United States Postal Service

475 L'Enfant Plaza, SW
Washington, DC 20260

202-268-2000
www.usps.com

Quarterly Financial Report

For the Three Months Ended December 31, 2005

February 09, 2006

Part I. Financial Information

Part II. Other Information

Part I. Financial Information

Item 1. Financial Statements

United States Postal Service
Statements of Operations
(dollars in millions)

	Three months ended December 31, 2005 (unaudited)	Three months ended December 31, 2004 (unaudited)
Operating revenue	**$ 18,498**	$ 18,786
Operating expenses:		
Compensation and benefits	**14,100**	13,667
Transportation	**1,509**	1,419
Other	**2,121**	1,973
Total operating expenses	**17,730**	17,059
Income from operations	**768**	1,727
Interest and investment income	**27**	11
Interest expense on deferred retirement obligations	**(65)**	(54)
Other Interest expense	**(2)**	(2)
Net Income	**$ 728**	$ 1,682

See accompanying notes to financial statements.

United States Postal Service
Balance Sheets – Assets
(dollars in millions)

	December 31, 2005 (unaudited)	September 30, 2005
Assets		
Current assets:		
Cash and cash equivalents	**$ 1,681**	$ 930
Receivables:		
Foreign countries	**578**	590
U.S. government	**285**	280
Other	**230**	188
Receivables before allowances	**1,093**	1,058
Less allowances	**49**	50
Total receivables, net	**1,044**	1,008
Supplies, advances and prepayments	**161**	200
Total current assets	**2,886**	2,138
Other assets, principally revenue forgone appropriations receivable	**382**	376
Property and equipment, at cost:		
Buildings	**20,726**	20,480
Equipment	**18,701**	18,664
Land	**2,879**	2,878
Leasehold Improvements	**1,183**	1,172
	43,489	43,194
Less allowances for depreciation and amortization	**22,826**	22,400
	20,663	20,794
Construction in progress	**2,059**	1,895
Total property and equipment, net	**22,722**	22,689
Total Assets	**$ 25,990**	$ 25,203

See accompanying notes to financial statements.

United States Postal Service
Balance Sheets – Liabilities & Net Capital
(dollars in millions)

	December 31, 2005 (unaudited)	September 30, 2005
Liabilities and Net Capital		
Current liabilities:		
Compensation and benefits	**$ 2,432**	$ 2,852
Estimated prepaid postage	**1,221**	1,200
Payables and accrued expenses:		
Commercial vendors and accrued expenses	**1,582**	1,568
Foreign countries	**603**	688
U.S. Government	**56**	76
Total payables and accrued expenses	**2,241**	2,332
Customer deposit accounts	**1,743**	1,720
Outstanding postal money orders	**874**	830
Prepaid box rent and other deferred revenue	**448**	477
Total current liabilities	**8,959**	9,411
Non-current liabilities:		
Workers' compensation	**6,983**	6,695
Employees' accumulated leave	**2,245**	2,016
Deferred revenue	**692**	692
Long-term portion capital lease obligations	**651**	644
Other	**356**	369
Total non-current liabilities	**10,927**	10,416
Total Liabilities	**19,886**	19,827
Net capital:		
Capital contributions of the U.S. Government	**3,034**	3,034
Retained earnings since reorganization	**3,070**	2,342
Total Net Capital	**6,104**	5,376
Total Liabilities and Net Capital	**$ 25,990**	$ 25,203

See accompanying notes to financial statements.

United States Postal Service
Statements of Changes in Net Capital

Three months ended December 31, 2005 and the year ended September 30, 2005
(dollars in millions)

	Capital Contributions of U.S. Government	Retained Earnings Since Reorganization	Total Net Capital
Balance, September 30, 2004	$ 3,034	$ 897	$ 3,931
Net Income	-	1,445	1,445
Balance, September 30, 2005	3,034	2,342	5,376
Net Income– Three months ended December 31, 2005 (unaudited)	-	728	728
Balance, December 31, 2005 (unaudited)	**$ 3,034**	**$ 3,070**	**$ 6,104**

See accompanying notes to financial statements.

United States Postal Service
Statements of Cash flows
(dollars in millions)

	Three months ended December 31, 2005 (unaudited)	Three months ended December 31, 2004 (unaudited)
Cash flows from operating activities:		
Net Income	**$ 728**	$ 1,682
Adjustments to reconcile net income		
to net cash provided by operating activities:		
Depreciation and amortization	**530**	499
(Gain)Loss on disposals of property and equipment, net	**(2)**	4
Increase in revenue forgone appropriations receivable	**(6)**	-
Increase in USPS workers' compensation liability	**288**	312
Increase in employees' accumulated leave	**229**	126
Increase (Decrease) in long-term portion capital lease obligations	**7**	(2)
Decrease in other non-current liabilities	**(13)**	(32)
Changes in current assets and liabilities:		
Increase in receivables, net	**(36)**	(76)
Decrease in supplies, advances and prepayments	**39**	42
Decrease in compensation and benefits	**(420)**	(304)
Increase (Decrease) in estimated prepaid postage	**21**	(12)
Decrease in payables and accrued expenses	**(90)**	(199)
Increase in customer deposit accounts	**23**	159
Increase in outstanding postal money orders	**44**	19
(Decrease) Increase in prepaid box rent and other deferred revenue	**(29)**	16
Net cash provided by operating activities	**1,313**	2,234
Cash flows from investing activities:		
Purchase of property and equipment	**(570)**	(576)
Proceeds from sale of property and equipment	**8**	2
Net cash used in investing activities	**(562)**	(574)
Cash flows from financing activities:		
Issuance of debt	**-**	-
Payments on debt	**-**	(1,800)
Net cash used in financing activities	**-**	(1,800)
Net increase (decrease) in cash and cash equivalents	**751**	(140)
Cash and cash equivalents at beginning of year	**930**	877
Cash and cash equivalents at end of period	**$ 1,681**	$ 737
Supplemental Data		
Cash paid during the year for Interest	**$ -**	$ -

See accompanying notes to financial statements.

Notes to Financial Statements

Note 1. Basis of Presentation

This interim report reflects the operations of the United States Postal Service for the three months ended December 31, 2005 and December 31, 2004. The financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and should be read in conjunction with the significant accounting policies and other disclosures in our 2005 Annual Report. The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and judgments that affect the amounts reported in the financial statements and accompanying notes. The accounting estimates that require management's most difficult and subjective judgments include: workers' compensation liability, estimated prepaid postage, and contingent liabilities. The Civil Service Retirement System (CSRS) "supplemental liability" represents an additional substantial estimate that, pursuant to Public Law 108-18 (P.L.108-18), is calculated by the Office of Personnel Management (OPM). The actual results experienced may differ from estimates.

Certain comparative prior year amounts in the financial statements and accompanying notes have been reclassified to conform to the current year presentation. These reclassifications had no effect on previously reported operating income and net income.

In the opinion of management, the accompanying unaudited financial statements present fairly our financial position as of December 31, 2005 and September 30, 2004, the results of our operations for the three months ended December 31, 2005 and 2004, and our cash flows for the three months ended December 31, 2005 and 2004.

Note 2. Retirement Programs

We account for our involvement in the retirement programs of the U.S. Government as participation in a multiemployer plan arrangement in accordance with Financial Accounting Standard ("FAS") 87, *Employers' Accounting for Pension Costs*. Therefore, the costs of these benefits are expensed as we incur them. We provide pension benefits as defined by OPM and have a parent-subsidiary type relationship with the United States Government. As a subsidiary, we cannot direct the costs, benefits or funding requirements of the federally-sponsored plans.

