates the cost of FEHBP to the various participating government agency employers, of which the Postal Service is a participant. The Postal Service cannot direct the costs, benefits, or funding requirements of the plan. Accordingly, multiemployer plan accounting rules are used. Contributions to the plan are recorded as an expense in the period in which the contribution is due. The portion of the premium cost paid by the Postal Service for most of its active employees is determined through collective bargaining agreements.

Employees paid approximately 24% of total premium costs in 2014 and 22% of total premium costs in 2013 and 2012. Postal Service employee health care expense was $4.8 billion, $5.0 billion and $5.2 billion in 2014, 2013 and 2012, respectively, and are included in *"Compensation and benefits"* in the *Statements of Operations*.

### Retirees

Employees who participate in the FEHBP for the five years immediately preceding their retirement may participate in the FEHBP during their retirement. The Postal Service is required to contribute a share of health insurance premiums for all retired Postal Service employees and their survivors who participate in the FEHBP and who retired on or after July 1, 1971. The Postal Service's contribution rate is set by law and is not subject to negotiation with its unions, but could fluctuate significantly by the passage of new federal law, or in some circumstances, by the OPM under its authority as administrator. Several factors could significantly change future health benefit costs, including investment performance of the PSRHBF, changes in demographics, higher healthcare premiums, changes in actuarial assumptions and increased or decreased benefits to participants.

In 2006, P.L. 109-435 created the PSRHBF, which is held by the U.S. Treasury and controlled by the OPM, but funded by the Postal Service. P.L. 109-435 established a ten-year schedule of Postal Service prefunding payments that ranged between $5.4 billion and $5.8 billion per year. However, the 2009 scheduled prefunding payment was decreased from $5.4 billion to $1.4 billion due to the enactment of P.L. 111-68. On September 30, 2011, P.L. 112-33, *Continuing Appropriations Act, 2012,* rescheduled the required PSRHBF payment of $5.5 billion previously scheduled to be due by September 30, 2011, to be due by October 4, 2011. This date was then rescheduled by a number of laws subsequently passed. The most recent law impacting the PSRHBF payment, P.L. 112-74, *Consolidated Appropriations Act, 2012*, rescheduled the due date to August 1, 2012. As a result, the total required PSRHBF payments in 2012 were $11.1 billion: $5.5 billion due by August 1, 2012 and $5.6 billion due by September 30, 2012. Since that time, no law changes have altered the payment requirements for the 2014 to 2016 scheduled payments.

Upon enactment of P.L. 109-435, the Postal Service became required to prefund $51.8 billion for retiree health benefits into the PSRHBF from 2007 through 2016. No other federal agency that participates in FEHBP is required to prefund retiree health benefits for their employees. As of September 30, 2014, the Postal Service defaulted on $22.4 billion for payments due during the years 2012 – 2014 because of insufficient funds to make the payments. Prior to the defaults, the Postal Service notified key stakeholders, including the Administration and Congress, of the imminent default. These same stakeholders have been advised of the Postal Service's likely inability to satisfy future payment obligations. Although the Postal Service defaulted on its payments due in 2014, 2013 and 2012, $5.7 billion, $5.6 billion and $11.1 billion, respectively, the expense was recorded as *"Retiree health benefits"* in the respective year's *Statements of Operations*. Defaulted amounts of $22.4 billion and $16.8 billion are recorded as a current liability in *"Retiree health benefits"* on the *Balance Sheets* as of September 30, 2014 and 2013, respectively.

Current law obligates the Postal Service to make additional payments of $5.7 billion in 2015 and $5.8 billion in 2016, each due by September 30. To date, no law changes have addressed these required payments and it remains unlikely that the Postal Service will have sufficient liquidity to make any of these scheduled future payments if it is to fulfill its other statutory obligations, including the obligation to provide universal mail service to the nation, as discussed in *Note 2- Liquidity.* Although P.L. 109-435 dictates the annual prefunding requirements through 2016, these amounts and the timing of funding could change at any time with enactment of a new law or an amendment of existing law. P.L. 109-435 contains no provisions addressing a payment default. As of the date of this report, no penalties have been assessed.

These annual prefunding payments are in addition to the regularly allocated cost of premiums for current retirees, which continue to be payable through 2016. The law requires the OPM to perform an actuarial valuation no later than 2017, to determine if additional payments into the PSRHBF are required. If required, they will create an amortization schedule to fully fund any remaining liability by 2056. Under current law the Postal Service's share of the health insurance premiums for current and future Postal Service retirees will be paid from the PSRHBF, beginning in 2017. At that time, the Postal Service will also be required to fund the actuarially determined normal cost. The Postal Service did not make any prefunding payments in 2014, 2013, or 2012. At September 30, 2014, the balance in the fund was $48.8 billion. This amount represents 50% of the total accumulated health benefit retirement obligation of $97.7 billion as of September 30, 2014.

At September 30, 2014, scheduled prefunding payments to the PSRHBF are as follows:

| (in millions) | P.L. 109-435 Requirement |
|---|---|
| 2015* | $ 28,100 |
| 2016 | 5,800 |
| 2017** | — |
| 2018** | — |
| 2019** | — |
| **Total PSRHBF commitment** | **$ 33,900** |

*The 2015 commitment includes the $22.4 billion of payments previously defaulted on and $5.7 billion which is due no later than September 30, 2015.
**Effective in 2017, the unfunded liability will be calculated by the OPM. The Postal Service is obligated to fund the actuarially determined normal cost and the amortized portion of the unfunded liability. Currently, these amounts cannot be estimated.

Components of retiree health benefits expense during the years ended September 30, 2014, 2013 and 2012 were as follows:

| (in millions) | 2014 | 2013 | 2012 |
|---|---|---|---|
| Retiree health benefits premiums | $ 2,985 | $ 2,850 | $ 2,629 |
| P.L. 109-435 payment to PSRHBF | 5,700 | 5,600 | 11,100 |
| **Total retiree health benefits** | **$ 8,685** | **$ 8,450** | **$ 13,729** |

These costs are reflected as "*Retiree health benefits"* in the *Statements of Operations* and include the Postal Service's contribution to the FEHBP and the accrual of prefunding payments to PSRHBF. Because the amounts to be paid into the PSRHBF are set by legislation, retiree health benefits expense may represent more or less than the full cost of the benefits earned by Postal Service employees.

## Note 10- Workers' Compensation

Postal Service employees injured on the job are covered by the FECA, administered by the DOL OWCP, which makes all decisions regarding injured workers' eligibility for benefits. The Postal Service reimburses the DOL for all workers' compensation benefits paid to or on behalf of Postal Service employees including an administrative fee.

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

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 the balance sheet date, in accordance with U.S. GAAP. The impact of changes in the discount and inflation rates is included in operating expenses.

The estimation of the liability is highly sensitive to changes in discount rates. A 1% increase in the discount rate would decrease the September 30, 2014 liability and related expense by approximately $1.9 billion. A 1% decrease in the discount rate would increase the September 30, 2014 liability and related expense by approximately $2.3 billion.

The following table presents the inflation and discount rates used to estimate the liability at September 30, 2014, 2013 and 2012:

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| **Compensation claims liability:** | | | |
| Discount rate | 2.8 % | 3.0 % | 2.1 % |
| Wage inflation | 2.9 % | 2.9 % | 2.9 % |
| **Medical claims liability:** | | | |
| Discount rate | 2.7 % | 3.0 % | 2.2 % |
| Medical inflation | 9.0 % | 9.1 % | 8.9 % |

Changes in the workers' compensation liability are attributable to the combined impact of changes in the discount and inflation rates, routine changes in actuarial estimation, new compensation and medical cases and the progression of existing cases. The present value of the total liability for future workers' compensation payments was $18.4 billion and $17.2 billion for the periods ended September 30, 2014 and 2013 respectively. The current portion of the liability was $1.3 billion at both September 30, 2014 and 2013.

