United States Postal Service

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Quarterly Financial Report

For the Three Months and Nine Months Ended June 30, 2007

August 9, 2007

United States Postal Service
Quarterly Financial Report Index

United States Postal Service
Statements of Operations

(Dollars in millions)	Three Months Ended June 30 2007	Three Months Ended June 30 2006	Nine Months Ended June 30 2007	Nine Months Ended June 30 2006
Operating revenue	$ 18,361	$ 17,835	$ 56,316	$ 54,948
Operating expenses:				
Compensation and benefits	13,403	13,661	40,782	40,829
Retiree health benefits	1,793	422	8,313	1,236
Transportation	1,548	1,433	4,917	4,469
Other	2,313	2,262	6,919	6,715
Total operating expenses	19,057	17,778	60,931	53,249
(Loss) Income from operations	**(696)**	**57**	**(4,615)**	**1,699**
Interest and investment income	38	52	152	116
Interest expense on deferred retirement obligations	-	(28)	-	(159)
Other interest expense	(1)	-	(6)	(1)
Net (Loss) Income	**$ (659)**	**$ 81**	**$ (4,469)**	**$ 1,655**

See accompanying notes to the financial statements

United States Postal Service
Balance Sheets - Assets

(Dollars in millions)	June 30, 2007	September 30, 2006
Assets		
Current Assets		
Cash and cash equivalents	$ 1,096	$ 997
Receivables:		
Foreign countries	485	527
U.S. government	143	150
Other	202	210
Receivables before allowances	830	887
Less allowances	48	48
Total receivables, net	782	839
Supplies, advances and prepayments	147	205
Total Current Assets	**2,025**	**2,041**
Cash - Restricted	-	**2,958**
Appropriations Receivable - Revenue Forgone	**394**	**394**
Property and Equipment, at Cost:		
Buildings	21,416	21,083
Equipment	20,767	19,729
Land	2,895	2,887
Leasehold improvements	844	1,232
	45,922	44,931
Less allowances for depreciation and amortization	24,506	23,951
	21,416	20,980
Construction in progress	1,826	2,115
Total Property and Equipment, Net	**23,242**	**23,095**
Total Assets	$ **25,661**	$ **28,488**

See accompanying notes to the financial statements

United States Postal Service
Balance Sheets - Liabilities and Net Capital

(Dollars in millions)	June 30, 2007	September 30, 2006
Liabilities and Net Capital		
Current Liabilities:		
Compensation and benefits	$ 2,200	$ 3,221
Retiree health benefits	4,055	3
Payables and accrued expenses:		
Trade payables and accrued expenses	995	1,481
Foreign countries	570	567
U.S. government	101	111
Total payables and accrued expenses	1,666	2,159
Customer deposit accounts	1,553	1,647
Deferred revenue - prepaid postage	1,187	1,187
Outstanding postal money orders	871	885
Prepaid box rent and other deferred revenue	436	454
Debt	-	2,100
Total Current Liabilities	**11,968**	**11,656**
Non-Current Liabilities:		
Workers' compensation costs	7,658	6,869
Employees' accumulated leave	2,350	2,116
Deferred appropriations revenue	631	631
Long term portion capital lease obligations	625	637
Deferred gains on sales of property	302	123
Other	320	180
Total Non-Current Liabilities	**11,886**	**10,556**
Total Liabilities	**23,854**	**22,212**
Net Capital		
Capital contributions of the U.S. government	3,034	3,034
Retained (deficit) earnings since reorganization	(1,227)	3,242
Total Net Capital	**1,807**	**6,276**
Total Liabilities and Net Capital	**$ 25,661**	**$ 28,488**

See accompanying notes to the financial statements

United States Postal Service
Statements of Changes in Net Capital

(Dollars in millions)		Capital Contributions of U.S. Government	Retained Earnings (Deficit) Since Reorganization	Total Net Capital
Balance, September 30, 2006	(audited)	$ 3,034	$ 3,242	$ 6,276
Net Loss - Nine months Ended June 30, 2007		-	(4,469)	(4,469)
Balance, June 30, 2007		$ 3,034	$ (1,227)	$ 1,807

See accompanying notes to the financial statements

United States Postal Service
Statements of Cash Flows

(Dollars in millions)	Nine Months Ended June 30, 2007	Nine Months Ended June 30, 2006
Cash flows from operating activities:		
Net (loss) income	$ (4,469)	$ 1,655
Adjustments to reconcile net (loss)income to net cash provided by operating activities:		
Depreciation and amortization	1,588	1,587
Loss on disposals of property and equipment, net	7	8
(Increase) in appropriations receivable revenue forgone	-	(19)
Increase in workers' compensation liability	789	864
Increase in employees accumulated leave	234	215
(Decrease) Increase in long-term portion capital lease obligations	(12)	20
Increase (Decrease) in other non-current liabilities	140	(39)
Changes in current assets and liabilities:		
Receivables, net	57	60
Supplies, advances and prepayments	58	31
Compensation and benefits	(1,021)	59
Retiree health benefits	4,052	-
Deferred revenue - prepaid postage	-	21
Payables and accrued expenses	(406)	(664)
Customer deposit accounts	(94)	(52)
Outstanding postal money orders	(14)	(19)
Prepaid box rent and other deferred revenue	(18)	18
Net cash provided by operating activities	891	3,745
Cash Flows from investing activities:		
Decrease in restricted cash	2,958	-
Purchase of property and equipment	(1,804)	(1,730)
Proceeds from sale of property and equipment	61	17
Net cash provided by (used in) investing activities	1,215	(1,713)
Cash flows from financing activities:		
Proceeds from building financing activity, net	180	-
Issuance of debt	-	-
Payments on debt	(2,100)	-
Payments for capital lease obligations	(27)	(33)
U.S. government appropriations - received	-	-
U.S. government appropriations - expended	(60)	(60)
Net Cash used in financing activities	(2,007)	(93)
Net increase in cash and cash equivalents	99	1,939
Cash and cash equivalents at beginning of year	997	930
Cash and cash equivalents at end of period	$ 1,096	$ 2,869

See accompanying notes to the financial statements

Item 1 – Notes to Financial Statements

Note 1 – Basis of Presentation

These interim financial statements reflect the results of operations of the United States Postal Service for the three and nine months ended June 30, 2007 and 2006 and our financial position as of June 30, 2007 and September 30, 2006. The financial statements should be read in conjunction with the significant accounting policies and other disclosures in our 2006 Annual Report. As in the annual report, all references to years, unless otherwise stated, refer to our fiscal year beginning October 1 and ending September 30. All references to quarters, unless otherwise stated, refer to fiscal quarters within 2007. The preparation of financial statements requires management to make estimates and judgments that affect the amounts reported in the financial statements and accompanying notes. Actual results 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 our previously reported results of operations or our financial position.

In the opinion of management, the accompanying unaudited financial statements present fairly our financial position as of June 30, 2007 and September 30, 2006, the results of our operations for the three and nine months ended June 30, 2007 and 2006 and cash flows for the nine months ended June 30, 2007 and 2006. Operating results for the nine-month period ended June 30, 2007 are not necessarily indicative of the results that may be expected for the year ending September 30, 2007.

Note 2 – Public Law 109-435 (P.L. 109-435), Postal Accountability and Enhancement Act

P.L.109-435, enacted December 20, 2006, made significant reforms in the governance of the Postal Service and significantly altered some of our financial responsibilities, particularly in respect to the funding of Civil Service Retirement System (CSRS) benefits and retiree health benefits. The legislation does not change our parent-subsidiary type relationship as an independent establishment of the U.S. government. Our employees and retirees continue to participate in all federally-sponsored retirement and health benefit plans. The U.S. government determines the extent and nature of these employee benefits and the funding requirements of these plans. Therefore we continue to account for our participation in U.S. government sponsored health benefit and retirement plans using multi-employer plan accounting rules in accordance with Financial Accounting Standards Board Statement (FAS) 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions* and FAS 87, *Employers' Accounting for Pensions*.

A number of major provisions of P.L.109-435 directly impact our financial statements. The anticipated financial impacts are further discussed in Item 2, *Management's Discussion and Analysis* in this document; however, for a complete understanding of the new law, one must consult the full text of P.L.109-435, which can be found at www.Thomas.gov.

P.L.109-435 returned to the U.S. Treasury the obligation to fund the portion of the retirement benefit for postal employees in CSRS that was earned while serving in the military. This funding obligation, originally estimated by the Office of Personnel Management (OPM) at $27 billion, was transferred from the U.S. Treasury to us in 2003 with the enactment of Public Law 108-18 (P.L.108-18). With the return of this funding requirement to the U.S. Treasury, it has been estimated by OPM that we have fully funded our CSRS pension obligation as of September 30, 2006. Recognizing this, the law exempts us from making the employer contribution to CSRS that would otherwise be required under Title 5, Section 8334(a)(1), of the United States Code. This provision was effective October 14, 2006. See Note 9, *Retirement Programs,* for further discussion of this accounting treatment.