We are required by P.L.108-18 to pay an additional annual amount, if necessary, each September, beginning in 2004, as determined by OPM. The additional amount is based on a calculation of any potential "supplemental liability", if one exists. The "supplemental liability", represents the excess of the actuarial present value of future benefits over the actuarial present value of plan assets, future contributions, earnings, and other actuarial factors related to postal participants in the CSRS plan. P.L.108-18 requires that this supplemental liability be retired by September 30, 2043. In June 2005, OPM estimated the total "supplemental liability" to be $4,200 million as of September 30, 2004. The September 30, 2003 "supplemental liability" was estimated to be $3,500 million. Our payment for September 2005 was $290 million. The September 2004 payment was $240 million.

For the three months ended December 31, 2005 we have accrued $73 million for the estimated "supplemental liability" payable on September 30, 2006 compared to $60 million accrued as of December 31, 2004.

Note 3. Retiree Health Benefits

We are required to pay a portion of the health insurance premiums of those retirees and their survivors who participate in the Federal Employees Health Benefits Program (FEHBP). We account for our involvement in FEHBP as participation in a multiemployer plan arrangement in accordance with FAS 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*. Therefore, the costs of these benefits are expensed as we incur them.

Note 4. Emergency Preparedness Funding

Congress provided an appropriation of $587 million in 2002, to assist in paying for the decontamination of two of our facilities, and the purchase of equipment to enhance the safety of the mail, and protect our customers and employees. This appropriation has been fully expended. In December, 2004, an additional appropriation by Congress of $503 million provided funds for Ventilation and Filtration Systems, Biohazard Detection Systems and an irradiation facility. For both appropriations, revenue is recognized as the capital equipment that was purchased with the appropriations, is depreciated. Funds for capital items that have not been offset against depreciation expense are shown on our balance sheet as deferred revenue ($63 million current, $692 million non-current). For the 1st Quarter we recorded depreciation expense and associated appropriations revenue totaling $17 million for 2006 and $2 million in 2005. This brings the total revenue recognized from the 2002 appropriation to $335 million. Other costs of mail security and employee protection such as maintenance and consumable supplies are being funded from postal revenue and charged as operating expense.

Note 5. Commitments

The following section summarizes our commitments for capital purchases and our lease obligations.

Capital

At December 31, 2005, our financial commitment (resources on order) for approved capital projects in process is $2,983 million.

Rents

At December 31, 2005 our future minimum lease payments for all non-cancelable leases are as follows:

Future Minimum Lease Payments (Dollars in millions)		
	December 31, 2005	
Year	**Operating**	**Capital**
2006	**$ 631**	**$ 57**
2007	**823**	**104**
2008	**793**	**102**
2009	**741**	**99**
2010	**684**	**95**
After 2010	**5,896**	**506**
	$ 9,568	**963**
Less: Interest at 5.25%		**262**
Total Capital Lease Obligations		**701**
Less: Short-term Portion of Capital Lease Obligations		**50**
Long-term Portion of Capital Lease Obligations		**$ 651**

Most of these leases contain renewal options for periods ranging from 3 to 20 years. Certain non-cancelable real estate leases give us the option to purchase the facilities at prices specified by such leases.

Capital leases are classified as “Buildings” on the Balance Sheet. Capitalized leases were $906 million at December 31, 2005 and $906 million at September 30, 2005. Total accumulated amortization related to capital leases was $329 million at December 31, 2005 and $318 million at September 30, 2005. Amortization expense for capital lease assets is recorded as depreciation expense.

Note 6. Contingent Liabilities

Each quarter we review pending litigation against us. We classify and adjust our contingencies for claims when we can reasonably estimate the amount of a probable, unfavorable outcome. These relate to labor claims, equal employment opportunity claims, environmental matters, traffic accidents, injuries sustained on postal properties, personal claims, claims for property damages and suits and claims arising from postal contracts. Additionally we evaluate the materiality of cases determined to have a reasonable chance of adverse outcome. Such cases are immaterial to our financial statements taken as a whole. Management and General Counsel believe that we have made adequate provision for the amounts that may become due under the suits, claims and proceedings we have discussed here.

Item 2. Management's discussion and analysis of results of operations and financial condition

Cautionary Statements

The "Management's Discussion and Analysis of Results of Operations and Financial Condition" and other parts of this report include statements representing our expectations about our business and financial results that may be affected by risks and uncertainties we discuss here and in our Annual Report, such as economic conditions, regulatory and legislative changes, trends we know about, trends we anticipate, and trends we believe are relevant to future operations. Some of these factors may cause our actual results to differ materially from those contemplated. This report should be read in conjunction with our 2005 Annual Report. As in the Annual Report all references to years, unless otherwise stated, refer to our fiscal year beginning October 1st and ending September 30th.

Introduction

Under the terms of the Postal Reorganization Act, the Postal Service (we) commenced operations on July 1, 1971 as an independent establishment of the executive branch of the United States government. The Act requires that the Postal Service offer mailing services as a "fundamental service" to the American people on a "fair and equitable basis."

Our primary lines of business are First-Class Mail, Standard Mail, Priority Mail, International Mail, Express Mail, Periodicals and Package Services. We serve individual and commercial customers throughout the nation. Our services compete for business in the communications, distribution and delivery, advertising and retail markets. The rates and fees for our services are subject to a regulatory review process controlled by the independent Postal Rate Commission (PRC).

Our products are distributed through our more than 37,000 Post Offices, Stations and Branches and a large network of consignees as well as through our website, USPS.com. Mail is delivered to nearly 145 million city, rural, post office box and highway contract delivery points. We conduct our significant operations primarily in the domestic market, with international operations representing less than 3 percent of our total revenue.

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

Segmentation of marketing and product management, and generation of revenues, however, is oriented towards product lines. Our business segment reporting addresses volume growth and revenue generation, by class of mail. As with the reporting on expenses, this mode of reporting on volume and revenues presents the results of and outlook concerning our operations as viewed through the eyes of management. We do not report revenues from individual customers. No single customer represents more than two percent of our revenues.

Our labor force is primarily represented by the American Postal Workers Union, the National Association of Letter Carriers, the National Postal Mail Handlers Union and the National Rural Letter Carriers Association. Approximately 90 percent of our career employees are covered by collective bargaining agreements. By law, we consult with management organizations representing most of the employees not covered by collective bargaining agreements. The management organizations include the National Association of Postal Supervisors, the National League of Postmasters, and the National Association of Postmasters of the United States. We participate in federal employee benefit programs covering retirement, health benefits and workers' compensation.

We are not subject to regulation by the Securities and Exchange Commission (SEC). However, we comply voluntarily with SEC financial reporting requirements to the extent that they reasonably may be applied to a non-publicly traded, government-owned entity with a breakeven mandate. Therefore, this report excludes certain SEC reporting elements normally included in Part II – Other Information of a standard Form 10-Q. The excluded items are: Item 2 - Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities; Item 3 - Defaults upon Senior Securities; and Item 4 - Submission of Matters to a Vote of Security Holders.

Additional information on our organization and our finances, including our Cost and Revenue Analysis reports, Integrated Financial Plan, and Revenue, Pieces, and Weight reports, may be found on our website, at www.usps.com/financials.

Results of Operations

Operating revenue in the first quarter was $18,498 million, compared to $18,786 million in the corresponding quarter last year. This 1.5 percent revenue reduction was accompanied by a volume decline of 871 million pieces or 1.5 percent. The largest component of the revenue and volume declines came from First-Class Mail which experienced a $415 million reduction in revenue (4.3 percent) and a 994 million reduction in volume (3.8 percent). These reductions were in line with expectations.

For Quarter 1, operating expenses grew by 3.9 percent. Compensation and benefits expense contributed to most of the increase over the same period last year. Transportation expenses, driven by significantly higher jet fuel, diesel, and gasoline prices, contributed significantly to expense growth, in spite of the lower volume. Supplies and services and other non-personnel expenses, which include a number of fuel-sensitive items also increased significantly.