The following table presents the components of workers' compensation expense for the years ended September 30, 2014, 2013 and 2012:

| (in millions) | 2014 | 2013 | 2012 |
|---|---|---|---|
| Impact of discount rate changes | $ 485 | $ (1,745) | $ 346 |
| Actuarial revaluation of existing cases | 45 | 949 | 1,602 |
| Costs of new cases | 1,956 | 1,789 | 1,714 |
| Administrative fee | 68 | 68 | 67 |
| **Total workers' compensation expense** | **$ 2,554** | **$ 1,061** | **$ 3,729** |

## Note 11- Fair Value Measurement

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

Measurement of assets and liabilities at fair value is performed using inputs from a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value. The fair value hierarchy listed below consists of three broad levels, as defined in the authoritative literature:

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

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

The fair value of revenue foregone has been estimated using the income approach, which converts future cash flows to a single discounted amount using an interest rate for similar assets, a level 2 input. To determine the fair value, we calculate a net present value of anticipated annual payments received, discounted by the 20-year Treasury Constant Maturity Rate, which was 2.98% as of September 30, 2014.

Because no active market exists for the debt with the FFB, the fair value of the noncurrent portion of these notes has been estimated using expected future payments at risk-adjusted discount rates provided by the FFB, a level 3 input.

The carrying values and the fair values of noncurrent assets and liabilities that qualify as financial instruments in accordance with the accounting literature are summarized in the following table. Considerable judgment is involved in developing these estimates and, accordingly, may not necessarily be indicative of amounts that would be realized upon disposition. The following table is presented for disclosure purposes only. The Postal Service has not recognized gains as a result of these valuation measurements. All recognized losses have been incorporated into the financial statements and the unrecognized gains and losses are not considered to have a significant impact upon the operations.

For the years ended September 30, 2014 and 2013 there were no significant transfers between Level 1 and Level 2 assets or liabilities. The fair value of noncurrent financial assets and liabilities for these years are as follows:

| (in millions) | 2014 | | 2013 | |
|---|---|---|---|---|
| | **Carrying Amount** | **Fair Value** | **Carrying Amount** | **Fair Value** |
| Revenue forgone | $ 420 | $ 505 | $ 385 | $ 461 |
| **Total noncurrent financial assets** | **$ 420** | **$ 505** | **$ 385** | **$ 461** |
| Debt | $ 5,200 | $ 5,565 | $ 5,200 | $ 5,517 |
| **Total noncurrent financial liabilities** | **$ 5,200** | **$ 5,565** | **$ 5,200** | **$ 5,517** |

The liability for workers' compensation is reported at fair value and is estimated using unobservable data for which no active market exists, inflation and discount rates; therefore the liability is considered to be a level 3.

For additional information refer to *Note 6- Debt* and *Note 10- Workers' Compensation*.

## Note 12- Revenue Forgone

Revenue forgone is an appropriation received from the U.S. Government to compensate the Postal Service for the statutorily required free and reduced rate mailing provided to certain groups. A funding request for the estimated revenue forgone for the year is submitted to Congress at the beginning of each year. At the end of the year, the actual amount is reconciled to the funding request and the difference is adjusted by either party requesting additional funding or returning excess funding by adjusting the following year's funding request.

*The Revenue Forgone Reform Act of 1993* authorized Congress to make 42 annual payments of $29 million each, beginning in 1994 and continuing through 2035, to reimburse the Postal Service for certain services performed or revenue forgone from 1991 through 1998. These payments totaled $1.2 billion, which had a present value calculated at a 7% discount rate of approximately $390 million. The $390 million was recognized as revenue during fiscal years 1991 through 1998. For 2014 and 2013, Congress did not authorize any annual payments on this obligation. The discounted present value of the remaining future payment was $420 million and $397 million for the years ended September 30, 2014 and 2013, respectively.

There was no adjustment for the appropriations to the *Statements of Operations* for the years ended 2014, 2013 and 2012 as the revenue was previously recognized upon enactment of the *Revenue Forgone Reform Act of 1993*. Total appropriations received by the Postal Service from inception through 2011 were $504 million. The impact of P.L. 112-74, *Consolidated Appropriations Act of 2012* and P.L. 113-76, *Consolidated Appropriations Act of 2014* represented a change in the timing of the funding, but not a change to the requirement for reimbursement. Current proposed legislation in the House of Representatives contains a provision for $29 million to be paid to the Postal Service under the *Revenue Forgone Reform Act of 1993;* however, corresponding legislation has not been proposed in the Senate and the outcome of 2015 appropriations remains uncertain. Unfunded amounts totaling $105 million have been included as part of subsequent annual appropriations requests and included in the *Balance Sheets* as *"Receivables, net"*

During 2014, the Postal Service recognized $75 million in revenue, including $22 million of imputed interest, from the appropriations, compared to $64 million, including $23 million of imputed interest in 2013. In 2012, $69 million was recognized in revenue, which included $23 million of imputed interest. The total receivable for revenue forgone was $470 million in 2014, of which $50 million was classified as current assets. In 2013, the total receivable was $453 million and the current portion was $68 million.

## Note 13- Quarterly Financial Data (Unaudited)

The following table sets forth the Postal Service's unaudited *Statements of Operations* for the quarterly periods ending September 30, 2014 and 2013.

| 2014 (in millions) | Quarter 1 | Quarter 2 | Quarter 3 | Quarter 4 |
|---|---|---|---|---|
| Total revenue | $ 17,994 | $ 16,727 | $ 16,504 | $ 16,605 |
| Total operating expenses | 18,306 | 18,559 | 18,421 | 17,892 |
| Loss from operations | (312) | (1,832) | (1,917) | (1,287) |
| Interest income (expense), net | (42) | (40) | (38) | (40) |
| **Net loss** | **$ (354)** | **$ (1,872)** | **$ (1,955)** | **$ (1,327)** |
| **2013** | **Quarter 1** | **Quarter 2** | **Quarter 3** | **Quarter 4** |
| Total revenue | $ 17,660 | $ 16,348 | $ 16,177 | $ 17,133 |
| Total operating expenses | 18,880 | 18,173 | 16,876 | 18,199 |
| Loss from operations | (1,220) | (1,825) | (699) | (1,066) |
| Interest income (expense), net | (44) | (41) | (41) | (41) |
| **Net loss** | **$ (1,264)** | **$ (1,866)** | **$ (740)** | **$ (1,107)** |

## Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

## Item 9A. Controls and Procedures

**(a) Disclosure Controls and Procedures**
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 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 September 30, 2014. Based upon and as of the date of the evaluation, the Postmaster General and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

**(b) Management's Report on Internal Control Over Financial Reporting**
Our management is responsible for establishing and maintaining adequate controls over financial reporting. Internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of our financial reporting for external purposes in accordance with accounting principles generally accepted in the United States of America. Internal control over financial reporting includes maintaining records that, in reasonable detail, accurately and fairly reflect our transactions, providing reasonable assurance that transactions are recorded as necessary for the preparation of our financial statements, providing reasonable assurance that receipts and expenditures of assets are made in accordance with management authorization and providing reasonable assurance that unauthorized acquisition, use, or disposition of assets that could have a material effect on our financial statements would be prevented or detected on a timely basis. Because of its inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that a misstatement of our financial statements would be prevented or detected.

Management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control – Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that our internal control over financial reporting was effective as of September 30, 2014.

**(c) Changes in Internal Control Over Financial Reporting**
There were no changes in the Postal Service's internal controls over financial reporting during the quarter ended September 30, 2014, that have materially affected, or are reasonably likely to materially affect, the Postal Service's internal control over financial reporting.

**(d) Report of Independent Registered Public Accounting Firm**
The effectiveness of our internal control over financial reporting as of September 30, 2014, has been audited by Ernst & Young LLP, the independent registered public accounting firm who also audited our financial statements included in this Annual Report on Form 10-K. Ernst & Young LLP's report on our internal control over financial reporting is included in this Annual Report on Form 10-K on page 40.