Under Section 8348 of Title 5, United States Code as revised, OPM was required by June 15, 2007 to determine the CSRS surplus or "supplemental liability" attributable to Postal employees as of September 30, 2006. OPM determined that this CSRS surplus was $17.1 billion as of September 30, 2006. The surplus represents the excess of the actuarial present value of plan assets, future contributions, earnings, and other actuarial factors over the actuarial present value of future benefits related to postal participants in the CSRS plan. The over-funded amount was transferred to the newly created Postal Service Retiree Health Benefits Fund (PSRHBF) on June 29, 2007.

The PSRHBF was established under P.L.109-435 and beginning in 2007 we are required to make payments into the PSRHBF. The PSRHBF, which is held by the U.S. Treasury and controlled by OPM, will be used, commencing in 2017, to pay our share of the health insurance premiums for our current and future Postal Service retirees. The payment schedule in the law requires us to pay on average, $5.6 billion per year into the fund for ten years, beginning in 2007. This is in addition to our regularly allocated cost of premiums for current retirees. After these payments are complete, OPM will make an actuarial valuation and determine whether any further payments into the PSRHBF are required. If further payments are required, OPM will design an amortization schedule to provide sufficient balance in the fund by September 30, 2056, to pay our share of the health insurance premiums for retired Postal Service employees. We expensed $4,050 million, representing three-fourths of the required $5.4 billion 2007 payment through June 30, 2007. We will expense $1,350 million in the fourth quarter of 2007. See Note 8, *Retirement Programs,* for further discussion of this accounting treatment.

P.L.109-435 repealed the escrow provisions of P.L.108-18 which required us to place into an escrow account by September 2006, any “savings” from the change in the retirement provisions created by P.L.108-18. OPM calculated the savings at $2,958 million as of September 30, 2006. P.L.109-435 required that we pay the 2006 escrowed “savings” to the PSRHBF. We expensed the entire amount payable to the PSRHBF in our Quarter I Statements of Operations as a component of retiree health benefits. On April 6, 2007, these “savings” were transferred to the PSRHBF.

Finally, P.L.109-435 defers until 2017 the provision of P.L.108-18 that required us to pay an additional annual amount known as a “supplemental liability,” into the Civil Service Retirement and Disability Fund (CSRDF) if necessary, each September, as determined by OPM. The “supplemental liability” payment anticipated for 2007 was $257 million. However, due to enactment of P.L.109-435, no “supplemental liability” payment, principal or interest, will be made in 2007. The following table summarizes the impacts of the new legislation on our statement of operations for the nine months ended June 30, 2007.

P.L. 109-435 Comparison Nine Months ended June 30, 2007 (Dollars in millions)		Prior to Public Law 109-435		P.L. 109-435 Impact		After Public Law 109-435
Line on Statement of Operations:						
Compensation and benefits	$	41,924	$	(1,142)	$	40,782
Retiree health benefits		1,305		7,008		8,313
Total		43,229		5,866		49,095
Deferred Interest on CSRS Supplemental Liability		172		(172)		-
Net Income (Loss)	$	1,225	$	(5,694)	$	(4,469)
Explanation of impact on Compensation and Benefits and Retiree Health Benefits expense						
Discontinuance of CSRS employer contributions			$	(1,122)		
Repeal of 2007 "Supplemental Liability" principal				(20)		
Subtotal			$	(1,142)		
Postal Service Retiree Health Benefit expense (9 months)			$	4,050		
Postal Service Retiree Health Benefit Fund expense (escrow transfer)				2,958		
Subtotal			$	7,008		

Note 3 – Debt and Related Interest

Interest expense was $1 million in Quarter III compared to $28 million in the same period last year. Year-to-date interest expense for 2007 was $6 million compared to $160 million in the same period of 2006. Our interest expense in 2007 consists of interest on borrowing and mortgage interest expense. For 2006 however, interest expense included interest on our deferred retirement liability. The passage of P.L.109-435 abolished the “supplemental liability” payment and its associated interest expense on deferred retirement obligations.

Note 4 – Property and Equipment

We record property and equipment at cost, including the interest we pay on the money we borrow to pay for the construction of major capital additions. We had no interest capitalized or material impaired assets during the nine months ended June 30, 2007 and 2006.

On March 30, 2007, we sold the James A. Farley building in New York City to the Empire State Development Corporation (ESDC) for $180 million and additional proceeds of up to $55 million, contingent upon the achievement of certain development and leasing criteria by the developer of the property. The agreements included a provision that we would provide an environmental clean up fund of up to $10 million funded with the transaction proceeds from ESDC. This building formerly housed retail, carrier and mail processing operations. Mail processing operations formerly housed in this facility had been transferred to other facilities in 2004. The Postal Service continues to conduct retail and carrier operations at this facility under the terms of an interim lease with annual rentals of $5.6 million per year. Once the carrier operations are relocated to other facilities, we will continue to conduct retail and some administrative functions in a smaller portion of the building under a 99-year lease, with a rental fee of $1. The Postal Service has an option to require the building owner to change the legal structure of the building ownership into condominium units, with the Postal Service being given the right to purchase the space subject to the 99-year lease.

The required accounting for this transaction is governed by the provisions of FAS 66 *Accounting for Sales of Real Estate* and FAS 98 *Accounting for Leases: Sale-Leaseback Transactions Involving Real Estate, Sales-Type Leases of Real Estate, Definition of the Lease Term, and Initial Direct Costs of Direct Financing Leases*. Under the provisions of these accounting standards, the form of the lease and purchase option and the contingent sales proceeds in the transaction preclude accounting for the transaction as a sale of real estate and accordingly, we have accounted for the transaction as a direct financing lease under the provisions of FAS 98. The gain will not be recognized in our Statement of Operations until the lease and other continuing involvement in the building have expired. If the condominiumization of the building is legally completed prior to that time, and the contingent payments are satisfied, or we completely move out of the facility, then the gain could be recognized earlier.

A long-term liability related to this transaction of $180 million is included on our balance sheet at June 30, 2007 as deferred gains on sales of property.

Additionally, from the funds ESDC paid us, $10 million was set aside for an environmental clean up fund. Our environmental liability is limited to $10 million and is included on our balance sheet under trade payables and other accrued expenses.

Note 5 – Commitments

Each year we establish new capital commitments and expense commitments. Capital commitments consist of capital lease obligations for buildings and contracts for capital items such as equipment, building construction and improvements, and vehicles. Expense commitments consist of operating lease obligations for buildings, contracts for normal operational expense items, inventory and research and development contracts.

Since prior year capital and expense commitments are not normally fully expended within one year, we track our total resources on order for capital and expense commitments. The total resources on order being reported in a given period would equal outstanding commitments from prior years, plus new commitments, less expenditures.

CAPITAL COMMITMENTS, EXPENDITURES, RESOURCES ON ORDER

In Quarter III of this year we added new capital commitments of $397 million compared to $485 million in the same period last year. As a result, our June 30, 2007 balance of resources on order for capital items was $2,667 million. The schedules presented below reflect our capital resources on order and our future minimum lease payments for all non-cancelable capital leases.

Capital Resources on Order (Dollars in millons)		June 30, 2007
Mail Processing Equipment	$	1,715
Postal Support Equipment		328
Building Improvements		337
Construction and Building Purchase		149
Vehicles		100
Retail Equipment		38
Total	$	2,667

Capital Lease Obligations (Dollars in millions)		June 30, 2007
2007	$	25
2008		100
2009		98
2010		96
2011		93
After 2011		677
Total Lease Obligations	$	1,089
Less: Interest		437
Total Capital Lease Obligations	$	652
Less: Short-term portion of capital lease		27
Long-term Portion of Capital Lease	$	625

EXPENSE COMMITMENTS, RESOURCES ON ORDER

At June 30, 2007, we estimate our expense resources on order to be $5,384 million. Our future minimum lease payments for all non-cancelable operating lease obligations and our rental expense on operating leases are also shown below.