The combined effect of these factors was a net income of $728 million for the three months ending December 31, compared to a net income of $1,682 million in the same quarter last year. This lower level of net income was largely expected, given exceptionally strong revenue performance in Quarter 1 last year and the inflationary pressures on our costs cited above. Unlike the private sector, our rates setting mechanism does not provide flexibility to increase prices in line with inflation and costs.

Summary of Interim Financial Results

Financial Results (Dollars in millions)	**Three months ended December 31,**		
	2005	**2004**	**% change**
Operating revenue	**$ 18,498**	**$ 18,786**	**-1.5%**
Operating expense			
Compensation and benefits	**14,100**	**13,667**	**3.2%**
Transportation	**1,509**	**1,419**	**6.4%**
Supplies and Services	**489**	**439**	**11.5%**
Depreciation and amortization	**530**	**499**	**6.1%**
Other Expenses	**1,102**	**1,035**	**6.4%**
Total operating expense	**17,730**	**17,059**	**3.9%**
Income from operations	**768**	**1,727**	**NM**
Interest and investment income	**27**	**11**	**152.3%**
Interest on deferred retirement obligations	**-65**	**-54**	**20.4%**
Interest expense on borrowings	**-2**	**-2**	**NM**
Net Income	**$ 728**	**$ 1,682**	**NM**

Note: Percentages are calculated based on unrounded numbers.

NM: Not Meaningful to present as % difference.

Effect of P.L.108-18 and use of "Savings"

P.L.108-18 identifies as "savings" the difference between the contributions we would have made to the Civil Service Retirement and Disability Fund (CSRDF) had the legislation not been enacted, and the contributions we now make under the law. In 2003 and 2004 we were required to use these "savings" to reduce our debt. In 2005 we paid our remaining debt of $1.8 billion, and used the remainder of the "savings" to offset operational expenses and hold postage rates constant for a third consecutive year.

Any "savings" after 2005 must be held in escrow. To fund the 2006 escrow requirement, we increased most postal rates and fees by 5.4% effective January 8, 2006.

Although the law directs this escrow requirement to be an operating expense, generally accepted accounting principles (GAAP) do not allow for this treatment. Therefore although our September 30, 2006 financial statements will show approximately $3 billion as restricted cash on the balance sheet, not as an expense, management must operate as if the escrow is an expense.

This translates to a quarterly amount of $750 million. If the escrow were reported as an expense, we would have a net loss of $22 million for the three months ended December 31, 2005.

	Three Months ended December 31, 2005
Total Revenue	**$ 18,525**
Total Expense	**17,797**
Net Income	**728**
Escrow Allocation	**750**
Net Loss	**$ (22)**

Operating Revenue

Operating revenue for Quarter 1 of $18,498 million was $288 million or 1.5 percent lower than for the same period last year. The first quarter of FY 2005 included a spike in the month of November during which revenues grew by 12.6 percent, due to the quadrennial impact of election mailings, increased activity in marketing financial services and credit cards and a calendar shift that added two days to the holiday marketing and mailing season between Thanksgiving and Christmas. It was expected that revenues and volumes would decline in the first quarter of 2006. Detailed volume and revenue data by product are shown in the tables that follow.

The majority of the volume decline in Quarter 1 came from First-Class Mail which showed a 3.8 percent decrease of just over 994 million pieces. This decrease was anticipated. Growth in Standard Mail, Package Services and Priority Mail was expected to offset most of the volume losses in First-Class Mail, but none of these products' performance met expectations.

For First-Class Mail volume, single-piece letters decreased 6.3 percent while workshare letters decreased 1.5 percent. Both were in line with expectations. First-Class card volume fell 2.2 percent.

Single-piece First-Class letter volume continued its long consistent decline. Workshare letter volume which grew for five consecutive quarters, declined in Quarter 1. Single-piece letter trends reflect the diversion of mail to electronic media, such as automatic bank account deductions, payments by credit cards and Internet bill payments. The negative impact of electronic diversion more than offsets the positive impact of economic and population growth. Electronic diversion is thought to play a smaller role in the volume trends of workshare letters.

Standard Mail volume exceeded First-Class Mail volume in the first quarter. This relationship has held for five of the last six quarters and is expected to continue into the future. The changing mail mix reflects the persistent, gradual erosion of single-piece letter volume at a time when advertising by mail continues to maintain its share of the advertising market.

Priority Mail finished Quarter 1 with 4.1 percent volume growth. This is the sixth consecutive quarter of volume gains for Priority Mail. Four factors underlie this performance. First, Priority Mail rates have not changed since June 2002, while competitors' published rates have increased annually. Second, the proliferation of competitors' surcharges for fuel, residential delivery, and delivery in rural areas make Priority Mail increasingly attractive, especially for small-volume users of Priority Mail, who generally cannot negotiate discounts or other pricing concessions with private sector competitors. Third, Priority Mail is much easier to use. Customers can purchase postage and print mailing labels with free delivery confirmation on-line through Click-N-Ship (http://www.usps.com/onlinepostage) or on websites such as eBay. Carrier pickup saves customers a trip to the Post Office and, the flat rate envelope and flat rate box simplify Priority Mail use further. Finally, we have worked to consistently improve Priority Mail service performance.

Express Mail experienced positive growth of 5.7 percent in Quarter 1, the sixth straight quarter of volume gains for Express Mail. Like Priority Mail, Express Mail has benefited from continued rate stability, and the impact of surcharges imposed by private sector competitors, as well as website access on www.usps.com.

Volume by Class of Mail
(Pieces in millions)

	Three months ended December 31		
	2005	2004	% change
First-Class Mail	25,434.1	26,428.2	-3.8%
Priority Mail	249.5	239.6	4.1%
Express Mail	14.3	13.5	5.7%
Periodicals	2,294.5	2,340.2	-2.0%
Standard Mail	27,076.0	26,954.4	0.5%
Package Services	326.8	314.7	3.9%
International	245.7	249.1	-1.4%
Other	233.7	219.3	6.6%
Total Mail Volume	55,874.6	56,759.0	-1.5%

Note: Percentages are calculated based on unrounded numbers.

Standard Mail volume growth was slightly positive at 0.5 percent. Although Standard Mail volume has grown for eight consecutive quarters, growth in the last four quarters has been significantly slower. Mail continues to hold its ground in the advertising market by virtue of its two dominant characteristics: it can be targeted to specific audiences and its effectiveness can be measured. The lower than expected growth in Standard Mail volume coincides with slower than expected growth in total advertising spending, which has caused advertising forecasters to revise downward their estimates of 2006 spending.

Periodicals volume declined 2.0 percent in Quarter 1. Weight per piece increased slightly but revenue per piece was virtually unchanged.

Package Services volume increased 3.9 percent in Quarter 1, however, as explained later, revenue declined 4.2 percent. Only Bound Printed Matter - at 12.1 percent volume growth - grew faster than expected. After three consecutive quarters of volume growth, Parcel Post volume declined 3.7 percent, well below expectations. Media Mail volume inched up 0.6 percent, about one-tenth of its expected volume growth. Library Mail volume, which fell 16.2 percent, continued to decline for the twentieth consecutive quarter.

International Mail originating in the United States decreased 1.4 percent in Quarter 1. Revenues from International Mail continue to grow as volume shifts from Economy Mail classes to Air Mail classes.

"Other" volume, in the table, includes mail sent by the U.S. Postal Service and Free Mail for the Blind and Handicapped. Volume from Other mail volume grew 6.6 percent in the first quarter, due primarily to our efforts to use the mail to promote usps.com convenience and our self service Automated Postal Centers (APC).