## Item 9B. Other Information

None.

# Part III.

## Item 10. Directors, Executive Officers and Corporate Governance

### Board of Governors

The Postal Service is governed by an eleven member Board of Governors. The Board is composed of nine Governors appointed by the President of the United States with the advice and consent of the United States Senate, plus the Postmaster General and the Deputy Postmaster General. The four currently appointed Governors are:

| Name, Age and Term of Office | Positions and Experience |
|---|---|
| Mickey D. Barnett<br>Chairman of the<br>Board of Governors,<br>Age 63<br><br>Governor since August 2006.<br>Term expired December 2013.<br>Currently serving a holdover year. | Chairman of the Board of Governors since December 2012. Vice Chairman of the Board of Governors, 2011. Member of the Audit and Finance Committee and the Compensation and Management Resources Committee. Attorney in Albuquerque, New Mexico. Former member, New Mexico State Senate. Former member, New Mexico Supreme Court and the Court of Appeals nominating commission. Former Legislative Assistant to Senator Pete Domenici of New Mexico. |
| James H. Bilbray,<br>Vice Chairman of the<br>Board of Governors,<br>Age 76<br><br>Governor since August 2006.<br>Term expiring December 2015. | Vice Chairman of the Board of Governors since December 2012. Member of the Compensation and Management Resources Committee. Attorney at the law firm of Kaempfer Crowell Renshaw Gronauer & Fiorentino in Las Vegas, Nevada. Former member, U.S. House of Representatives from Nevada. Former member, Nevada State Senate. Former Deputy District Attorney in Clark County, Nevada. Member of 2005 Base Closure and Realignment Commission. |
| Louis J. Giuliano, Governor<br>Age 68<br><br>Governor since November 2004.<br>Term expiring December 2014. | Past Chairman of the Board of Governors, 2010 and 2011. Vice Chairman of the Board of Governors, 2009. Chairman, Audit and Finance Committee and Operations Subcommittee, and member, Compensation and Management Resources Committee. Former Chairman of Board of Directors, President and Chief Executive Officer of ITT Corp. Senior Advisor at the Carlyle Group, and active member of the CEO Forum and the Advisory Board for the Princeton University Faith and Work Initiative. Non-Executive Chairman of the Board of Vectrus Corp., and Chairman of Meadowkirk Retreat Center. |
| Ellen C. Williams, Governor,<br>Age 57<br><br>Governor since August 2006.<br>Term expiring December 2014. | Chairman of the Compensation and Management Resources Committee and a member of the Audit and Finance Committee. Partner in MML&K, a government relations firm with offices in Frankfort, KY and Washington, DC. Former owner and CEO of Capital Network. Former Vice Chairman of the Kentucky Public Service Commission from 2004 to 2005. Former Commissioner of the Governor's Office for Local Development in Kentucky from 2005 to 2006. Former Chairman of the Republican Party of Kentucky from 1999 to 2004. Former executive assistant to Senator Bob Kasten. |

**Audit and Finance Committee**

The Audit and Finance Committee is composed of three Governors, Governor Giuliano, Chairman, Governor Williams and Governor Barnett. The Board of Governors has determined that Governor Giuliano qualifies as an audit committee financial expert as defined by the rules of the SEC. All Audit and Finance Committee members are independent as defined by the rules of the SEC.

**Compensation and Management Resources Committee**

The Compensation and Management Resources Committee, composed of Governor Williams, Chairman, Governor Giuliano, Governor Barnett and Governor Bilbray during fiscal year 2014, was responsible for making recommendations to the Governors with respect to compensation decisions.

## Executive Officers

The Postal Service had eight executive officers as of September 30, 2014 as follows:

| Name and Age | Positions and Experience |
|---|---|
| Patrick R. Donahoe<br>Age 59 | 73rd Postmaster General and Chief Executive Officer since December 2010 and a member of the Board of Governors since April 2005. Deputy Postmaster General and Chief Operating Officer from April 2005 until December 2010. Chief Operating Officer and Executive Vice President during the years 2001 to 2005. Senior Vice President, Operations from February 2001 to September 2001. |
| Ronald A. Stroman<br>Age 62 | 20th Deputy Postmaster General and member of the Board of Governors of the United States Postal Service since April 2011. Served as Staff Director, Committee on Oversight and Government Relations at the U.S. House of Representatives, from 2009 to April, 2011. Prior to this, served as Managing Director, Office of Opportunity and Inclusiveness, U.S. General Accounting Office, from 2001 to 2009. |
| Megan J. Brennan<br>Age 52 | Chief Operating Officer and Executive Vice President since December 2010. Previously, Vice President, Eastern Area Operations from December, 2006 to December, 2010, and Vice President, Northeast Area Operations from April, 2005 to December, 2006. |
| James P. Cochrane<br>Age 59 | Chief Information Officer and Executive Vice President since October 2013. Previously, Vice President, Product Information from January 2011 to October 2013. Prior to that, served as Vice President, Product Visibility and Operational Performance from February 2010 to January 2011; and Vice President, Ground Shipping from March 2008 to January 2010. |
| Joseph Corbett<br>Age 55 | Chief Financial Officer and Executive Vice President since 2009 (except for a brief period from June 20 through September 30, 2012 when he served as Acting Chief Information Officer and Executive Vice President). Founder and Managing Director of FinSol, LLC, a finance and accounting CFO services firm from 2005 to 2009. Consultant, Chief Financial Officer and Executive Vice President of BearingPoint, Inc., a U.S. government contracting, consulting, and systems integration company, from 2004 to 2005. Executive Vice President and Chief Financial Officer of Intelsat, Ltd., from 1998 to 2004 and Intelsat Controller from 1995 to 1998. |
| Nagisa Manabe<br>Age 51 | Chief Marketing and Sales Officer and Executive Vice President since May 2012. Prior to joining the Postal Service, Ms. Manabe was Vice President of New Growth Platforms at the Coca Cola Company from September 2011 to May 2012. Before that, she was the vice president of Marketing for Diageo Guinness USA, the beer and malt beverage division of Diageo, a leading worldwide spirits, wine and beer company from August 2004 to April 2011. |
| Thomas J. Marshall<br>Age 52 | General Counsel and Executive Vice President since May 2013. Previously, Deputy General Counsel from March 2009 to May 2013. Prior to that, Managing Counsel, Civil Practice, from February 2004 to March 2009. |
| Jeffrey Williamson<br>Age 39 | Chief Human Resources Officer and Executive Vice President since March 2013. Vice President, Pricing from June 2012 to March 2013. Postal Service MIT Sloan Fellow Representative from May 2011 to June 2012. Manager, Performance and Field Operations from September 2009 to May 2011. Prior to that, Manager, Network Development and Support from October 2006 to September 2009. |

## Code of Ethics

All Postal Service employees are required to comply with the Standards of Ethical Conduct for Employees of the Executive Branch (“Standards”). The Standards are published in the Code of Federal Regulations (“CFR”) at 5 CFR Part 2635 and cover prohibitions and restrictions on the acceptance of gifts, conflicting financial interests, the obligation of all employees to perform their duties impartially, restrictions on the misuse of government positions, restrictions on certain outside activities and other related ethical obligations. Postal Service employees are also covered by a set of additional restrictions that apply only to the employees of the Postal Service. These supplemental standards can be found at 5 CFR Part 7001 and focus on limitations on outside employment and outside business activities that could give rise to a conflict with their official duties. The Standards of Conduct and the Supplemental Standards contain many examples to help employees identify and resolve ethical issues. New employees receive ethics training at their orientation and ethics officials provide ethics training throughout the year as required by law and as otherwise deemed appropriate. To ensure that all of our employees can receive timely and accurate ethics advice, we have established a dedicated ethics telephone helpline and an email address that is managed by ethics specialists.

Certain high level employees are also subject to the Senior Financial Managers’ Code of Ethics. This Code of Ethics can be found on our website at: *http://about.usps.com/who-we-are/financials/senior-financial-managers-code-of-ethics-2010.pdf*.