Expense Resources on Order (Dollars in millons)		June 30, 2007
Operational Contracts	$	5,257
Inventory Contracts		79
Research and Development Contracts		48
Total	$	5,384

Operating Leases (Dollars in millions)		June 30, 2007
2007	$	200
2008		764
2009		746
2010		697
2011		637
After 2011		5,340
Total Lease Obligations	$	8,384

Rental Expense	Three Months Ended June 30,				Nine Months Ended June 30,			
(Dollars in millions)		2007		2006		2007		2006
Non-cancelable real estate leases including related taxes	$	225	$	226	$	701	$	697
Facilities leased from GSA subject to 120-day cancellation		12		13		34		36
Equipment and other short-term rentals		66		46		187		135
Total Rental Expense	$	303	$	285	$	922	$	868

Note 6– Contingent Liabilities

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

Each quarter we review significant new claims and litigation and evaluate the probability of an adverse outcome. If the claim is deemed "probable" for an unfavorable outcome and the amount of payout is estimable, we record a liability. Each quarter we also review and adjust any prior contingencies for settlements, or revisions to prior estimates. No individual claim currently assessed as probable is material to our financial statements when taken as a whole. The table summarizes our contingent liabilities provided for in the financial statements.

Contingent Liabilities (Dollars in millions)		June 30 2007		September 30, 2006
		(unaudited)		(audited)
Labor Cases	$	466	$	254
Equal Employment Opportunity Cases		57		66
Tort Cases		48		57
Environmental Cases		25		25
Contractual Cases		8		16
Total	$	604	$	418

We believe that adequate provision has been made for the probable liabilities from claims and suits. The current portion of this liability at June 30, 2007 of $313 million, is included on the balance sheets under the heading Trade payables and accrued expenses. At September 30, 2006 this amount was $267 million. The long-term portion at June 30, 2007 of $291 million is accrued under the heading Other Non-Current Liabilities in our balance sheets. At September 30, 2006 the long-term liability was $151 million.

We also have other claims and suits which we deem reasonably possible of an unfavorable outcome and for which we cannot yet determine the amounts or a reasonable range of potential losses, if any. No provisions for these are included in our financial statements.

Note 7 – Current Employee Health Benefits

Substantially all of our current employees are covered by the Federal Employees Health Benefits Program (FEHBP). The OPM administers the program and allocates the cost of the program to the various participating government agencies. We cannot direct the costs, benefits, or funding requirements of the federally-sponsored plan.

Health benefit costs for our current employees were $1,350 million during Quarter III, compared to $1,345 million in the same period last year. For the nine months ending June 30, 2007, current employee health costs were $4,056 million compared to $3,990 million in the same period last year.

Note 8 – Retirement Programs

RETIREE HEALTH BENEFITS

Employees who participate in the FEHBP for at least the five years immediately before their retirement may participate in the FEHBP during their retirement. We are required to pay the employer's share of health insurance premiums for all employees and their survivors who participate in the FEHBP and who retire or retired on or after July 1, 1971. However, we do not include the costs attributable to federal civilian service before that date. We account for our retirees participation in FEHBP using multi-employer plan accounting rules in accordance with FAS 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions.*

With passage of P.L.109-435, we continue to make monthly payments to OPM for our share of premiums for our retirees due to FEHBP. Additionally, we will be making payments into the new PSRHBF held by the U.S. Treasury and controlled by OPM. For 2007, the required contribution to the fund is $5.4 billion, which we are expensing at the rate of $1,350 million per quarter. Also as stated in Note 2, *Public Law 109-435,* with the passage of this law, the $2,958 million held in escrow as of September 30, 2006 was expensed in Quarter I, and was transferred to the PSRHBF on April 6, 2007. During Quarter III we expensed $1,793 million for retiree health benefits; $443 million was for retiree health benefits invoices from OPM for current retirees and $1,350 million for the PSRHBF. For the same period in 2006 we expensed $422 million for retiree benefits. Year-to-date total expenses for retiree health benefits were $8,313 million, comprised of $1,305 million for retiree health benefits invoiced by OPM for current retirees and $7,008 million for payments made into the PSRHBF. For the nine months ending June 30, 2006, retiree health benefits were $1,236 million.

Postal Service Retiree Health Benefit Fund Schedule of Future Payments (Dollars in millions)		Expense
2007	$	5,400
2008		5,600
2009		5,400
2010		5,500
2011		5,500
After 2011		28,400
10-Year Total	$	55,800

We will be making an average annual payment of approximately $5.6 billion to the PSRHBF through 2016, as shown in the schedule above. At that point, the fund will begin to pay our employer share of FEHBP premiums for postal retirees. Until that time, we will continue to pay our employer share of the health care premiums for current retirees as invoiced by OPM.

PENSION PROGRAMS

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

The following table reflects our contributions for retirement compared to last year:

Retirement Contribution (Percentage)	June 30, 2007	2006
CSRS Employer	-	17.4
CSRS Employee	7.0	7.0
Dual CSRS Employer	-	18.0
Dual CSRS Employee	0.8	0.8
FERS Employer	11.2	11.2
FERS Employee	0.8	0.8

P.L.109-435 exempts us from making the employer contribution to the CSRS, otherwise required under Title 5, Chapter 83, of the United States Code. This provision was effective October 14, 2006. We continue to make employer contributions for FERS employees. As a result, our retirement expense for Quarter III was $1,417 million, compared to $1,747 million for the same period last year. Year-to-date, our expense was $4,310 million compared to $5,207 million in the same period last year.

P.L.109-435 also defers until 2017 the provision of P.L.108-18 that required us to pay an additional annual amount known as a “supplemental liability”, if necessary, each September as determined by OPM. The "supplemental liability" represented 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. The “supplemental liability” payment, including principal and interest, anticipated for 2007 was $257 million. Due to the change to this provision by P.L.109-435, there was no expense associated with the supplemental liability in Quarter III, compared to $32 million in the same period last year. During the nine-month period ending June 30, 2007 we had no “supplemental liability” expense compared to $177 million for the same period in 2006.

Note 9 – Workers’ Compensation

We pay for workers’ compensation costs under a program administered by the Department of Labor (DOL). These costs include employees’ medical expenses, payments for continuation of wages and DOL administrative fees. We record these costs as an operating expense under Compensation and Benefits. Our quarterly expense for workers’ compensation was $274 million during Quarter III of 2007, compared to $299 million for the same period last year. For the fiscal 2007 year-to-date, workers’ compensation expense was $824 million compared to $897 million for the same period in 2006.

In Quarter III, the net discount rates used to determine the present value of estimated future workers’ compensation payments was changed, in consultation with an independent actuary. We increased the medical claims net discount rate from -0.8% to 0.4% resulting in a decrease in our medical claims liability and expense of $320 million. We increased the compensation claims net discount rate from 3.3% to 3.6%, thereby decreasing that liability and expense by $140 million. These combined changes decreased our total workers' compensation liability and expense by $460 million. The effect of the adoption of these changes is accounted for as a change in accounting estimate as defined by generally accepted accounting principles (GAAP).

Note 10 – Revenue Forgone

Revenue Forgone is an appropriation from Congress which covers our cost of providing free and reduced rate mailing service to groups designated by Congress. During Quarter III, we recognized $21 million for Revenue Forgone appropriations, compared to $26 million during the same period last year. Year-to-date revenue forgone was $64 million in 2007, compared to $80 million for the same period in 2006.

Note 11 – Emergency Preparedness Funding

We recognize revenue from Emergency Preparedness Program (EPP) Appropriations as we depreciate the capital equipment purchased with the appropriation. The EPP Appropriations revenue and corresponding depreciation expense recognized during Quarter III was $33 million, compared to $22 million in the same period last year. Through June 30, 2007, our year-to-date appropriation revenue was $60 million compared to $60 million in the same period of 2006.

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

Cautionary Statements

The *Management's Discussion and Analysis of Financial Condition and Results of Operations* 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, changes in actuarial assumptions, 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. Operating results for the nine-month period ended June 30, 2007 are not necessarily indicative of the results that may be expected for the year ending September 30, 2007.This report should be read in conjunction with our 2006 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. References to quarters, unless otherwise noted, refer to quarters in 2007.

Critical Accounting Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make significant judgments and estimates to develop 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 our accounting policies and to evaluate the appropriateness of the many estimates that are required to prepare the financial statements of a large organization. However, even under optimal circumstances, estimates routinely require adjustment based on changing circumstances and new or better information.

The three critical accounting policies that we believe are either the most judgmental, or involve the selection or application of alternative accounting policies, and are material to our financial statements are those relating to workers compensation costs, deferred revenue for prepaid postage, and contingent liabilities. Management has discussed the development and selection of these critical accounting policies and estimates with the Audit and Finance Committee of our Board of Governors and with our independent public accounting firm. In addition, Note 2 to the financial statements in our 2006 Annual Report contains a summary of our significant accounting policies.