Given constant postage rates over the last few years, changes in revenue performance are expected to be highly correlated with changes in mail volume. Differences in revenue and volume growth rates are attributable to mail mix changes within the categories reported herein. Specifically, if volume growth in a particular mail class exceeds revenue growth, this indicates that low yield (in terms of revenue per piece) volume within the class was growing faster than high yield volume. Put differently, when volume growth exceeds revenue growth, revenue per piece declines.

Both single-piece and workshare First-Class Mail volume – by far the largest two categories in the Class – fell, resulting in a decline in First-Class Mail revenue. Standard Mail volume growth in the commercial subclasses (Regular and ECR) was 2.5 percent. Revenue growth in the commercial subclasses was only 1.8 percent since the volume growth came from low yield categories. The smaller Nonprofit Standard subclasses lost volume (9.4 percent) and revenue (8.4 percent). The decline in Nonprofit had been expected in light of the fact that unlike 2004, 2005 was not an election year. On balance, Standard Mail revenues (0.6 percent) grew only slightly faster than volumes (0.5 percent).

About 84 percent of Package Services revenue comes from Parcel Post and Bound Printed Matter. Bound Printer Matter revenue growth fell well short of volume growth and Parcel Post volume and revenue declined. As a whole the Package Services class lost 4.2 percent in revenues compared to the first quarter of 2005.

Revenue by Class of Mail
(Dollars in millions)

	Three months ended December 31		
	2005	**2004**	**% change**
First-Class Mail	**$ 9,335**	**$ 9,748**	**-4.2%**
Priority Mail	**1,358**	**1,294**	**4.9%**
Express Mail	**231**	**218**	**6.2%**
Periodicals	**554**	**563**	**-1.7%**
Standard Mail	**5,084**	**5,054**	**0.6%**
Package Services	**619**	**646**	**-4.2%**
International	**521**	**507**	**2.6%**
Other	**796**	**755**	**5.4%**
Total Operating Revenue	**$ 18,498**	**$ 18,786**	**-1.5%**

Note: Percentages are calculated based on unrounded numbers.

Revenue from International Mail grew 2.6 percent despite a volume decline of 1.4 percent. This result reflects the shift in the mail mix from low yield Economy Mail to higher yield Air Mail. Also, International revenues include revenues from foreign postal transactions not included in volume estimates.

“Other” revenue which includes special services increased 5.4 percent, mostly as a result of increased recognition of emergency preparedness (EPP) appropriations revenue tied to EPP equipment depreciation, and passport acceptance revenue.

Additional detailed data on product volumes and revenues may be found in the Quarterly Revenue, Pieces, and Weight reports on www.usps.com/financials/rpw.

Operating Expenses

Compensation and Benefits and Workhour Analysis

Total compensation and benefits for Quarter 1 was $14,100 million, or 3.2 percent higher than the prior year period amount of $13,667 million. This increase of $433 million was driven by salary and benefit increases of $412 million, which included an increase in wages of $301 million, $88 million in employee health benefits, and an increase in retirement contributions of $24 million. Retiree health benefit increases of $41 million and other personnel cost increases of $5 million were partially offset by a $25 million decrease in workers compensation costs.

Wages

Wages grew in Quarter 1 by $301 million compared to same period last year. This is due to increases in wage rates and overtime usage. Bargaining unit employees, except for the American Postal Workers Union, received pay increases of 1.3 percent in November 2005. In addition, almost all bargaining unit employees received annualized cost of living increases ranging from $208 to $229 per eligible employee in March, 2005 and $707 to $728 in September, 2005. The September, 2005 COLA of $728 per eligible employee was the largest COLA since May 1980 and was responsible for $183 million of the $301 million increase in wages. Included in the wage growth is the impact of a 4.9 percent growth in overtime hours in Quarter 1. This contributed $89 million in Quarter 1 to the total wage increase.

Our cost of providing health benefits to current employees increased by $88 million, from the same quarter last year. Overall, benefits make up over 24 percent of our total personnel compensation expense.

Workhours

A change in workhours is usually created by a change in workload, a change in productivity, or both. The two major workload factors that impact our operations are changes in mail volume and changes in possible deliveries. In our first quarter, mail volume decreased by 884 million pieces, or 1.6 percent and we added 2 million new delivery points, as compared to the same quarter last year. Total workhour usage declined 0.9 million hours, or 0.2 percent, from the comparable period last year. Operations Support, Rural Delivery and Vehicle Services are the only functions that increased workhour usage.

Workhours and salaries and benefits by Function for Quarter 1 of 2006 compared with the same period last year. Functional definitions can be found in Item 6.

Compensation , Benefits and Workhour Analysis

Workhours Three months ended December 31, (In thousands)				Salaries & Benefits Three months ended December 31, (Dollars in millions)		
2005	**2004**	**% change**		**2005**	**2004**	**% change**
			Operations:			
119,433	119,895	-0.4%	-City Delivery	$ 4,354	$ 4,231	2.9%
89,630	90,276	-0.7%	-Mail Processing	3,070	2,996	2.5%
60,111	60,520	-0.7%	-Customer Services, Retail & Sales	2,114	2,060	2.6%
46,280	44,727	3.5%	-Rural Delivery	1,362	1,257	8.4%
20,303	20,307	0.0%	-Plant & Equip Maintenance	779	751	3.7%
8,145	8,134	0.1%	-Vehicles Services	312	302	3.5%
2,358	2,239	5.3%	-Operations Support	107	98	9.6%
28,636	29,729	-3.7%	Headquarter, Area & District Management, Postmasters, Administration and Other	1,209	1,200	0.8%
374,895	375,827	-0.2%	Subtotal	13,307	12,895	3.2%
Not Applicable			Other Compensation			
			Workers' Compensation	299	324	-7.6%
			Retiree Health Benefits	395	354	11.5%
			Other	99	94	5.3%
374,895	375,827	-0.2%	Total	$ 14,100	$ 13,667	3.2%

Note: Percentages are calculated based on unrounded numbers.

Other Compensation

Workers' Compensation costs represented approximately 2.1 percent of compensation and benefits expenses in the quarter, compared to 2.4 percent for the comparable period last year. Our employees are covered by the Federal Employees' Compensation Act, administered by the Department of Labor's Office of Workers' Compensation Programs (OWCP). The current year workers' compensation liability and expense accruals are estimated using an actuarial model based on the number of cases, severity of the injury, the age of the injured employee, the trend of our experience with such an injury and other factors. The primary drivers for our Workers' Compensation expense are the number of claims reported and cost per claim. In 2005 we experienced a 4.4 percent decrease in the number of paid medical claims and a 5.5 percent decrease in the number of paid compensation claims. For the first quarter we experienced a 5.3 percent decrease in the number of paid medical claims and the number of paid compensation claims. This is a continuation of this favorable trend due to our efforts to prevent workplace injuries and our joint initiative with OWCP to increase the number of injured employees returned to work.

Retiree Health Benefits costs were about 2.8 percent of compensation and benefits expense in Quarter 1, compared to 2.6 percent in the corresponding quarter last year. Under the Federal Employees Health Benefits Program (FEHBP), the Office of Personnel Management (OPM) bills us for the cost of our retirees participating in the plan. The major drivers of Retiree Health Benefits expense are the number of participants on the rolls and inflation in premium costs. As of December 31, 2005, we had approximately 446,000 participants on the rolls, an increase of about 6,000 over the prior year. Our expense related to retiree health benefits was $395 million during this quarter, compared to $354 million in the first quarter of 2005, an increase of 11.5 percent.

Employee Complement
Employee complement was reduced by 2,141 during the quarter. The total number of career employees at the end of the quarter was 702,575. This represents a reduction of 3,561 employees from the same quarter last year, all through attrition.