## Item 11. Executive Compensation

## Compensation Discussion and Analysis

Role of the Board of Governors and Statutory Compensation and Benefits Requirements and Limitations

The Board of Governors of the Postal Service establishes executive officer compensation and benefits, subject to the requirements and limitations of federal law. The Board has delegated to its Compensation and Management Resources Committee (“Compensation Committee”) authority for initial review of management proposals related to compensation and benefits for executive officers. The Compensation Committee, which meets several times throughout the year, is composed solely of presidentially-appointed, Senate-confirmed Governors who are independent of postal management. The Compensation Committee makes recommendations to the full Board for their review and approval.

Federal law governing the Postal Service, set forth in Title 39 of the United States Code, provides that compensation and benefits for all officers in the Postal Service shall be comparable to the compensation and benefits paid for comparable levels of work in the private sector of the economy. The Postal Service is the second largest civilian employer in the nation, with approximately 618,000 career and non-career employees as of the end of Fiscal Year 2014. The Postal Service operates approximately 211,000 motor vehicles and approximately 32,000 retail units. In 2014, the Postal Service delivered 155.5 billion pieces of mail, almost half of the world’s mail, and generated nearly $68 billion in revenue. In 2014, the Postal Service ranked 134th in Fortune Magazine’s listing of Fortune Global 500 Companies. By way of comparison, two of our largest competitors ranked 182nd and 236th on this list. If the Postal Service were listed on the Fortune 500 annual ranking of America’s largest corporations, it would be ranked 43rd. The same two of our largest competitors are ranked 50th and 64th on that list.

Even as the economy continues to be challenged, comparably sized companies typically provide their top executives with annual salaries well in excess of $1 million and total compensation and benefits valued at several million dollars. These compensation packages typically consist of annual and long-term performance incentives, including a combination of cash payments and stock options and a number of benefits and perquisites.

Although the law governing the Postal Service provides that executives and others should be compensated at a level comparable to the private sector, the law does not afford the Governors the tools to achieve a standard of compensation comparable to the private sector. Compensation for executive officers of the Postal Service remains significantly below that of similarly-situated senior executives in the private sector. Postal law imposes three different caps on compensation for Postal Service employees. The first cap provides that no officer or employee may be paid compensation “at a rate in excess of the rate for level I of the Executive Schedule under section 5312 of title 5” of the United States Code. 39 U.S.C. § 1003(a). In 2014, the upper limit on federal salaries rose 1% to $201,700, after having been frozen for four years.

With the approval of the Board the Postal Service may develop a program to award a bonus or other reward in excess of the compensation cap discussed above, as long as this does not cause the total compensation paid to the officer in a year to “exceed the total annual compensation payable to the Vice President [of the United States] under [3 U.S.C. § 104] as of the end of the calendar year in which the bonus or award is paid.” 39 U.S.C. § 3686(a)-(b). In 2014, this cap rose 1% to $233,000, after having been frozen for four years. The Board may approve a program allowing for bonuses or other rewards if it determines, for the annual appraisal period involved, that the performance appraisal system for affected employees makes meaningful distinctions based on relative performance.

In addition, the Board may allow up to 12 officers or employees of the Postal Service in critical senior executive or equivalent positions to be paid total annual compensation up to "120 percent of the total annual compensation payable to the Vice President [of the United States] under [3 U.S.C. § 104] as of the end of the calendar year in which such payment is received." 39 U.S.C. § 3686(c). Based on the Vice President's salary for Calendar Year 2014, this compensation cap was $279,600 for Calendar Year 2014.

By law, Postal Service employees, including executive officers, are entitled to participate in either the Civil Service Retirement System or Federal Employees Retirement System, depending on when their federal employment began. These retirement systems are described later in this compensation discussion and analysis. In addition, in order to remain competitive with comparable employment in private industry and other parts of the federal government, postal policy also authorizes certain additional benefits for all officers of the Postal Service, including executive officers. These include participation in the Federal Employees Health Benefits plan, paid life insurance, a periodic physical examination and parking. Other than changes required by law, the Board must authorize any increases to benefits for officers.

## Compensation Philosophy and Objectives

The Board recognizes that there is a significant disconnect between the comparability requirement and the compensation caps in the law governing the Postal Service and that the various compensation caps do not enable the Board to provide compensation and benefits for executive officers that are fully comparable to the private sector. This is especially true given the Postal Service's current financial challenges. The Board also recognizes that many of the compensation and benefit tools available in the private sector, such as equity ownership, are not available to the Postal Service, given its status as part of the federal government. These limitations make it more difficult for the Postal Service to compete in the marketplace for executive officers and to retain current executive officers.

To attempt to achieve some level of comparability within the confines of the law, the Board has designed a compensation system intended to balance an executive's annual salary with the ability to earn additional compensation by meeting performance goals and objectives; a portion of this compensation might need to be deferred because of the compensation caps. Since 2008, the compensation system has not functioned as originally intended, in that significant performance-based incentives have not been available to the officers of the Postal Service since then. At the start of Calendar Year 2014, officers received a 1% increase in their basic compensation. This 1% increase was preceded by six consecutive years in which officer compensation was impacted by a freeze in salary and/or a non-payment of performance lump sums, as listed more specifically below. In addition, some non-executive officers received financial awards in Fiscal Year 2014 for outstanding performance on particular strategic projects in Fiscal Year 2013. By comparison, federal employees only experienced any pay freeze from 2011 through 2013. Furthermore the federal employees pay freeze applied only to cost-of-living adjustments (COLA), and not to longevity (step-increase) raises or performance awards. In 2014, federal employees received a 1% general increase, in addition to step increases and available performance awards.

History of USPS Officer Pay Freezes:

| Year | Description |
|---|---|
| 2014 | • Base salaries increased 1%<br>• No performance lump sums awarded |
| 2013 | • Base salaries frozen<br>• No performance lump sums awarded |
| 2012 | • Base salaries frozen<br>• No performance lump sums awarded |
| 2011 | • Salary ranges frozen<br>• Base salaries frozen<br>• No performance lump sums awarded |
| 2010 | • Salary ranges frozen<br>• Base salaries frozen |
| 2009 | • No performance lump sums awarded |
| 2008 | • Base salaries frozen |

Note: USPS non-bargaining employee compensation does not include COLA payments.

For the past seven years, the officer compensation system has not worked as designed because the Postal Service has faced significant financial challenges caused in part by the ongoing decline of First-Class Mail, the economy, and problems with its business model. The Postal Service has taken significant steps, described elsewhere in this report, to reduce costs and generate revenue. However, it has sought and continues to need comprehensive legislative change to have much greater flexibility to reduce costs, generate new revenue and return to financial stability. The ongoing financial challenges facing the Postal Service continued to influence significantly the decisions on compensation for Fiscal Year 2014.

Within the confines of its legislative authority and the financial constraints confronting the Postal Service, the Board's philosophy is that:

- There should be a strong connection between individual executive compensation and the Postal Service's performance on a number of dimensions, including service, net income and productivity.
- Compensation and benefits should be designed to attract and retain top organizational contributors to ensure the Postal Service has the caliber of executives who will enable it to operate at the highest levels of performance and productivity.
- Lump sum incentives should be set to motivate executives to improve performance continuously on a long-term basis and to perform above the annually-established goals and objectives. If individual performance exceeds the goals and objectives set for the year, the employee should receive additional compensation. Likewise, if overall performance falls below the annual goals and objectives, the individual should be paid less.
- A significant amount of the executive's compensation should be at risk and the "at-risk" amount should increase as the executive's level of responsibility increases.
- Innovation, effectiveness as an agent for change, the ability to balance day-to-day priorities and long-term strategies, and organizational value as defined by the achievement of key corporate goals and objectives should be rewarded.
- Executive compensation should be fair and equitable internally, recognizing the width and breadth of the responsibilities of the Postal Service's executives.
- Executive success is defined by a number of factors, including financial returns, the quality of service the Postal Service provides, the results achieved by the executive's actions to enhance the organization's efficiency and overcome challenges and whether an executive met established individual goals.