Introduction

The United States Postal Service (we) commenced operations on July 1, 1971, as an independent establishment of the executive branch of the United States government. We are 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 Senate, the Postmaster General and the Deputy Postmaster General. Under the Postal Reorganization Act, we have a legal mandate to be operated as a "basic and fundamental service" to the American people. We fulfill this legal mandate by offering a variety of classes of mail services without undue discrimination among our many customers. This means that within each class of mail our price does not unreasonably vary by customer for the levels of service we provide.

We have a very diverse customer base and we are not dependent upon a single customer or small group of customers. We do not report revenue from individual customers. No single customer represents more than 2% of our revenue.

Our primary lines of business are First-Class Mail and Standard Mail which account for about 94% of our volume. Priority Mail, International Mail, Express Mail, Periodicals and Package Services are other significant services we provide. 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 new independent Postal Regulatory Commission (PRC), formerly the Postal Rate Commission. See the *Postal Accountability and Enhancement Act* section on the following page for a discussion of changes to the PRC and their role in the rate setting process.

Our mailing services are sold through our nearly 37,000 Post Offices, stations, branches, contract postal units, our website www.usps.com and a large network of consignees. We deliver mail to over 147 million city, rural, Post Office box and highway delivery points. We conduct our operations primarily in the domestic market, with international operations representing less than 3% 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 business 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.

Our labor force is primarily represented by the American Postal Workers Union, National Association of Letter Carriers, National Postal Mail Handlers Union and National Rural Letter Carriers Association. Over 85% of our career employees are covered by collective bargaining agreements. Refer to Item 5, *Other Information*, in Part II for additional information.

By law, we consult with management organizations representing most of the employees not covered by collective bargaining agreements. These consultations provide the organizations an opportunity to participate directly in the planning, development, and implementation of programs and policies affecting non-bargaining employees in the field. Our 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 as required by statute, for retirement, health benefits and workers' compensation.

Beginning in 2008, we will be required to produce, publish and file financial reports with the PRC that comply with certain Securities and Exchange Commission (SEC) rules and regulations on financial reporting. Currently, we are guided by SEC reporting requirements to the extent deemed practical for a non-publicly traded, government-owned entity. Additionally, we make disclosures not required by SEC reporting rules through the publication of certain reports that we either must make, or choose to make public. These additional disclosures on our organization and 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.

Rate and Classification Activity

On May 3, 2006, the Postal Service filed a request with the PRC to increase prices. The request was not an across-the-board increase, but was intended to align our prices with our costs, in addition to generating additional revenue. The filing included numerous innovative classification proposals.

The most sweeping of these classification proposals was more extensive shape-based pricing. Under the new classification, the dimensions of the mail piece determine pricing, in addition to the weight, which was the primary criterion under the former rate structure. For example, under the new shape-based pricing model a mail piece that weighed one ounce mailed in a large envelope would have a price of 80 cents, but if the contents were folded and mailed in a letter size envelope the price would be 41 cents.

The PRC issued its recommendation for new rates on February 26, 2007 which modified some of the original proposed rate structure, reducing the proposed First-Class one ounce rate of 42 cents to 41 cents and reducing the proposed additional ounce rate from 20 cents to 17 cents. To compensate for the revenue reductions from these changes the PRC's recommended decision increased the rates for flats and periodicals well above our original request. On March 19, 2007, the Governors approved the PRC recommended First-Class one ounce mail rate of 41 cents and the additional ounce rate of 17 cents, issuance of the "forever stamp" and approved shape-based pricing. These rate changes took effect May 14, 2007.

Consumers are now able to purchase the new "forever stamp" for the 41 cents one ounce First-Class single-piece rate, but will be able to use it forever to mail a one ounce First-Class mail piece, even if rates increase in the future.

The Governors delayed implementation of new prices for periodicals until July 15, 2007 and requested reconsideration by the PRC of the Standard Mail flat rates. On June 19, 2007, the Governors decided not to implement a temporary change to Standard Mail Regular and Nonprofit Flat prices recommended in the latest PRC decision on reconsideration, and instead decided that the current Standard Mail Flat prices will remain in effect.

Postal Accountability and Enhancement Act, Public Law 109-435 (P.L.109-435)

P.L.109-435, officially named the Postal Accountability and Enhancement Act, was signed into law by President Bush on December 20, 2006. Since its passage, we have been working to ensure that we are ready to meet its requirements.

It is our goal to work with the mailing community, the new Postal Regulatory Commission (PRC), and our unions and management associations to make the transition as smooth as possible for all stakeholders. For example, we have been working with mailers through the Mailing Technical Advisory Committee on developing modern service standards and performance measurement systems. We have received input on service standards from a number of other stakeholders. We have met informally with the PRC and will soon meet with them for formal consultation. We have also provided extensive comments to the PRC to help them develop new rules for the market-dominant and competitive products rate-setting process that will ensure a smooth transition for everyone involved. We also continue to work internally to ensure that our systems will be ready to meet the new reporting requirements both for price-setting purposes and financial reporting. However, there will be uncertainty in this area until the PRC issues its final rules.

For our retail customers, the new law anticipates that universal service can be preserved at affordable rates. For commercial mailers it is intended to provide rate predictability. For employees, ratepayers, and taxpayers, the new law is designed to provide assurance that the employer portion of the Postal Service's health and retirement benefits funding obligations becomes fully funded.

The new law, once fully implemented, will divide our services into two broad categories: market-dominant and competitive. Market-dominant services include, but are not limited to, First-Class Mail, Standard Mail and Periodicals. Future rate increases for these services will be subject to a price cap based on the Consumer Price Index for urban consumers. Competitive services, such as Priority Mail and Express Mail, Bulk Parcel Post and Bulk International Mail will have greater pricing flexibility.

P.L.109-435 also directs the Department of the Treasury to resume financial responsibility for the portion of the CSRS pensions of postal employees attributable to military service. This takes the financial burden added by P.L.108-18, estimated at approximately $27 billion by OPM, off of the Postal Service. Our CSRS obligations are now estimated by OPM to be fully funded as of September 30, 2006, pending future actuarial revaluations by OPM. P.L. 109-435, abolished a federally mandated escrow requirement and directed that money to be placed into a new Postal Service Retiree Health Benefits Fund (PSRHBF). Over the next ten years we anticipate making payments into the PSRHBF that average $5.6 billion per year. By 2017, we expect our retiree health benefits will be substantially funded. We also estimate the effect of P.L. 109-435 will be a negative impact on our cash flow of $600 million to $700 million in 2007, which in turn may increase our anticipated debt at the end of the year.

P.L.109-435 also reconstitutes the former Postal Rate Commission into a regulatory body, renamed the Postal Regulatory Commission (PRC). The PRC has until June 2008 to develop regulations for both market-dominant and competitive products. The Postal Service is allowed by P.L.109-435 to file one last rate case under the current rules, to be filed not later than December 20, 2007. Our Governors have not yet determined whether to file such a case.

The PRC will now have its own Office of Inspector General (OIG). The Postal Service will continue to be required to provide the funding for our Office of Inspector General, the PRC and the PRC's OIG.

Additionally, P.L.109-435 requires the Postal Service, beginning in 2008, to file with the PRC a number of financial reports not previously required. These include quarterly reports containing information required by the SEC to be filed on Form 10-Q within 40 days after the end of each quarter, an annual report containing the information required by the SEC on Form 10-K within 60 days of the end of each fiscal year, and periodic reports containing the information prescribed by the SEC on Form 8-K within the prescribed time frames. Further, P.L.109-435 requires that the Postal Service comply with the rules prescribed by the SEC implementing Section 404 of the Sarbanes-Oxley Act of 2002 (Section 404). The requirement to comply with Section 404 is effective beginning with the 2010 annual report. The exact cost of complying with Section 404 of the Sarbanes-Oxley Act is not yet known. Our external auditor's professional fees are also expected to increase in order for us to comply with the requirements under this act, as well as with our requirements to file SEC 10-Q and 10-K reports with the PRC.

Financial Impacts under P.L.109-435 (Dollars in millions)	Three Months Ended June 30, 2007	Nine Months Ended June 30, 2007
Net Income before legislation	$ 220	$ 1,225
P.L.109-435 Impacts:		
2006 escrow transferred into PSRHBF	-	(2,958)
2007 PSRHBF expense	(1,350)	(4,050)
CSRS savings	471	1,314
Net Loss	$ (659)	$ (4,469)

On April 6, 2007, we transferred $2,958 million, representing the entire amount of funds held in escrow, as required by P.L.108-18, to the PSRHBF. Since we will no longer hold these funds, it is anticipated that there will be a substantial decrease in interest income for the remainder of the year and into the future.