Retirement Expense
Our employees participate in one of three retirement programs based on their date of employment. These programs are the Civil Service Retirement System (CSRS), the Dual CSRS/Social Security System, and the Federal Employees Retirement System (FERS). Each of these programs is described in further detail in note 6 to the financial statements included in our 2005 Annual Report. The programs are administered by the Office of Personnel Management (OPM). The expenses of all of our retirement programs are included in compensation and benefits expense.

The implementation of P.L.108-18 in May 2003 did not alter the fact that retirement expenses remain a significant portion of our total expenses. Retirement contributions for current employees, which are included in compensation and benefits expense, represented 9.8 percent of our total expenses during the first quarter. They increased by $24 million compared to Quarter 1 of 2005.

Transportation
Transportation expenses were $1,509 million, an increase of $90 million, or 6.4 percent, for the quarter. Transportation costs are largely made up of air and highway transportation.

Air transportation expenses were $701 million, an increase of $52 million, or 8.1 percent, over the same quarter last year. This is primarily attributed to increased fuel charges and contractual rate increases for our dedicated air supplier. During the first quarter, the index by which the jet fuel costs are calculated for our dedicated air carrier increased 64.2 percent from the same quarter last year of approximately $46 million.

Transportation Expenses
(Dollars in millions)

	Three Months Ended December 31, 2005	2004	% Change
Air Transportation	**$ 701**	**$ 649**	**8.1%**
Highway Transportation	**761**	**679**	**12.1%**
Other Transportation	**47**	**91**	**-48.0%**
Total	**$ 1,509**	**$ 1,419**	**6.4%**

Note: Percentages are calculated based on unrounded numbers.

Highway transportation expense of $761 million increased by $82 million, or 12.1 percent, over the same quarter last year. The increase was driven primarily by higher fuel prices and contractual rate increases for drivers. During the first quarter, retail gasoline prices increased an average of 28.9 percent from the same period last year. This resulted in an increase in fuel costs for highway contract operations of approximately $49 million for the first quarter. Due to network growth, additional miles driven accounted for an additional $10 million dollars in fuel charges. We are contractually obligated under the Service Contract Act to adjust contract payments to drivers each year based on the Department of Labor wage determinations. These payment increases resulted in $18 million of additional costs in the 1st quarter. Additionally in 2005, we shifted a majority of mail previously carried by rail transportation to highway transportation.

Other transportation expenses decreased $44 million dollars for Quarter 1 due primarily to decreased terminal dues payments to foreign postal administrations and related international expenses.

Supplies and Services
Supplies and services expenses of $489 million were $50 million or 11.5 percent higher than last year's comparable quarter. Supplies expense increased $22 million over the same quarter last year. A $12 million increase in the cost of expedited (Priority and Express Mail) supplies was the primary driver of supplies expense growth. This increase is attributable to higher expedited mail volumes, and higher packaging prices as compared to the comparable quarter last year. Expenses for the processing of credit and debit cards increased $27 million compared to the same quarter last year, due to growth in the usage of debit and credit cards by our customers. These growth items were partially offset by a $10 million decrease in consulting services expenses.

Depreciation and Amortization

Depreciation expenses of $530 million were $31 million more than last year's comparable quarter. The depreciation increase is the result of higher capital investment in 2005 than in prior years. In particular, depreciation of biohazard detection and ventilation and filtration systems contributed to $11 million of the increase. Additionally, an updated analysis of the useful life and salvage value of certain delivery vehicle assets resulted in an increase in depreciation expense of $12 million this quarter. This impact will continue for the next 11 years, decreasing over time as vehicles become fully depreciated.

Other Expenses

Other expenses of $1,102 million were $67 million or 6.4 percent higher than last year's comparable quarter. The major components included in this category are rent and utilities of $403 million, vehicle maintenance services of $170 million, rural carrier equipment maintenance allowances of $111 million, and information technology of $89 million. Rent expense remained relatively flat while utilities increased 19 percent, driven by electricity and gas natural costs. Vehicle maintenance services are increasing, up 23.3 percent, as bulk fuel costs rise.

Interest Expense

Interest expense of $67 million was $11 million higher than last year's comparable quarter. The entire increase is due to an increase in the CSRS supplemental retirement obligation calculated by the Office of Personnel Management in June 2005.

Productivity

Total Factor Productivity (TFP) measures the change in the relationship between outputs, or workload, and all the resources used in producing these outputs. The main outputs are mail and special services and carrier services to an expanding delivery network. TFP calculations include inputs for all resources including labor, materials, transportation and capital investments.

Quarter 1 TFP related workload decreased by 0.2 percent, while resource usage increased 0.5 percent, yielding a 0.7 percent decrease in TFP. This productivity decline is approximately equivalent to an expense increase of $124 million. The Quarter 1 workload decrease of 0.2 percent was driven primarily by mail volume declines compared to the first quarter of last year. Mail volume declines were significantly offset by the expanding delivery network as described previously and to a lesser extent by increases in the transportation of military mail. Resource usage increased this quarter and was driven by increases in materials and capital usage. These increases were offset to some extent by a reduction in labor usage.

Financial Condition

Debt and Liquidity

As of December 31, 2005, we had no outstanding debt with the U.S, Treasury's Federal Financing Bank, as was the case at December 31, 2004. Cash and cash equivalents were $1,681 million, $751 million higher than September 30, 2005, and $944 million higher than at the end of December 2004. For the quarter, cash flow from operating activities was $921 million lower this year, while net cash used in investing activities (capital outlays) was about the same as last year. Last year, we used the net cash flow from operations, after paying for capital investments, plus a reduction in cash of $140 million, to pay off $1.8 billion in debt. This year, with no debt to repay, the net cash flow increased cash and cash equivalents.

We do not anticipate any borrowing until the end of the fiscal year. In September, we have approximately $1.2 billion in lump sum payments for workers' compensation and retirement liabilities. Additionally, we do not expect cash flow from operations for the year to supply enough cash to fund both the escrow requirement, estimated at $3 billion, and capital investments. Consequently, we anticipate increasing debt by over $1 billion in 2006.

We continue to maintain two credit lines with the Federal Financing Bank. One credit line enables us to draw up to $3.4 billion with two days' notice; the other up to $600 million on the same business day that funds are requested. In addition, we can also use a series of other notes with varying provisions to draw upon with two day's notice.

Capital Expenditures and Commitments

The capital commitments for the first quarter were $153 million compared to $422 million for the same period last year.

During the first quarter, the Board of Governors approved funding for one project, Mail Processing Infrastructure (MPI) Phase III, to upgrade the existing mail processing data networks at 170 small to mid-size postal facilities to handle current and future data needs.

The capital cash outlays year-to-date were $570 million compared with $576 million in FY2005. The following table – Capital Commitments, Expenditures, and Resources on Order, below, summarizes FY2006 activity year-to-date compared to same period last year.

Capital Commitments, Expenditures, and Resources on Order

CAPITAL INVESTMENTS	COMMITMENTS[1]		CASH OUTLAYS		RESOURCES ON ORDER[2]	
(dollars in millions)	Year to Date Through December 31,		Year to Date Through December 31,		December 31	
	2005	2004	2005	2004	2005	2004
CONSTRUCTION AND BUILDING PURCHASE	$ 15	$ 31	$ 48	$ 61	$ 114	$ 160
BUILDING IMPROVEMENTS	78	24	109	100	386	303
MAIL PROCESSING EQUIPMENT	54	1	230	192	1,844	1,393
VEHICLES	4	1	50	53	157	68
RETAIL EQUIPMENT	0	2	0	40	38	57
POSTAL SUPPORT EQUIPMENT	2	363	133	130	444	632
TOTAL	$ 153	$ 422	$ 570	$ 576	$ 2,983	$ 2,613

(1) Capital Commitment - Binding agreements entered into by the Postal Service and vendors during the quarter for purchase of capital equipment, facilities, vehicles, or services, booked at the time the contract is signed.
(2) Resources on Order – All Capital Commitments that have not yet been paid.