## The Compensation Program

In 2007, with the assistance of an independent consulting firm specializing in executive compensation, the Compensation Committee recommended and the Board approved a salary band for the Postmaster General to be set at the legislative salary cap. In doing so, the Board's objectives were to design a compensation program that optimized the legislative flexibility granted by the Postal Act of 2006, reduced internal pay compression, improved external marketplace competitiveness and honored legislative constraints and existing pay ranges. For the other executive officers, the Board set pay bands based on salary relationships of comparable executive officers in the comparator external market. In general, the Board has maintained these types of pay band relationships since 2007.

When the Governors appointed the current Postmaster General, they set his salary at the legislative salary cap. Given the Postal Service's significant financial challenges when he assumed office, the current Postmaster General asked the Governors not to award him any additional compensation, beyond salary and the general types of benefits provided to Postal Service executives. The Governors agreed.

Over the years, the Governors have authorized the Postmaster General to establish salaries for the other executive officers, within the confines of the salary ranges established by the Governors. For Calendar Year 2014, after reviewing recommendations from the Postmaster General and the Compensation Committee and in light of the Postal Service's financial constraints, the Governors raised the salary ranges for some officers and increased officer salaries by 1%.

In 2014, the Postal Service continued to employ a national performance assessment program ("NPA") to set annual performance goals and metrics that vary among executive officers and are weighted to reflect appropriately the degree to which an executive is able to influence the overall performance of the Postal Service. Annual NPA metrics and targets generally take into consideration the Postal Service's performance during the prior year and particular challenges the Postal Service expects to face during the upcoming year. The NPA places emphasis on objective, measurable performance indicators. The Governors also set individual metrics and targets for the Postmaster General and Deputy Postmaster General and authorize the Postmaster General to establish individual metrics and targets for other officers.

As described above, the officer compensation system has not functioned as designed for the past seven years.

The officer compensation system is intended to operate as follows: The Board establishes annual Pay-for-Performance ("PFP") incentives to provide opportunities for the Postmaster General and the Deputy Postmaster General to earn enhanced compensation, directly tied to the level of their performance. The Postmaster General establishes annual PFP incentives for other officers, to provide them opportunities to earn increased compensation, based upon their performance. Incentive payouts are not to be made for a particular goal if the Postal Service or the individual fails to meet minimum acceptable performance standards. The payment of PFP incentives may sometimes be deferred for future payment where required due to the compensation caps.

The Postal Service's economic challenges have prevented the officer compensation system from functioning properly for an extended period. The Governors believe that this situation must be remedied. The Governors are concerned that if this situation persists much longer, it will erode the Postal Service's ability to retain highly-qualified individuals as officers and to recruit the best qualified individuals from outside the Postal Service, if external hiring is deemed to be the best solution to fill critical officer vacancies. Additionally, the Postal Service's financial constraints, which largely are the products of structural defects that only Congress can remedy, have prevented the Postal Service from fully complying with the statutory mandate that its officers be paid in a manner comparable with their private sector counterparts.

The Postal Service has continued to use the NPA process to measure performance during Fiscal Year 2014. NPA performance goals and rewards fall into several categories. These include areas that an officer may directly influence, such as service, efficiency, employee satisfaction, and productivity, as well as those that are more susceptible to being affected by general economic conditions, such as revenue generation.

For each goal, the Postmaster General establishes indicators identifying the type of performance that will enable the Postal Service to achieve or surpass the goal. These performance indicators are aligned at the corporate, functional, and individual levels and are weighted. The higher an individual's position is in the organization, the more his or her PFP goals will be tied to overall corporate performance. The executive officers' goals are aligned with national performance goals and linked to the overall success of the Postal Service.

Once the goals and indicators are established, executive officers are advised as to what the Postal Service expects of them in terms of performance during the year, how their performance will impact the entire Postal Service, and in years when performance incentives are authorized, the potential level of performance-based incentives they can expect depending on their individual performance and the performance of the Postal Service. Under this program, an individual executive officer can receive a rating of Non-Contributor, Contributor, High Contributor or Exceptional Contributor, with a numerical rating within each category, depending on how the Postal Service performs on the national indicators and the individual's performance, as determined by the Postmaster General. As shown in the chart below, a rating of Non-Contributor would result from an overall numerical rating of 1 to 3. A rating of Contributor would result from a numerical score of 4 to 9. A rating of High Contributor would result from a score of 10 to 12 and a rating of Exceptional Contributor would result from a score of 13 to 15.

**Overall Performance Rating**

| Adjective Rating | Number rating |
|---|---|
| Exceptional Contributor (EC) | 13, 14, 15 |
| High Contributor (HC) | 10, 11, 12 |
| Contributor (C) | 4 to 9 |
| Non Contributor (NC) | 1, 2, 3 |

The officer compensation system has not functioned as designed for the past seven years, due to the Postal Service's economic challenges. The system is supposed to operate as follows: An individual executive officer's performance rating would make the officer eligible for an increase to base salary, as well as for a performance-based lump sum payment. Due to statutory cap limitations, increases to the maximum of the salary range for executive officers would generally follow the percentage increase to the Executive Schedule for any given year. Any salary increases for executive officers are limited by these maximums and are solely performance based, as determined by the Postmaster General. Lump sum incentive payments would be tied to the Postmaster General's rating of the executive officer's performance and multiplied by a range of 1.33% to 2.50%, based on the degree to which the individual has achieved previously set individual goals and metrics. The Postmaster General's discretion on PFP incentives for executive officers in a given year is limited by the Postal Service's overall performance on NPA goals and metrics. Generally, officer performance scores must average to the Postal Service's overall NPA performance score for the fiscal year.

Salary increases, if any, are determined after the end of the fiscal year, and any new salaries become effective for the following calendar year. In making compensation decisions for Fiscal Year 2014, the Governors noted that management achieved very significant accomplishments in addressing the many challenges the Postal Service faced in the fiscal year. Despite a significant continuing decline in First-Class Mail volume over the past several years, management continued to take aggressive actions within its control to reduce costs, provide excellent service and secure revenue. Despite declining First-Class Mail volume, package volume increased during Fiscal Year 2014. Management improved total factor productivity by reducing the workforce, as well as through a number of other process improvement efforts. In addition to maintaining high levels of service, management also maintained employee satisfaction, introduced a number of new products and services, increased customer access and offered mailers pricing incentives to help stem the volume decline. Management continued to streamline operations, closing a number of facilities and beginning implementation of consolidations and other steps to optimize network and retail operations. Among these efforts was the continued implementation of the POSt Plan, which is designed to ensure that post offices remain open where and when they are needed, as well as planning for five-day delivery service. The Governors also noted that the Postal Service received an unqualified opinion from its independent registered public accounting firm as to the effectiveness of internal controls. Finally, management also took significant actions to pursue legislative reform in areas key to the Postal Service's ability to provide universal service in the future.

Despite the many significant accomplishments of the Postal Service's management team during Fiscal Year 2014, the Governors largely based their decisions on compensation on the fact that the Postal Service continues to face significant financial challenges. While these financial challenges result in part from the decline in First-Class mail, the Governors noted that comprehensive legislative change is needed to enable the Postal Service to return to financial stability. The absence of legislative change has had, and will continue to have, a significant negative impact on Postal Service finances. Given the Postal Service's financial challenges, the Governors approved a minimal 1% salary increase for officers for Calendar Year 2014. In addition, some non-executive officers received financial awards in Fiscal Year 2014 for outstanding performance on particular strategic projects.

Components of the executive officer compensation and benefits program are further outlined below.