Finally, we cannot yet estimate the additional costs associated with modifying any of our systems that will be required to separate the business into market dominant and competitive products and services, but have dedicated resources to identify these costs. Additional costs as a result of the new financial reporting requirements, costs of complying with new PRC regulations, and the cost of compliance with the requirements of Section 404 of the Sarbanes Oxley Act have not been determined. The extent of any systems changes and costs are dependent on the outcome of the regulatory process during which specific requirements will be developed. We have hired a technical advisor for the Section 404 compliance effort and have jointly been developing a process plan to help define the added cost of compliance.

Results of Operations

Overall, our financial results in Quarter III were a net loss of $659 million compared to net income of $81 million for Quarter III of last year. Year-to-date, we have a net loss of $4,469 million compared to net income of $1,655 million for the same period last year.

Quarter III operating revenue was $18,361 million, compared to $17,835 million in Quarter III of last year, an increase of $526 million or 2.9%. The revenue increase for the quarter was driven primarily by the rate change implemented in May 2007. See Revenue and Volume Analysis section on the following page.

Year-to-date operating revenue was $56,316 million, compared to $54,948 million for the same period last year, driven largely by a Standard Mail revenue increase of $637 million or 4.3%.

Quarter III operating expenses were $19,057 million, compared to $17,778 million in the corresponding quarter of last year, an increase of $1,279 million or 7.2%. The increase in operating expenses was driven by the impacts of P.L.109-435; for example, retiree health benefit expense increased by $1,371 million due in large part to changes from the new law.

As discussed later in this section, other changes to operating expenses in Quarter III, relative to last year, included compensation and benefits expense decreasing by $258 million and transportation expenses increasing by $115 million. All other operating expenses, including supplies and services, depreciation, and amortization had a net increase of $51 million.

Year-to-date operating expenses are $60,931 million, compared to $53,249 million in the same period last year. The increase of $7,682 million was driven mainly by retiree health benefit increases of $7,077 million, of which $7,008 million was required under P.L.109-435 for payment into the PSRHBF. Transportation expense increases of $448 million and other operating expense increases of $204 million also contributed to the growth of expenses over the comparable period last year.

Summary Interim Financial Results	Three Months Ended June 30,		Nine Months Ended June 30,	
(Dollars in millions)	2007	2006	2007	2006
Operating Revenue	$ 18,361	$ 17,835	$ 56,316	$ 54,948
Operating Expenses:				
Compensation and benefits	13,403	13,661	40,782	40,829
Retiree health benefits	1,793	422	8,313	1,236
Transportation	1,548	1,433	4,917	4,469
Supplies and services	625	649	1,871	1,835
Depreciation and amortization	553	513	1,588	1,587
Other expenses	1,135	1,100	3,460	3,293
Total Operating Expenses	19,057	17,778	60,931	53,249
(Loss) Income from Operations	(696)	57	(4,615)	1,699
Interest and investment income	38	52	152	116
Interest on deferred retirement obligations	-	(28)	-	(159)
Other interest expense	(1)	-	(6)	(1)
Net (Loss) Income	$ (659)	$ 81	$ (4,469)	$ 1,655

All percentages included in the MD&A are calculated on actual numbers and do not reflect amounts rounded for presentation purposes.

Revenue and Volume

Mail revenue and volume by category from the *Revenue, Pieces and Weight* report are preliminary for each quarter and are finalized at the end of each year. There is some slight recasting of 2006 revenue and volume by category compared to the preliminary results presented at June 30, 2006.

Rates for most of our services increased, on average, 7.6% on May 14, 2007. Because of rate design considerations, some categories of mail received increases more or less than 7.6%. Changes in revenue are a function of the changes in rates, mail volume and the change in average weight per piece. Rate increases typically increase revenue and decrease volume. Therefore, revenue normally increases by less than the rate increase amount.

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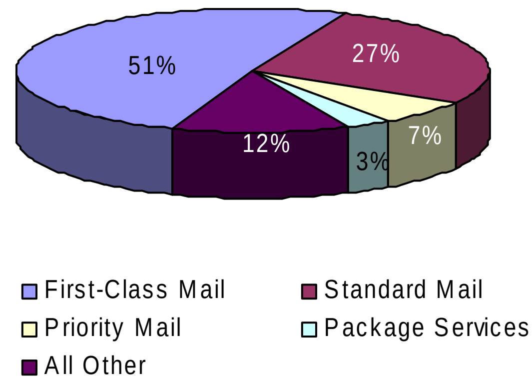
Revenue (Dollars in millions)	Three Months Ended June 30, 2007	2006	Nine Months Ended June 30, 2007	2006
First-Class Mail	$ 9,341	$ 9,185	$ 28,432	$ 28,104
Standard Mail	4,971	4,863	15,503	14,866
Priority Mail	1,256	1,212	3,990	3,902
Package Services	526	517	1,742	1,731
Periodicals	543	560	1,626	1,674
International	522	420	1,534	1,420
Express Mail	248	235	717	697
Other *	954	843	2,772	2,554
Operating Revenue	$ 18,361	$ 17,835	$ 56,316	$ 54,948
Interest Income	38	52	152	116
Total Revenue	$ 18,399	$ 17,887	$ 56,468	$ 55,064

* Included in the "Other" category are special service revenue and other income.

2007 Quarter III Revenue

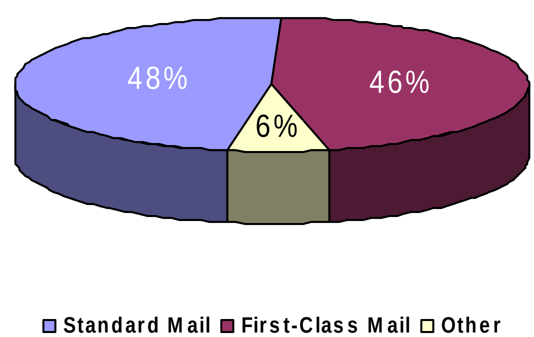


First-Class Mail revenue increased $156 million or 1.7%, in Quarter III on a volume decline of 323 million pieces or 1.4%, compared to the same period last year. Single-piece First-Class letters declined 304 million pieces or 3.0% for the quarter while Automation Presort Cards grew by 133 million pieces or 17.7%. The revenue increase is less than rate increase because of the decline in volume, shifts in the mail mix away from single-piece mail toward workshare mail, and the mid-quarter implementation of new rates. While rates have some effect on First-Class mail volume, technology is the major driver behind the continued volume decline in this mail class. We believe the single-piece First-Class letters decline will continue into the foreseeable future, driven by technology. Year-to-date, First-Class Mail revenue increased 1.2% or $328 million on a volume decrease of 970 million pieces or 1.3% including a decline of 1.4 billion pieces in single-piece First-Class letters and cards. We believe the rate increase will result in higher revenue for the remainder of the year.

Mail Volume by Type (Pieces in millions)	Three Months Ended June 30, 2007	2006	Nine Months Ended June 30, 2007	2006
First-Class Mail	23,591	23,914	73,363	74,333
Standard Mail	24,592	24,812	78,281	76,860
Priority Mail	215	222	696	714
Package Services	258	256	879	881
Periodicals	2,260	2,271	6,681	6,863
International	196	185	648	611
Express Mail	14	15	42	43
Other *	264	387	914	870
Total	51,390	52,062	161,504	161,175

* Postal Service mailing volume and free mail for the blind included in the "Other" category.

2007 Quarter III Mail Volume



Standard Mail revenue grew $108 million or 2.2% in Quarter III on a mail volume decrease of 0.9% or 220 million pieces, compared to the same period last year. Revenue growth was further constrained by a slight decrease in the average weight per piece. Standard mail volume had grown for 13 consecutive quarters before this decline. We may see several quarters of flat to decreasing volume before a return to growth. Automation Presort was once again the largest growth rate category with an increase of 2.7% or 411 million pieces for a revenue increase of $158 million. Enhanced Carrier Route (ECR) mail revenue and volume decreased. ECR mail volume decreased by 535 million pieces or 6.2% while revenue decreased $62 million or 4.2%. The May 2007 rate increase likely blunted the growth in Automation Presort and accelerated the decrease in ECR mail volume. Year-to-date, Standard Mail revenue is up by $637 million or 4.3% on a volume increase of 1.4 billion pieces or 1.8%. The Automation Presort rate category accounts for over 1.7 billion pieces and $528 million of the Standard Mail volume and revenue increase.

Priority Mail revenue increased $44 million or 3.7% in Quarter III compared to the same period last year. The revenue increase is the result of the newly-implemented rates, offset by a volume decrease of 7 million pieces or 2.8%, and a 0.6% decrease in average weight per piece. Priority Mail volume decreased for the second consecutive quarter after an extended period of growth. As Priority Mail is a rate-sensitive product, we anticipate several quarters of slower growth. We continue to work to improve Priority Mail service performance and make Priority Mail easy to use. Year-to-Date Priority Mail revenue is $88 million or 2.2% ahead of the same period last year on volume that is 17 million pieces or 2.4% lower.