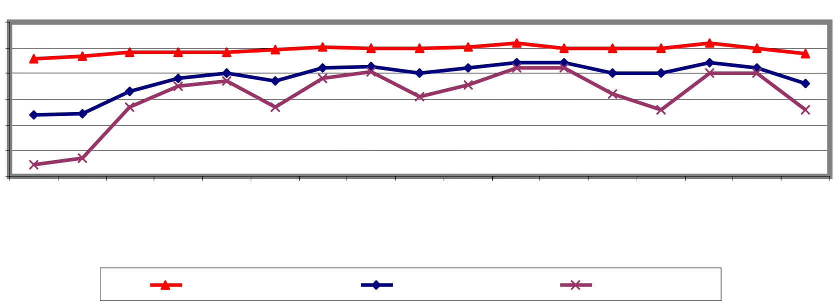
Service and Performance

Management monitors several key statistics to determine performance against service standards and monitors public perception of our service.

Performance

The External First-Class Mail measurement system (EXFC) is an independently administered system that provides an external measure of collection box to mailbox delivery performance. Although not a system-wide measurement of all First-Class Mail performance, EXFC continuously tests a panel of 463 3-digit ZIP Code areas selected on the basis of geographic and volume density, thereby providing a measure of service performance from the customer's point of view. Graph 1 – EXFC Performance summarizes EXFC results by quarter since 2000. For Quarter 1 all categories showed decline from the prior quarter. This is typical as we move from the fall months and into winter. When compared to Quarter 1 of the prior year EXFC 1 day delivery fell from 95 to 94 percent, EXFC 2 day delivery fell from 90 to 88 percent and EXFC 3 day delivery fell from 86 to 83 percent.

Graph 1 - EXFC Performance



Customer Satisfaction
In spite of the slight decline in performance, the independently measured customer satisfaction survey for residential household customers for Quarter 1 showed that 92 percent of these customers rated their experience with us as “excellent”, “very good” or “good.”

Rate and Classification Activity

The Postal Rate Commission is an independent establishment of the executive branch of the United States government. The Commission reviews our proposals to establish and change domestic mail rates, fees and mail classifications. Upon request by the Postal Service, the Commission holds public hearings and issues recommended decisions to the Governors of the Postal Service, who approve, reject, or, in some cases, modify the Commission’s recommendations. The PRC is also authorized to issue advisory opinions concerning proposed changes in the nature of postal services that affect service on a nation-wide or substantially nation-wide basis, to recommend decisions regarding rate complaints by interested parties, and to report complaints that parties are not receiving postal services in accordance with the policies of the Postal Reorganization Act. The PRC is also responsible for promulgating rules and regulations and establishing procedures deemed necessary and proper to carry out their functions and obligations. Specific information on these pending dockets can be obtained at the PRC web site http://www.prc.gov.

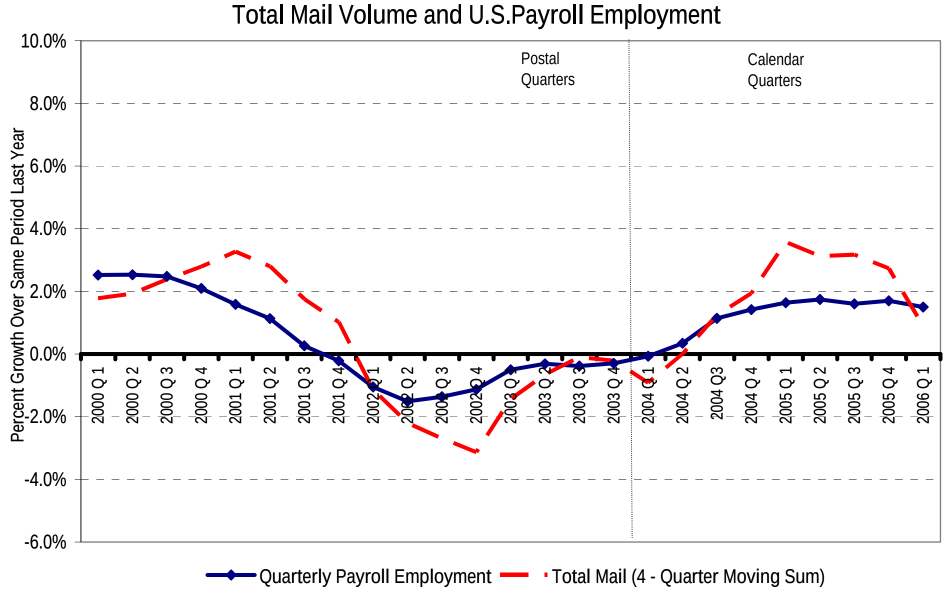
On November 1, 2005 the PRC issued its Decision on Docket No. R2005-1 to the Board of Governors. The Commission determined that the across-the-board increase suggested by the Postal Service will generate necessary revenues and is consistent with the public policies established by the Postal Reorganization Act. On November 14, 2005 the Governors voted to accept the Postal Rate Commission’s recommendations. The new rates took effect January 8, 2006.

Outlook

The outlook for the remainder of 2006 is challenging. Revenue growth for the remainder of the year will be driven by the impact of the January 2006 rate increase. Expense growth for the year will likely be comparable in 2006 to 2005. Sustained high fuel prices throughout the year and higher wage rates, primarily driven by larger COLAs for our bargaining employees, are the main drivers behind the expense growth.

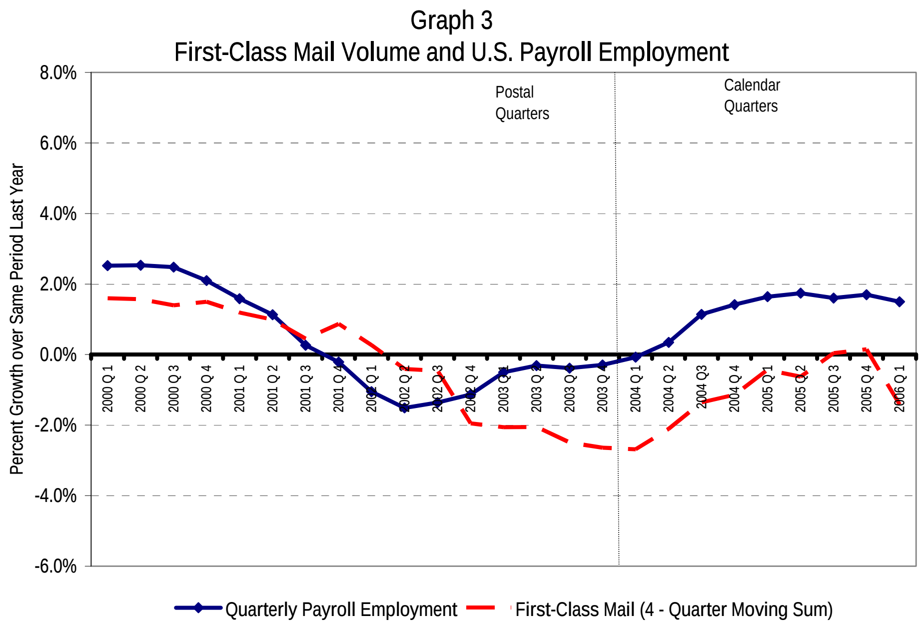
Revenue Outlook
The revenue outlook for the remainder of the year remains positive due to a 5.4 percent rate increase implemented on January 8, 2006. The volume of certain postal products such as Priority Mail and Express Mail that have benefited from price stability over the past three years will be most noticeably affected by the rate increase. Moreover, the January rate increase will come on the heels of slower than expected Quarter 1 growth in two price elastic products, Priority Mail and Standard ECR.