**Base Salary**

Base salaries provide a level of financial security that is appropriate for the executive's position within the Postal Service. Within the confines of law and the Postal Service's difficult financial condition, base salaries are to be scaled within pay ranges designed to be competitive with the market median. As discussed above, maximum payouts in a given year are set by federal law. Executive officer salaries are reviewed at least annually and adjusted, as appropriate and when permitted by financial constraints, to reflect individual performance, range of responsibilities, value and contribution to the organization, and experience. However, as discussed above, officer salaries have been frozen for five out of the last seven years, with a minimal increase occurring in Calendar Year 2014.

**Annual Incentive**

Annual incentives serve as a mechanism for adjusting total compensation levels commensurate with the attainment of planned results, thereby ensuring affordability and appropriate return to the Postal Service. As discussed above, the Postal Service uses the NPA program to set annual corporate performance goals and metrics. The Governors set the goals and indicators for the Postmaster General and the Deputy Postmaster General, and the Postmaster General establishes goals and indicators for the other executive officers. The Postmaster General's and the Deputy Postmaster General's performance is determined based on the degree to which they have achieved the previously set goals and metrics. Likewise, executive officers' individual performance ratings are determined by the Postmaster General based on the degree to which the individual has achieved the previously set individual goals and metrics.

**Other Compensation Incentives**

Executive officers are also eligible for performance awards for specific activities that reflect a high degree of leadership. Only a small number of these individual awards are given out in a typical year, and this was true in 2014. The Governors decided that a limited budget would be available for awards made to non-executive officers in 2014, for exceptional accomplishments during Fiscal Year 2013. In addition, executive officers are eligible for retention and recruitment incentives designed to attract and retain highly talented and marketable individuals in key postal positions. The payment of some of these awards may be deferred, in whole or in part, due to the Postal Service's compensation limits.

**Retirement Annuities**

Officers are covered either by the Civil Service Retirement System ("CSRS") or the Federal Employees Retirement System ("FERS"). Both systems have a defined benefit component and a defined contribution component. CSRS and FERS service is creditable for Medicare coverage. FERS service is creditable for Social Security.

**CSRS Defined Benefit:** The CSRS Basic Benefit annuity is a percentage of the high-3 salary multiplied by years of service. The percentage is 1.5% for the first 5 years of service, plus 1.75% from 5 years to 10 years of service and 2% for all years of service thereafter. Optional retirement thresholds are age 55 with 30 years of service, age 60 with 20 years of service, and age 62 with 5 years of service, with a requirement of completing at least 5 years of creditable civilian service. The annuity is fully indexed to the Consumer Price Index ("CPI"). Disability, early retirement, deferred and survivor benefits are available.

**FERS Defined Benefit:** The FERS Basic Benefit annuity is 1 percent of high-3 salary per year of service, or 1.1 percent for retirement at age 62 with at least 20 years of service. Optional retirement thresholds are the Minimum Retirement Age ("MRA") is 55 to 57 depending on year of birth) with 30 years of service, age 60 with 20 years of service, age 62 with 5 years of service, or MRA with 10 years of service (at a reduced benefit), with a requirement of completing at least 5 years of creditable civilian service. Employees who retire at MRA with 30 years of service, or at age 60 with 20 years of service, receive a retirement supplement approximating the value of Social Security benefits attributable to federal service; this benefit is paid until age 62. Beginning at age 62, the annuity is indexed to CPI, fully when the CPI increase is 2 percent or less, at 2 percent when the CPI increase is between 2 and 3 percent, and at CPI - 1 when the CPI is at least 3 percent. Disability, early retirement, deferred and survivor benefits are available.

**Defined Contribution:** The Thrift Savings Plan ("TSP") is similar to 401(k) plans; it has a component that mirrors traditional 401(k) plans and an option similar to Roth plans. CSRS and FERS employees may contribute up to the indexed IRS maximum ($17,500 in 2013). There is no Postal Service contribution for CSRS employees. For FERS employees, the Postal Service makes an automatic contribution of 1 percent of basic pay and a matching contribution of up to 4 percent of basic pay, for a total employer contribution of up to 5 percent of basic pay. Employees who will be at least age 50 in the year of contribution may make a separate catch-up contribution up to the indexed IRS maximum ($5,500 in 2014). TSP investment options are a government securities fund; index funds that track the Barclays Capital Aggregate Bond Index, the S&P 500, the Dow Jones U.S. Completion TSM Index, and the Morgan Stanley Capital International EAFE (Europe, Australasia, Far East) stock index; and lifecycle funds.

**Supplemental Non-Qualified Deferred Compensation**

Where appropriate and on a highly selective basis, the Postal Service offers supplemental non-qualified deferred compensation as a recruitment or retention tool.

**Life Insurance**

Officers are entitled to basic group life insurance coverage under the Federal Employees Group Life Insurance ("FEGLI") Program in the amount of their annual basic salary, rounded up to the next $1,000, plus $2,000. If basic coverage is held, an officer will also receive an additional $10,000 coverage (Option A) and Option B coverage up to three times their salary. All premiums for Option A, Option B, and basic coverage are paid by the USPS. At their own expense, officers may elect additional Option B coverage in an amount equal to two times their salary. Also at their own expense, officers may elect Option C, family optional insurance coverage, of up to 5 multiples of $5,000 for their spouse and $2,500 for each eligible dependent child. Officers continuously covered under FEGLI for the 5 years immediately preceding retirement, or since the first opportunity, may continue coverage during retirement (if entitled to an immediate annuity). USPS pays former officers an actuarially determined lump sum to cover the cost of Option A premiums during retirement to retiring officers.

**Health Benefits**

The Postal Service participates in the Federal Employees Health Benefits Program ("FEHBP"), which allows all career employees to enroll in one of a number of self only or self and family health benefit plans offered as part of this program. The Postal Service pays a portion of the cost of the premium for its officers and executives. Beginning in January 2012 and continuing over a three-year period, the Postal Service is increasing the percentage its officers and executives pay until the percentage matches the percentage paid by employees in the rest of the federal government. In 2012, the Postal Service's share of the premium was reduced from 100 percent to 91 percent. In 2013, the Postal Service's share of the premium was reduced to 82 percent of the federal weighted average premium, limited to not more than 85.5 percent of the total premium for any given plan, and enrolled officers and executives will pay the balance of the premium for the plan they select. In 2014, the Postal Service's share of the premium was further reduced to 72 percent of the federal weighted average premium, limited to not more than 75.0 percent of the total premium for any given plan, and enrolled officers and executives will pay the balance of the premium for the plan they select. This is the same benefit provided to employees of other federal agencies.

Employees who retire with immediate entitlement to an annuity are eligible to continue FEHB coverage into retirement as long as they have participated in an FEHB plan for the five years preceding their retirement or since their first opportunity. Officers are under the same cost sharing formula as other Postal Service and Federal retirees-the Postal Service pays according to the federal premium formula, which is 72 percent of the federal weighted average premium, limited to not more than 75 percent of the total premium for any given plan, with the retiree paying the balance of the premium for the plan they select.

## Other Benefits

To remain competitive with the comparator marketplace, the Postal Service also offers the following additional benefits to its executive officers: periodic physical examinations, parking, financial counseling services, employer-paid life insurance premiums, and membership in up to two airline clubs per year.