Package Services revenue increased $9 million or 1.6% in Quarter III compared to Quarter III of 2006 while volume increased 2 million pieces or 0.8%. A volume increase of 0.7% in Parcel Post ended six straight quarterly declines. The effect of rates and volume increases were virtually negated by a 3.3% per piece decrease in weight of Parcel Post mail. Media Mail had its fifth consecutive quarterly volume decline, decreasing 4.3%. The decline in Media Mail volume reflects the effect of the rate increase coupled with continued migration of Media Mail to Bound Printed Matter. Year-to-date, Package Services volume is 2 million pieces lower while revenue is $11 million higher.

Periodical Mail volume decreased 11 million pieces or 0.5% in Quarter III compared to the same period last year. Periodicals volume is trending downward over the long term, reflecting trends in reading behavior. The volume decline for Periodicals resulted in a decrease in revenue of $17 million or 3.0% compared to the same period last year. Periodicals actually saw revenue and volume growth in the Special Nonprofit rate category. However, this rate category is less profitable than the larger Regular Periodical rate category, producing a revenue decrease greater than the overall volume decrease. The Regular Periodical rate category was further hampered by a 1.1% per piece decrease in the average weight per piece. Year-to-date, Periodicals volume is down 183 million pieces or 2.7% and revenue has decreased by $48 million or 2.8%.

Revenue from International Mail increased $102 million or 24.3% in Quarter III compared to the same period last year. Revenue from mail-related volume increased by $54 million or 14.4% on volume growth of 11 million pieces or 5.9%. During Quarter III, revenue from foreign postal transactions and international mail fees increased $48 million nearly offsetting large decreases in the prior quarter. International Surface Airlift Mail volume growth, which had been very robust in the first two quarters, moderated somewhat to 6.4% in Quarter III. Year-to-date, International Surface Airlift Mail volume increased by 19.3% and is the driver behind a 5.9% increase in total International Mail volume. Year-to-date, International Mail revenue is up 8.0% or $114 million over the prior year.

Express Mail revenue grew by 5.2% or $13 million in Quarter III compared to the same period last year. Weight and volume changes were minimal during the quarter. Express Mail volume was once again virtually flat, decreasing by 70 thousand pieces over the same period last year. Express Mail is our most price sensitive business line and rate increases in January 2006 and May 2007 will likely result in lower volumes for the foreseeable future. Year-to-date Express Mail results are relatively stable with a revenue increase of 2.8% or $20 million on a volume decrease of 1.3% or 537 thousand pieces.

Other Revenue, which includes Domestic and International Additional Services, and non-mail revenue increased $111 million or 13.2% in Quarter III compared to the same quarter last year. Additional services grew by $49 million on stronger Certified and Delivery Receipts Services fees. Other Revenue grew by $49 million driven by Passport Fees in response to the new Homeland Security passport regulations. While we anticipate a slackening of demand for passports, we believe other revenue will remain relatively stable due to the increase in rates. Year-to-date other revenue has experienced a revenue increase of 8.5% or $218 million.

Other volume includes mail sent by the U.S. Postal Service and Free Mail for the Blind. Volume from other mail decreased 123 million pieces or 32.0% in Quarter III. Year-to-date growth in this category was 44 million pieces or 5.1% with most of that growth a function of a continuing Postal Service promotional campaign.

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

Operating Expenses – Compensation and Benefits

COMPENSATION AND BENEFITS

Compensation and benefits for Quarter III was $13,403 million, $258 million lower than the prior year amount of $13,661 million, a decrease of 1.9%. The decrease reflects a reduction in the employer share of the CSRS contribution and a reduction of work hours. Our cost of providing health benefits to current employees increased by $5 million over the same quarter last year.

Total compensation and benefits totaled $40,782 million for the first nine months of 2007, a very slight decrease when compared to the three quarter total for the prior year of $40,829 million. The reduction is a result of P.L.109-435 and a reduction of work hours as presented in the table below.

Compensation, Benefits and Work Hour Analysis	Work Hours Three Months Ended June 30			Salaries and Benefits Three Months Ended June 30		
	2007	2006	Pct Change	2007	2006	Pct Change
	(Work Hours in thousands)			(Dollars in millions)		
City Delivery	115,452	117,672	-1.9%	$ 4,299	$ 4,361	-1.4%
Mail Processing	76,409	80,766	-5.4%	2,772	2,907	-4.6%
Customer Services & Retail	58,162	61,238	-5.0%	2,094	2,237	-6.4%
Rural Delivery	48,065	47,139	2.0%	1,462	1,402	4.3%
Other, including						
Plant, Operational Support & Administration	56,082	56,363	-0.5%	2,332	2,360	-1.2%
Subtotal	354,170	363,178	-2.5%	12,959	13,267	-2.3%
Other Compensation						
Workers' Compensation				274	299	-8.4%
Other				170	95	78.9%
Total	354,170	363,178	-2.5%	$ 13,403	$ 13,661	-1.9%

Compensation, Benefits and Work Hour Analysis	Work Hours Nine Months Ended June 30			Salaries and Benefits Nine Months Ended June 30		
	2007	2006	Pct Change	2007	2006	Pct Change
	(Work Hours in thousands)			(Dollars in millions)		
City Delivery	348,762	352,069	-0.9%	$ 13,206	$ 12,979	1.7%
Mail Processing	241,656	252,963	-4.5%	8,744	8,891	-1.7%
Customer Services & Retail	178,582	186,771	-4.4%	6,620	6,701	-1.2%
Rural Delivery	141,806	138,417	2.4%	4,366	4,098	6.5%
Other, including						
Plant, Operational Support & Administration	166,961	169,119	-1.3%	6,601	6,981	-5.4%
Subtotal	1,077,767	1,099,339	-2.0%	39,537	39,650	-0.3%
Other Compensation						
Workers' Compensation				824	897	-8.1%
Other				421	282	49.3%
Total	1,077,767	1,099,339	-2.0%	$ 40,782	$ 40,829	-0.1%

WAGES

Wages increased by $92 million in Quarter III compared to same period last year. This is due to increases in wage rates. Effective November 2006, certain bargaining unit employees received pay increases of approximately 1.2% to 1.3%. In addition, eligible bargaining unit employees received annualized COLA increases ranging from $791 to $812 per employee effective September 2006.

Wages increased in the first nine months of 2007 by $866 million compared to the same period last year. The increase in wage rates was partially mitigated by a reduction in work hours in Quarter III, discussed below.

QUARTER III WORK HOURS

A change in work hours 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 delivery points. In Quarter III, mail volume decreased by 1.4%, and we added almost 1.9 million new delivery points compared to the same quarter last year. The impact of management initiatives and a focus on reducing overtime hours has helped total work hour usage decline 9.0 million hours or 2.5% with a corresponding decline in salaries and benefits before other compensation of $308 million or 2.3% from the comparable period last year. Mail processing work hours were reduced by almost 4.4 million; customer service and retail work hours declined by 3.1 million and city delivery hours by 2.2 million. Corresponding salaries and benefits reductions include mail processing of $135 million, customer service and retail of $143 million and city delivery of $62 million. As rural deliveries continue to grow, rural work hours and salaries and benefits continue to grow at 2.0% and 4.3%, respectively.

YEAR-TO-DATE WORK HOURS

In the first nine months of 2007, mail volume increased by 0.2% compared to the same period last year. Total work hour usage declined 21.6 million hours, or 2.0% from the comparable period last year, partially as a result of the management initiatives mentioned above. Salaries and benefits decreased at a slower rate of 0.3% or $114 million. The National Day of Mourning for President Ford also contributed to the reduction of work hours. Mail processing, customer service and city delivery all experienced a decrease in work hours and salaries and benefits. Rural deliveries, with most of the new delivery points, had an increase in work hours of 2.4% and salaries and benefits of 6.5%.

RETIREMENT EXPENSE – CURRENT EMPLOYEES

Retirement expenses remain a significant portion of our total operating expense. During Quarter III, our retirement expense for the CSRS, Dual/CSRS and FERS plans was $1,417 million compared to $1,747 million for the same period last year. This was $330 million below the same period last year, or 19%. The reduction was due to the passage of the P.L.109-435 which reduced the employer contributions for CSRS employees. However, this reduction in retirement expense is offset by the increases we are now required to pay for retiree health benefits. For the nine months ending June 30, 2007, our retirement expense was $4,310 million compared to $5,207 million in the same period last year, again driven by the changes from P.L.109-435. Retirement expenses for current employees are included in compensation and benefits on our Statements of Operations.