Graph 2
Total Mail Volume and U.S.Payroll Employment



Growth in economic activity was solid through most of 2005 and should continue through the remainder of 2006. Macroeconomic forecasters continue to shuffle their forecasting deck from month-to-month as they sort out the timing and magnitude of effects of an unusual set of economic events such as hurricane recovery, unprecedented automobile price rollbacks, interest rate hikes on investment financing, fuel price increases, and inflation. Interest rate increases that normally would suppress growth in investment will be offset by hurricane recovery-related investments in 2006. Increases in fuel prices are expected to put upward pressure on the cost of goods and services in 2006. The steady and gradual tightening by the Federal Reserve should help consumer inflation to moderate by 2007. Big changes in the marketing and pricing of automobiles in 2005 in the U.S. have made retail sales measures, used in our projections, much more volatile and difficult to forecast. In light of events such as these, it is not surprising that the composition (among various components of consumption, investment and government spending) and timing of macroeconomic activity has posed a challenge to forecasters in the last several months.

Of all the macroeconomic measures available, total U.S. employment is the measure that has most closely tracked mail volume growth in recent years. U.S. employment and Total Mail volume growth are compared in Graph 2. As the graph shows, mail volume losses (measured as four-quarter moving sums) tracked declines in payroll employment in 2002 and 2003. Mail volume growth turned positive in 2004, coincident with employment growth. This growth continues into 2006. In fact, until Quarter 1, mail volume growth had exceeded employment growth for four consecutive quarters. Mail volume growth for the remainder of 2006 is expected to be suppressed by the 5.4 percent increase in rates at the start of Quarter 2.



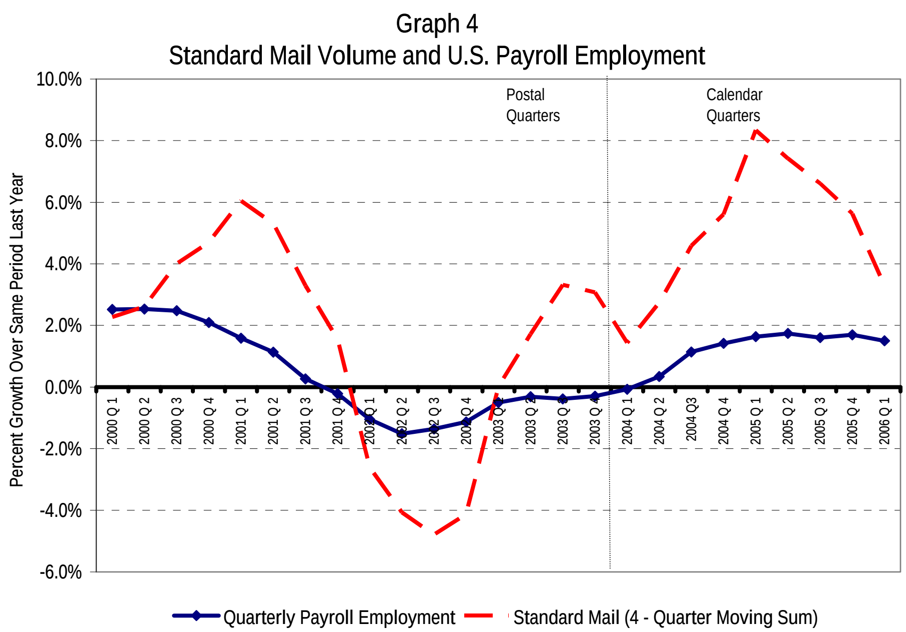
Continued employment growth will positively affect total mail volume, but will have a lesser effect on total revenue because of mail mix changes, which continue the substitution of low revenue-per-piece volumes for high revenue-per-piece volumes.

About 90 percent of the contribution to institutional costs is derived from First-Class Mail and Standard Mail. First-Class Mail has been and continues to be affected by diversion and consolidation. Electronic diversion of hard copy communications like bill payments continues unabated, despite recent concerns about data security. An additional type of diversion occurs when mail consolidators, among the fastest growing postal customers, convert single-piece mailings into bulk mailings. Consolidation of single-piece First-Class Mail into workshare First-Class Mail is relatively innocuous financially since single-piece and workshare letters generate similar per piece contribution. Consolidation becomes a concern to the extent single-piece First-Class Mail is converted to Standard Mail, which has a lower contribution per piece than First-Class Mail.

Graph 3 shows the trend in First-Class Mail volume growth (on a moving four-quarter sum basis) in relation to U.S. employment. First-Class Mail volume growth is consistently slower than growth in Employment for the last three years. The continued loss of single-piece letter volume is expected to keep First-Class Mail growth below employment growth indefinitely. Moreover, the trend in First-Class Mail volume turned negative in 2002 and is expected to remain negative indefinitely.

We project continued Standard Mail volume growth through the remainder of the year due to the positive economic outlook and continuing strength in direct marketing channels. Projected softness in advertising expense growth for the remainder of the year and the effects of the January 2006 price increase are likely to attenuate Standard Mail growth somewhat. As Graph 4 Standard Mail Volume and U.S. Payroll Employment shows, Standard Mail, which is far more prone to cyclical variations than First-Class Mail, has been growing more rapidly than the employment indicator in recent years. The gap between Standard Mail volume and employment growth has narrowed somewhat over the last six months and is likely to do so for the remainder of 2006.

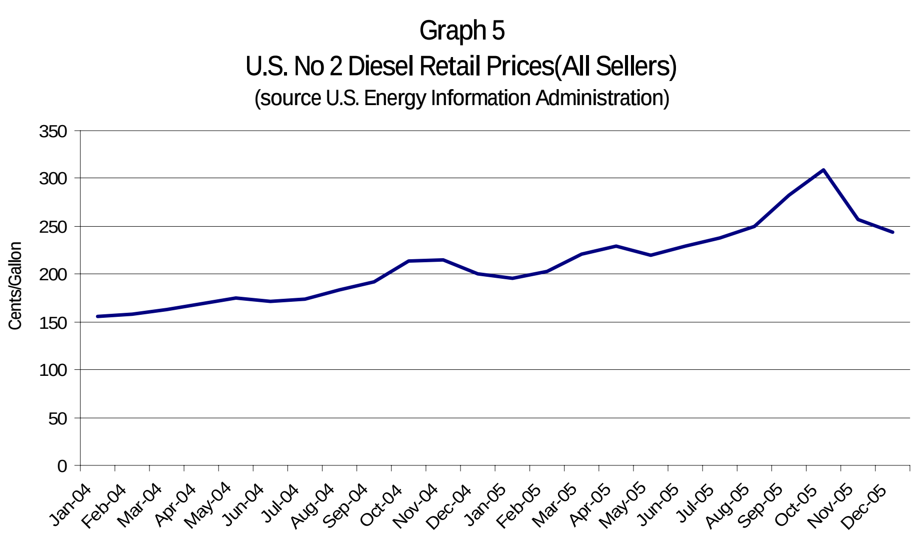
Another six to seven percent of the contribution to institutional costs comes from Priority Mail and Express Mail, two highly price sensitive products. Priority Mail volume growth has now been positive for six consecutive quarters, but this most likely will change as rates increase in January 2006. Express Mail has grown for five consecutive quarters and, like Priority Mail, will probably see this volume trend end as a result of the January price increases. Unlike Priority Mail, however, Express Mail volume showed surprising strength in Quarter 1.