## Fiscal Year 2014 Executive Officer Compensation

### Summary Compensation Table

The following table presents information regarding the compensation of our five most highly compensated executive officers (the "named executive officers"):

| Name and principal position | Year | Salary ($) | Bonus ($) | Non-equity incentive plan compensation ($) | Change in pension value and non-qualified deferred compensation earnings ($) | All other compensation ($) | Total ($) |
|---|---|---|---|---|---|---|---|
| (a) | (b) | (c) | (d) | (e) | (f) | (g) | (h) |
| Patrick R. Donahoe | FY14 | 278,538 | - | - | 53,064 | 16,941 | 348,543 |
| Postmaster General & CEO | FY13 | 276,840 | - | - | 145,321 | 14,379 | 436,540 |
| | FY12 | 276,840 | | | 186,536 | 48,717 | 512,093 |
| Joseph Corbett | FY14 | 240,563 | - | 35,000 | 36,379 | 19,432 | 331,374 |
| Chief Financial Officer & Executive VP | FY13 | 239,000 | - | 35,000 | 29,504 | 18,981 | 322,485 |
| | FY12 | 239,000 | | 30,000 | 26,748 | 20,093 | 315,841 |
| Megan J. Brennan | FY14 | 236,536 | 20,000 | - | 77,271 | 17,848 | 351,655 |
| Chief Operating Officer & Executive VP | FY13 | 235,000 | - | - | 87,447 | 18,475 | 340,922 |
| | FY12 | 235,000 | - | - | 82,811 | 16,890 | 334,701 |
| Thomas J. Marshall[1] | FY14 | 231,504 | - | - | 69,064 | 18,568 | 319,136 |
| General Counsel & Executive VP | FY13 | 199,820 | - | - | 42,211 | 12,848 | 254,879 |
| | FY12 | - | - | - | - | - | - |
| James P. Cochrane[2] | FY14 | 230,135 | - | - | 226,128 | 9,349 | 465,612 |
| Chief Information Officer & Executive VP | FY13 | - | - | - | - | - | - |
| | FY12 | - | - | - | - | - | - |

*Notes:*
*Column (c) Salaries for executive level officers were frozen for Calendar Year 2013 and 2012. The salary amounts vary from FY14 and FY13 because salaries were increased by 1% on January 25, 2014 following the December 23, 2013 executive order which authorized a 1 percent across-the-board increase for statutory pay systems effective January 1, 2014.*
*[1] Mr. Marshall was appointed in May 2013, therefore, the salary shown in the table above reflects actual compensation as he was appointed mid-year. He was not a named executive officer in FY12 and, as such, information for this fiscal year is not reported.*
*[2] Mr. Cochrane was not a named executive officer in FY13 or FY12 and, as such, information for these fiscal years is not reported.*

*Column (d) Ms. Brennan received an award in FY14 for efficiency / cost savings initiatives.*

*Column (e) The amounts in this column reflect the performance-based incentive compensation awarded to executive officers in prior fiscal years; as noted above, this incentive compensation was not awarded for FY13 or FY12. Pursuant to Mr. Corbett's employment contract, his non-equity incentive plan compensation includes $30,000 in deferred performance-based compensation for FY12 and $35,000 for FY13 and FY14. Any amounts that could not be paid to an executive officer due to the compensation cap or their contract were deferred for future payment.*

*Column (f) Mr. Donahoe and Mr. Cochrane participate in the Civil Service Retirement System ("CSRS"), which is a defined benefit plan. Mr. Corbett, Ms. Brennan and Mr. Marshall participate in the Federal Employees Retirement System ("FERS"), a portion of which is a defined benefit plan. The calculation of retirement annuities under CSRS and FERS is explained in the Pension Benefits table, the associated note and in the Retirement Annuities section of the Compensation Discussion and Analysis. The amounts shown in column (f) for each of these individuals are the amounts by which the value of their annuities has increased since the end of the prior fiscal year. "Non-qualified deferred compensation earnings" is defined as above-market earnings on deferred income. There were no reportable amounts of non-qualified deferred compensation earnings for the named executive officers in FY14, FY13, or FY12, with the exception of Mr. Corbett, whose above-market earnings on deferred income were $1,008 in FY14, $721 in FY13 and $473 in FY12.*

*Column (g) For all executive officers listed, the "All Other Compensation" category includes financial planning services, Thrift Savings Plan employer matching contribution for FERS employees, non-cash awards, parking, physical examinations, life insurance premiums paid for by the Postal Service, airline clubs, and relocation costs. Security costs for FY14 are also included for the Postmaster General.*

## Grants of Plan-Based Awards

The following table presents information regarding potential non-equity incentive awards to the named executive officers for Fiscal Year 2015. Whether a named executive officer receives an award and, if so the amount of an award for Fiscal Year 2015 will depend on the Postal Service's and the individual's performance.

| Name | Grant Date | Estimated Future Payouts Under Non-Equity Incentive Plan Awards | | |
|---|---|---|---|---|
| | | Threshold ($) | Target ($) | Maximum ($) |
| (a) | (b) | (c) | (d) | (e) |
| Patrick R. Donahoe | October 2014 | 14,875 | 33,552 | 104,850 |
| Joseph Corbett | October 2014 | 12,842 | 28,967 | 90,521 |
| Megan J. Brennan | October 2014 | 12,627 | 28,482 | 89,006 |
| James P. Cochrane | October 2014 | 12,493 | 28,179 | 88,059 |
| Thomas J. Marshall | October 2014 | 12,358 | 27,876 | 87,113 |

*Note: Columns (c)-(e). The USPS Pay-for-Performance ("PFP") program relies on a 15-point scale with clearly defined and transparent corporate goals. The PFP plan target in any given year is set at a rating of 6. Incentives are not paid for any rating below or equal to 3. The maximum threshold for payment is set at a rating of 15. Individual ratings vary but the corporate score is used as the regulator.*

## Pension Benefits

The following table shows the present value of accumulated pension benefits payable to the named executive officers as of September 30, 2014:

| Name | Plan name | Number of years credited service (#) | Present value of accumulated benefit ($) |
|---|---|---|---|
| (a) | (b) | (c) | (d) |
| Patrick R. Donahoe | CSRS Annuity | 39 Years | 4,080,932 |
| Joseph Corbett | FERS Annuity | 6 Years | 160,986 |
| Megan J. Brennan | FERS Annuity | 28 Years | 790,455 |
| James P. Cochrane | CSRS Annuity | 40 Years | 2,974,563 |
| Thomas J. Marshall | FERS Annuity | 19 Years | 410,241 |

*Note: All named executive officers are eligible for CSRS or FERS retirement benefits available to career employees of the Federal Government. These benefits are described in the Retirement Annuities section of the Compensation Discussion and Analysis. The present value of the accumulated CSRS or FERS benefit represents the value of the pension over the individual's actuarial lifetime, as of September 30, 2014. Mr. Donahoe and Mr. Cochrane participate in CSRS, and Mr. Corbett, Ms. Brennan and Mr. Marshall participate in FERS. Mr. Donahoe and Mr. Cochrane are eligible for retirement, the calculation of which is described in the Retirement Annuities section of the Compensation Discussion and Analysis. The valuation for Mr. Corbett, Ms. Brennan and Mr. Marshall assumes that they have satisfied vesting requirements for retirement; however, because of their current tenure with the Postal Service, their retirement annuities have not fully vested.*

## Non-qualified Deferred Compensation

The following table presents information regarding the contributions to, and earnings on, the named executive officers' deferred compensation balances during Fiscal Year 2014 and also shows the total deferred amounts for the named executive officers as of September 30, 2014:

| Name | Executive contributions in last FY ($) | Aggregate earnings in last FY ($) | Aggregate balance at September 30, 2014 ($) |
|---|---|---|---|
| (a) | (b) | (c) | (d) |
| Patrick R. Donahoe | - | 389 | 8,781 |
| Joseph Corbett | 35,000 | 6,875 | 186,537 |

*Notes: Column (b) The amounts in this column represent amounts deferred due to the compensation cap or contract agreements. The amount shown for Mr. Corbett reflects the lump-sum performance retention payment required by his employment agreement which has been deferred.*

*Column (c) The Postal Service calculates interest on deferred compensation semi-annually at 5.0% per year for Mr. Corbett per contract, others are calculated at the Federal Long Term Rate; 4.7% in FY14. Interest is prorated from the relevant pay period of the deferral.*

*Column (d) The amount shown for Postmaster General Donahoe reflects a deferred FY10 PFP amount plus interest through FY14.*

## Director Compensation

The following table presents information regarding the compensation of the members of the Board of Governors during Fiscal Year 2014:

| Name | Fees earned or paid in cash ($) | All other compensation ($) | Total ($) |
|---|---|---|---|
| Mickey D. Barnett | 35,400 | - | 35,400 |
| James H. Bilbray | 36,000 | - | 36,000 |
| Louis J. Giuliano | 37,200 | - | 37,200 |
| Dennis J. Toner | 7,467 | - | 7,467 |
| Ellen C. Williams | 35,700 | - | 35,700 |

*Note: Each Governor receives a basic stipend of $30,000 per year plus $300 per day for not more than 42 days of meetings each year. Governor Toner served 2 months and 7 days in Fiscal Year 2014.*

## Potential Payments Upon Termination

As described in the Compensation Discussion and Analysis, in 2009 the Postal Service entered into an employment agreement with Joseph Corbett, the Chief Financial Officer, for recruitment and retention purposes. Mr. Corbett's agreement provides for deferred compensation payable in installments commencing on the date of his separation from the Postal Service or October 22, 2019, whichever is later.