WORKERS' COMPENSATION

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 the cost per claim. In Quarter III of 2007 we experienced an increase in paid medical claims of 652, or 4.4%, and an increase in paid compensation claims of 122 or 3.1% compared to Quarter III of 2006. Year-to-date, we experienced a decrease in paid medical claims of 5,345, or 4.6%, and a decrease in paid compensation claims of 56 or 0.2% compared to the prior 12-month period.

Workers' compensation expense for Quarter III was $274 million compared to the same period last year at $299 million. For the first nine months of 2007, workers' compensation expenses were $824 million compared to $897 million in 2006.

In Quarter III, the net discount rates used to determine the present value of estimated future workers' compensation payments was changed, in consultation with an independent actuary. We increased the medical claims net discount rate from -0.8% to 0.4% resulting in a decrease in our medical claims liability and expense of $320 million. We increased the compensation claims net discount rate from 3.3% to 3.6%, thereby decreasing that liability and expense by $140 million. These combined changes decreased our total workers' compensation liability and expense by $460 million.

We are in the process of developing a replacement for the actuarial model that we are currently using to determine the workers' compensation liability and annual expense. In addition to updating the technology platform, this new model will use state-of-the-art actuarial practices. This new model will be completed in time for use in estimating our year-end workers' compensation liability. It is possible that the adoption of this new liability estimation model may impact our financial results in the fourth quarter.

EMPLOYEE COMPLEMENT

Employee complement was reduced by 2,352 during Quarter III. The total number of career employees at the end of the quarter was 686,188. This represents a reduction of 11,279 employees from the same quarter last year, all through attrition.

RETIREE HEALTH BENEFITS

Health benefit expenses for our retirees were $1,793 million for the quarter ended June 30, 2007 compared to $422 million in the same period 2006. This increase of $1,371 million was driven by P.L.109-435 and the additional expenses for the new PSRHBF of $1,350 million.

Retiree Health Benefits	Three Months Ended June 30		Nine Months Ended June 30	
(Dollars in millions)	2007	2006	2007	2006
Retiree Health Benefit Premiums	$ 443	$ 422	$ 1,305	$ 1,236
Postal Service Retiree Health Benefit Fund	1,350	-	7,008	-
Total	$ 1,793	$ 422	$ 8,313	$ 1,236

P.L.109-435 includes a ten year payment schedule, which requires that we pay $5.4 billion into the PSRHBF by September 30, 2007. We are expensing the $5.4 billion in equal amounts during each quarter throughout the year, at a rate of $1,350 million per quarter. In addition, we expensed the $2,958 million held in escrow under provision of P.L.108-18 in Quarter I. These items combine to total $7,008 million in new expense through Quarter III that are not reflected in the comparative statements of Quarter III, 2006. See the *Postal Accountability and Enhancement Act* section above, Note 2, *Public Law 109-435* and Note 8, *Retirement Programs* in the Financial Information section for further discussion of this accounting treatment.

Under the FEHBP, the OPM charges us for the cost of our retirees currently participating in the plan. The major drivers of Retiree Health Benefits expense are the number of current participants on the rolls and premium costs. As of June 30, 2007, we had approximately 449,000 participants on the rolls, an increase of about 2,000 over the prior year. The increase in participants, as well as modest premium increases, drove the additional $69 million in expense for the nine months ending June 30, 2007.

Operating Expenses – Transportation

Transportation expenses were $1,548 million, an increase of $115 million, or 8.0% for Quarter III. Transportation costs are largely made up of highway and air transportation. When compared to the same period last year, our expenses for transportation increased by $448 million for the first nine months of this year.

Transportation Expense (Dollars in millions)	Three Months Ended June 30, 2007	 2006	Nine Months Ended June 30, 2007	 2006
Highway Transportation	$ 771	$ 702	$ 2,360	$ 2,218
Air Transportation	714	658	2,291	2,044
Other Transportation	63	73	266	207
Total	$ 1,548	$ 1,433	$ 4,917	$ 4,469

Highway transportation expenses of $771 million in Quarter III increased by $69 million or 9.8% over the same quarter last year. The increase was driven primarily by the number of miles driven by highway contractors, which added $55 million; of this $24 million were fuel expenses. Year-to-date, highway transportation expenses increased by $142 million or 6.4% compared to the same period last year. Increases in miles driven added $63 million of expense, fuel expenses added $25 million, contract wages increased $40 million, and delivery growth added $14 million.

Air transportation expenses of $714 million in Quarter III increased by $56 million or 8.5% from the same quarter last year. Year-to-date, air transportation increased $247 million, or 12.1% over the same period last year. This was driven by increases in expense to our dedicated air carriers of $105 million, which included a $27 million increase in fuel costs. Holiday peak service increased $75 million over the same period last year. Increased foreign postal settlements for air transportation and International air transportation cost of $45 million added to the increase for the first three quarters of 2007. These were offset slightly by a reduction in commercial air carrier expenses.

Other transportation expenses including rail service decreased by $10 million or 13.7% in Quarter III over the same period last year. The quarterly decrease can be attributed to a reduction to foreign postal settlements in the amount of $26 million. For the three quarters of 2007, other transportation expense increased by $59 million or 28.5% over the same period last year. Foreign postal transaction expense increased $87 million or 28.5% over the same period as last year to $130 million.

Operating Expenses – Other Operating Expenses

Other operating expenses of $2,313 million for Quarter III were $51 million or 2.3% higher than last year's comparable quarter. Year-to-date, other operating expenses were $204 million or 3.0% higher than the same period last year, as shown in the table below.

Other Operating Expenses (Dollars in millions)	Three Months Ended June 30, 2007	 2006	Nine Months Ended June 30, 2007	 2006
Supplies and Services	$ 625	$ 649	$ 1,871	$ 1,835
Depreciation and Amortization	553	513	1,588	1,587
Rent and Utilities	408	406	1,268	1,259
Vehicle Maintenance Service	198	180	567	518
Information Technology and Communications	146	167	452	451
Rural Carrier Equipment Maintenance Allowance	112	110	355	347
Other	271	237	818	718
Total	$ 2,313	$ 2,262	$ 6,919	$ 6,715

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 volume, special services, and carrier services to an expanding delivery network. TFP calculations include inputs for all resources including labor, materials, and capital investments.

In Quarter III, TFP increased by 1.8% compared to the same quarter last year. Although workload decreased by 0.3% in the quarter, resource usage decreased by 2.1%. The workload reduction was driven by a 1.9% decrease in weighted mail volume due to declines in all mail classes except Package Services. The most significant declines were in First-Class single-piece letters at 3.0% and First-Class single-piece cards at 7.6%. Weighted mail volume represents 65% of total workload. The 9.3% growth in miscellaneous output (special services) was significant, but not enough to offset the decline in weighted mail volume. Delivery points increased 1.5% compared to the same quarter last year.

On the resource usage side, labor input decreased by 2.5% compared to the same quarter last year. Labor input represents 78% of total resource usage. Materials input decreased by 1.6%. Significant declines in non-transportation materials inputs such as miscellaneous services and freight, supplies, and telephone more than offset the increases in transportation inputs for Quarter III. Capital input was 2.1% higher compared to the same quarter last year.

Year-to-date, TFP increased by 1.4% compared to the first nine months of 2006. Workload increased by 0.3% during this period, even though weighted mail volume decreased by 0.7%. The decrease in weighted mail volume is substantially different than the change in total volume due to significant volume decreases in First-Class single-piece letters and cards, which are high-cost subclasses. However, the aggregate Standard Mail volumes, low-cost mail subclasses, increased by 1.8%. The volume increases in low-cost subclasses along with the 1.4% increase in delivery points and a 6.2% increase in miscellaneous output more than offset the high-cost subclass volume declines.

Total resource usage for the first nine months of 2007 decreased by 1.2% compared to the first nine months of 2006. Labor decreased by 2.0%, capital input increased by 2.9%, and materials input increased by 1.4%. Labor usage was driven by a 2.0% decline in work hours. Capital outlays were mainly driven by increases in postal support equipment. Increases in transportation inputs were the primary drivers of materials usage.

Debt and Liquidity

Borrowing Agreements and Statutory Debt Limits

Under the Postal Reorganization Act, as amended by P.L.101-227 and P.L.109-435, we can issue and sell debt obligations. However, we are limited to total debt outstanding of $15 billion and to net annual increases of $3 billion.

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 credit line enables us to draw 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 days notice.

Cash Flow from Operating Activities

Year-to-date, cash flow from operating activities was $891 million, $2,854 million lower than last year’s level of $3,745 million. Cash flow from operating activities was greatly impacted during the nine-month period ended June 30, 2007 by changes to compensation and benefits driven by the passage of P.L.109-435 as discussed in Note 2. However, for cash flow purposes, the $7,008 million impact of the new law on compensation and benefits is offset by non-cash accruals for the nine-month period ended June 30, 2007of $4,050 million related to the new PSRHBF, payment for which will not take place until the end of the fiscal year.