Because the postal delivery network expands each year, revenue growth is needed to support that expansion. Declines in single-piece First-Class Mail volume pose a challenge for Postal Service finances going forward. Single-piece First-Class letters contribute about $9 billion to cover institutional costs annually, about 28 percent of the total contribution. As this mail volume falls, other products must grow in order to replace the contribution. Unfortunately, with the exception of workshare First-Class Mail, the mail categories that must grow are much more sensitive to price changes than single-piece First-Class Mail.

Expense Outlook

The continued high level of fuel costs remains a serious concern. In addition to transportation, increased energy costs for the year continue to negatively affect a variety of other non-personnel items, including utility expenses, vehicle servicing costs, rents and leases and rural carrier equipment maintenance allowances. The effects of fuel inflation also impact the Consumer Price Index, upon which cost-of-living allowances (COLAs) for our bargaining employees are based. As shown in Graph 5, retail prices for diesel fuel, for example, have risen steadily from an average of $1.55 per gallon in January 2004 to a peak of $3.10 per gallon in October 2005, before declining slightly in November and December. Even a continuation of current fuel price levels will represent a significant increase in fuel costs in 2006, relative to 2005. This will place continued upward pressure on total Postal Service expenses.



The outlook for the remainder of 2006 is for a continuation of the challenges that we have faced during the first quarter. The decline in TFP during the first quarter is indicative of those challenges. Although Quarter 1's results are disappointing, we anticipate that productivity will rebound in the second-half of the year. We are on track to reduce workhours for the seventh consecutive year. If fuel prices remain at current levels or increase further, it will be difficult to realize additional cost reductions to offset these inflationary pressures.

Pending Legislation

Postal Reform

The Board of Governors sent a letter opposing the legislation in its current form to all United States Senators. Full text of their position on the legislation can be found on our website www.usps.com and is identified under Item 5. Other information, as a press release dated January 24th, 2006.

The administration still opposes the Postal Services' position on several issues, and believes the legislation must be budget neutral. The full text of the proposed legislation can be found at the website http://thomas.loc.gov/.

Medicare Part D Drug Subsidy

In October 2005, we applied to receive the Medicare Part D retiree drug subsidy under the Medicare Prescription Drug Improvement and Modernization Act of 2003. Public and private employers providing qualified drug coverage can receive a reimbursement from Medicare equal to 28 percent of their drug costs.

The Centers for Medicare and Medicaid Services (CMS) accepted our application to be a participant in this program in November 2005. The prescription drug subsidy is projected to save our customers at least $250 million annually. In December 2005, at the direction of the Office of Personnel Management, CMS then reversed its acceptance and rejected our application. We disagree with this action and will pursue our right to participate in this program.

Free Mailing Privileges for Service-Member Families

Chairman Tom Davis (R-VA) amended H.R. 923 during the committee mark-up to address Postal Service and Department of Defense concerns about the implementation of the original bill. This bill is currently on the calendar for debate.

Item 3. Quantitative and qualitative disclosures about market risk

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

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

Item 4. Controls and procedures

We are currently documenting and updating the controls over our financial processes. These processes are under review and existing documentation will be revised to conform to the Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework.

No material control deficiencies or weaknesses were identified or reported during the quarter ending December 31, 2005.

Part II. Other Information

Item 1. Legal proceedings

See Note 6, Contingent Liabilities, December 31, 2005 financial statements.

Item 5. Other information

Labor Agreements
Because our workforce is heavily unionized, our costs are largely determined by the provisions of existing labor agreements. Our current agreements call for regularly scheduled general wage increases and cost-of-living allowances (COLA). The COLA adjustments are calculated based on the “National Consumer Price Index for Urban Wage Earners and Clerical Workers" (CPI-W), published by the Bureau of Labor Statistics, using a conversion rate of 1 cent per hour for each full 0.4 of a point increase in the CPI-W index. COLA adjustments are made in March, based on the January CPI-W and September, based on the July index. In no event will a decline below the base index result in a decrease in the pay scales covered by our collective bargaining agreements.

Summaries of the relevant portions of our major agreements follow:

In September 2005, we reached a one-year contract extension with the American Postal Workers Union (APWU, AFL-CIO). The agreement affects approximately 287,000 postal employees represented by the APWU. The contract extension covers the period from November 20, 2005 through November 20, 2006. The agreement provides for a 1.6 percent wage increase effective March 18, 2006 and includes the continuation of the cost-of-living allowances.

The current agreement with the National Association of Letter Carriers (NALC) was negotiated and subsequently ratified in June 2002. The five-year agreement with the NALC is due to expire on November 20, 2006. During 2006, NALC employees will receive regularly scheduled COLA payments in March and September. In addition, in November 2005, employees received a 1.3 percent general wage increase.

National Postal Mail Handlers Union members ratified a two-year contract extension with the United States Postal Service in May 2003. This action resulted in a 1.3 percent wage increase for approximately 58,000 postal employees effective November 27, 2004, and a 1.3 percent increase effective November 26, 2005. Other terms of this contract extension, covering the period from November 20, 2004, through November 20, 2006, provide for the continuance of March and September COLA payments and the establishment of a joint task force to discuss issues relating to repositioning employees. All other terms of the contract remain the same.

In November 2004, the National Rural Letter Carriers Association (NRLCA) extended their collective bargaining agreement with us by two years. The existing collective bargaining agreement was originally set to expire on November 20, 2004. It has now been extended to November 20, 2006. The agreement provides for a 1.3 percent wage increase effective November 27, 2004, and a 1.3 percent increase effective November 26, 2005. Terms of the agreement include continuing the March and September COLA payments, establishing a standard time allowance for reloading and unloading vehicles, increasing the reimbursement rate for rural carriers who furnish their own vehicles and creating a joint task force to discuss issues related to future developments in mail delivery. All other provisions of the contract remain in effect.

Other Financial Information
Other financial information such as Annual and Quarterly reports, Comprehensive Statements on Postal Operations and Revenue, Pieces and Weight reports can be obtained at http://www.usps.com/financials/

Press Releases
The following are press releases relevant to events discussed in this report. The full text of these releases can be obtained at http://www.usps.com/communications/news/press/welcome.htm.

January 24, 2006 - News Release #06-003
Postal Service Opposes Passage of Senate Postal Reform Bill (S. 662)

January 10, 2006 - News Release #06-001
Challenges, Opportunities, and Uncertainties In '06, Says Potter

December 6, 2005 - News Release #05-108
USPS Ends Year in Black and Debt Free; Escrow Fund Looms

November 14, 2005 - News Release #05-097
Governors Approve Change in Postage Rates

November 3, 2005 - News Release #05-093
Postal Service Applies As Medicare Part D Provider

November 1, 2005 - For Immediate Release
Remarks of John E. Potter, Postmaster General -
Open Session Board of Governors Meeting

Item 6. Exhibits and reports

Functional Definitions

Operations Support consists of supervisory, administrative and clerical hours in support of mail processing, delivery and retail operations. Operations Support activities assist field operations in optimizing efficiency.

Mail Processing includes workhours for manual, mechanized and automated distribution of the mail.

Rural and City Delivery functions include delivery and collection of mail, carrier office and street activities, supervisory support, and training.

Vehicle Services includes hours for operating and maintaining the postal vehicle fleet and support hours for stockroom duties and vehicle accident investigations.

Plant and Equipment Maintenance includes hours for maintaining mail handling equipment, building maintenance and custodial activities.

Customer Services includes workhours in support of retail and delivery operations at post offices. This includes providing service to customers at window units, distribution of mail to post office boxes and to rural and city delivery routes, and miscellaneous clerical duties in support of retail and delivery services.

Postmasters and Installation Heads, Administration, and Other covers all remaining functions, including support activities involving information systems, finance, human resources, marketing and sales at all locations. This category also includes employees on limited duty and rehabilitation.