The Postmaster General and all of the other named executives are subject to the standard policies governing the CSRS or FERS, as described in the Compensation Discussion and Analysis. The present value of these CSRS and FERS benefits are found in the Pension Benefits table in the Executive Officer Compensation section of this report. The information below describes and quantifies certain compensation, in addition to that due pursuant to CSRS or FERS, that would become payable under existing plans and arrangements if the named executive officer's employment had terminated on September 30, 2014. Additionally, pursuant to statutes and regulations generally applicable to federal employees, the named executives would be entitled to receive the federal employer's standard contribution toward retiree health benefits, in the event they have qualifying service and participated in the Federal Employees Health Benefits Plan for the requisite period of time prior to retiring.

**Deferred Compensation**

All federal employees, including Postal Service employees, are subject to annual compensation limits established pursuant to federal statutes and regulations. When amounts earned by federal employees cannot be paid because of these compensation limits, these payments are deferred until a year in which their payment would not cause total annual compensation paid to the employee to exceed the compensation limit, or the year in which an employee leaves federal service, whichever occurs first. Named executive officers appearing in the non-qualified deferred compensation table in the Executive Officer Compensation section of this report have deferred compensation in the amounts indicated therein. These amounts would have been paid to them in a lump-sum or pursuant to their contract with the Postal Service following their departure, had they ended their Postal Service employment on September 30, 2014. Mr. Corbett's employment agreement provides for deferred incentives linked in part to his performance. Mr. Corbett began accruing deferred performance-based compensation at the end of Fiscal Year 2010. When Mr. Corbett concludes his Postal Service employment, or on October 22, 2019, if that date is later than Mr. Corbett's departure from the Postal Service, his deferred compensation will be paid to him in three approximately equal annual installments.

**Supplemental Pension Benefit**

The Governors have not authorized a supplemental pension benefit for any executive officer at this time.

**Severance Payment**

Mr. Corbett is entitled to a severance payment of $230,000, in the event the Postal Service terminates his employment for any reason other than for cause or breach of contract.

**Insurance Benefits**

The Governors have not authorized supplemental insurance benefits for any executive officer at this time. The insurance benefits to which all postal executives are entitled are described above.

**Outplacement Assistance**
The Governors have not authorized any outplacement assistance for any executive officer at this time.

**Accrued Annual Leave**
All Postal Service employees are entitled to receive and accrue paid days off, known as annual leave. Upon their separation from the Postal Service, all employees, including the named executive officers, are entitled to be paid, in a lump-sum, the value of all accrued annual leave. The table below shows the accrued value of the annual leave of the named executive officers, as of September 30, 2014.

| Name | Value of accrued annual leave ($) |
|---|---|
| Patrick R. Donahoe | 238,601 |
| Joseph Corbett | 68,703 |
| Megan J. Brennan | 90,718 |
| James P. Cochrane | 18,628 |
| Thomas J. Marshall | 35,738 |

## Compensation Committee Report
The Compensation and Management Resources Committee has reviewed and discussed the Compensation Discussion and Analysis with management and, based on such review and discussions, the Compensation and Management Resources Committee recommended to the Governors that the Compensation Discussion and Analysis be included in this Report.

The Compensation and Management Resources Committee

Ellen C. Williams, Chairman
Mickey D. Barnett, Member
James H. Bilbray, Member
Louis J. Giuliano, Member

# Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Not applicable. As an "independent establishment of the executive branch of the Government of the United States," we do not issue equity securities.

# Item 13. Certain Relationships and Related Transactions and Director Independence

## Certain Transactions
We enter into significant transactions with other government agencies, as disclosed throughout this report and the financial statements.

## Director Independence
All of the Governors of the Postal Service Board of Governors who are currently serving and have been appointed by the President of the United States, with the advice and consent of the Senate, are independent based on the New York Stock Exchange definition of independence.

## Item 14. Principal Accountant Fees and Services

In 2002, the Board of Governors selected Ernst & Young LLP as its independent auditor to perform external auditing services. In October 2009, the contract was extended to February 2014. In March 2014, we entered into a new contract which covers the period of March 2014 through February 2016 with five one-year options to renew. As with previous contracts for external audit services, Ernst & Young LLP will not perform consulting work for us for the duration of the contract, which would impair their independence. Fees for services totaled approximately \$11.0 million, \$11.0 million and \$11.6 million in 2014, 2013 and 2012, respectively, including fees for professional services associated with the annual audit, the reviews of the Postal Service's quarterly reports on Form 10-Q and testing of the company's internal control over financial reporting.

# Part IV.

## Item 15. Exhibits, Financial Statement Schedules

## (a) The following documents are filed as part of this Annual Report:

1. **Financial Statements**
   The following consolidated financial statements of the United States Postal Service for each of the years ended and as of the periods noted are submitted in *Part II. Item 8. Financial Statements and Supplementary Data* of this report.



**2. Financial Statement Schedules**
None.

All other financial statement schedules have been omitted because they are not applicable or the required information is included in the Postal Service's financial statements or the notes thereto.

| 3. Exhibits | |
|---|---|
| 31.1 | Certificate of USPS Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certificate of USPS Principal Financial Officer Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certificate of USPS Principal Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certificate of USPS Principal Financial Officer 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: December 5, 2014

Pursuant to the requirements of the Postal Accountability and Enhancement Act of 2006, this Report has been signed below by the following persons on behalf of the Postal Service and in the capacities indicated as of December 5, 2014.

| Signature | Title |
|---|---|
| /s/ Mickey D. Barnett<br>Mickey D. Barnett | Chairman, Board of Governors |
| /s/ James H. Bilbray<br>James H. Bilbray | Vice Chairman, Board of Governors |
| /s/ Louis J. Giuliano<br>Louis J. Giuliano | Governor |
| /s/ Ellen C. Williams<br>Ellen C. Williams | Governor |
| /s/ Patrick R. Donahoe<br>Patrick R. Donahoe | Board Member, Postmaster General and Chief Executive Officer |
| /s/ Ronald A. Stroman<br>Ronald A. Stroman | Board Member and Deputy Postmaster General |
| /s/ Joseph Corbett<br>Joseph Corbett | Chief Financial Officer and Executive Vice President, (Principal Financial Officer) |
| /s/ Maura A. McNerney<br>Maura A. McNerney | Controller, Vice President, (Principal Accounting Officer) |

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 annual report on Form 10-K 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 a significant role in the Postal Service's internal control over financial reporting.

Date: December 5, 2014

/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 annual report on Form 10-K 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 a significant role in the Postal Service's internal control over financial reporting.

Date: December 5, 2014

/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 Annual Report of the United States Postal Service (Postal Service) on Form 10-K for the period ended September 30, 2014, (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: December 5, 2014

/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 Annual Report of the United States Postal Service (Postal Service) on Form 10-K for the period ended September 30, 2014 (the “Report”), I, Joseph Corbett, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 that:

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

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

Dated: December 5, 2014

/s/ Joseph Corbett

Joseph Corbett

Chief Financial Officer and Executive Vice President