Cash Flow from Investing Activities

Purchases of Property and Equipment for the nine months ended June 30, 2007 were $1,804 million this year, a $74 million increase over the $1,730 million expended last year. The increase in capital investment for the period was partially offset by an increase in the proceeds from the sale of property and equipment of $44 million. The transfer of the $2,958 million held in escrow since September 30, 2006 to the new PSRHBF was accomplished by a reduction in restricted cash.

Cash Flow from Financing Activities

As of June 30, 2007, we had no outstanding debt with the U.S. Treasury's Federal Financing Bank as opposed to $2.1 billion on September 30, 2006. We used the net cash flow from operations and the net cash provided by investing activities after paying for capital investments, to pay off $2.1 billion of debt. During the comparable nine-month period last year, with no debt to repay, the net cash flow increased cash and cash equivalents. Additionally, as discussed in Note 4, we sold the James A. Farley building and recorded $180 million as proceeds from building financing activity.

Cash and cash equivalents on June 30, 2007 were $1,096 million, $99 million higher than the September 30, 2006 balance. For the same nine-month period last year ending cash and cash equivalents were $2,869 million, $2,144 higher than the September 30, 2005 balance.

We do not anticipate borrowing until the end of the fiscal year. In September 2007, we have a workers' compensation payment of approximately $950 million and a payment to the PSRHBF of $5.4 billion. This year's cash flows from operations will not supply enough cash to fund both these payments and our capital investments. We anticipate an increase in debt outstanding of around $2.2 billion over the September 30, 2006 level, bringing total debt outstanding to around $4.3 billion by year-end.

Service and Performance

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

EXTERNAL FIRST-CLASS MAIL MEASUREMENT (EXFC)

The 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.

Our EXFC scores improved in Quarter III of 2007 compared to Quarter III of 2006. Overnight delivery scores increased to 96% from 95% in the third quarter of 2006, 2-day service scores improved to 93% compared to 91% in 2006, and 3-day scores remained constant at 91%.

CUSTOMER SATISFACTION (CSM)

CSM is an independently administered survey of customer opinions of key areas of service to customers. In Quarter III of 2007, customer satisfaction remained constant, with 92% of our customers rating our service excellent, very good or good, the same score as a year ago.

Outlook

REVENUE OUTLOOK

The long-predicted slowdown in macroeconomic growth arrived in 2006 and apparently has bottomed out. Gross Domestic Product (GDP) growth in the previous quarter, Quarter II, was revised from 1.3% down to 0.7% but the revision was concentrated in inventories, leaving sales and inventories in better balance—and paving the way for faster economic growth in the third quarter. According to Global Insight, real GDP growth in FY 2007 remains at 2.3%, based on a stronger second half of the calendar year.

Growth in economic activity as measured by real GDP in 2006 averaged 3.3%. Growth slowed to 2.5% in Quarter I and 0.7% Quarter II. Preliminary numbers indicate that real GDP growth was 3.4% in Quarter III and according to Global Insight growth is expected to be 2.5% in Quarter IV, for annual growth of 2.3%. Real GDP growth in 2008 is expected to increase at a rate of 2.6%, however our performance will be tempered by the dampening effect of our May 2007 rate increase. Although real GDP is the bellwether macroeconomic measure, three other economic variables tend to influence demand for our services more directly: private sector non-farm employment, real retail sales and real gross domestic investment spending. Of these measures, employment has most closely tracked mail volume growth over time. The outlook for employment growth has changed little.

If the economy rebounds strongly from the effects of the slump in the residential housing market and if energy prices stay under control, the economy may out perform expectations. The 7.6% rate increase in May 2007 should continue to act to depress our mail volume growth for the last three months of the fiscal year. However, since the demand for most of our services tends to be relatively inelastic with respect to price, our revenue should increase.

The May 2007 rate increase, while increasing revenue, will result in much slower volume growth in our lower margin products.

Trends in the macro economy continue to be dominated by two major factors in 2007. Volatility in energy prices has made forecasting economic growth and inflation challenging. The continued slow down in the housing market will linger well into 2008. These two events may both reflect and affect the actions of the Federal Reserve with regard to interest rates. Thus far the Federal Reserve has deferred any action on short term interest rates and has stated "readings on core inflation have improved modestly in recent months."

Long-term, we are no longer holding funds in escrow; consequently we no longer have the interest earnings on the escrow account. The reduction of interest income will be over $100 million per year.

EXPENSE OUTLOOK

With the Quarter III decline in work hour usage, we are on track to reduce work hours for the seventh year out of the last eight. Management is committed to a continued focus on reducing both work hours and overtime hours. Fuel prices continue to be volatile, causing instability in our fuel-related costs.

The passage of P.L.109-435 will add another $1,350 million of PSRHBP expense for the remainder of the year, which will only be partially offset by the elimination of the CSRS contribution and the supplemental liability payment.

Longer term, P.L.109-435 will continue to add incrementally to our expenses, as we incur costs relating to Sarbanes-Oxley Section 404 compliance, system changes that may be needed to support segregation of competitive and market dominant business lines, required SEC-style financial reporting and other costs associated with the new law.

The exact cost of complying with Section 404 of the Sarbanes-Oxley Act may not be known for several years. Our external auditor's professional fees will also increase in order for us to comply with the requirements under this act, as well as with our requirements to file SEC 10-Q, 10-K and other reports with the PRC. There may also be increased borrowing in future years to cover the additional cash outlays which would increase our interest expense.

There are also uncertainties surrounding the potential ratification of the recently concluded labor negotiations with the National Association of Letter Carriers (NALC), as well as the arbitration process with the National Rural Letter Carriers Association (NRLCA). The results of the aforementioned update to the actuarial model used to determine our workers' compensation liability and annual expense also pose a risk to our reported results.

PENDING LEGISLATION

CONTRACT DELIVERY

The Mail Delivery Protection Act of 2007 (S. 1457) would put severe limitations on contract delivery services (CDS). Such restrictions would reduce the Postal Service's ability to restrain costs by contacting out portions of mail delivery. The bill has not yet been acted upon, but signals Congressional interest in Postal Service out-sourcing.

AVIATION SECURITY

On August 3, 2007, the President signed P.L. 110-53, the *Implementing Recommendations of the 9/11 Commission Act of 2007.* This law includes air cargo provisions that could have an impact on postal operations. The law mandates screening half of all air cargo on passenger planes within 18 months, and 100 percent of all such cargo after three years. Screening is defined as physical examination or non-intrusive methods of assessing whether cargo poses a threat to transportation security. The Postal Service expressed concern to Congress that such a requirement could impact mail operations because current screening equipment, such as x-ray machines, has low throughput compared to mail processing equipment.

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 risk related to the settlement of terminal dues and transit fees with foreign postal administrations for international mail.

We do 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.

See our 2006 Annual Report, Financial Section Part II, Item 7A-*Quantitative and Qualitative Disclosures about Market Risk*.

Item 4 – Controls and Procedures

We maintain a system of internal control that is designed to provide reasonable assurance that transactions are executed as authorized and accurately recorded, that assets are safeguarded, and accounting records are sufficiently reliable to permit the preparation of financial statements that conform to accounting principles generally accepted in the United States. We maintain disclosure controls and procedures designed to ensure that information to be disclosed by us is recorded, processed, summarized, and reported within the time periods specified by our Board of Governors and the Office of Management and Budget. We monitor our internal controls over financial reporting, disclosure controls and procedures through internal self-assessments.

With the passage of P.L.109-435, the Postal Service will be required to comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 by September 30, 2010.

Part II Other Information

Item 1 – Legal proceedings

See our 2006 Annual Report, Notes to the Financial Statements, Note 8, *Contingent Liabilities*.

Item 1A – Risk Factors

Not applicable to the United States Postal Service. As an “independent establishment of the executive branch of the United States government”, we do not issue stock or other securities. Therefore, we have no risk related to initial stock offerings.

Item 2 – Unregistered Sales

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

Item 3 – Defaults on Securities

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

Item 4 – Submission of Matters to a Vote of Security Holders

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

Item 5 – Other information

Labor Agreements

Because our workforce is heavily unionized, our costs are largely determined by the provisions of existing labor agreements. Labor agreements with our four major unions expired during Quarter I of 2007. As of the date of this report, we have signed new labor agreements with two of our four major unions.

We have also reached a tentative agreement, pending ratification, with The National Association of Letter Carriers (NALC). The agreement is now being submitted to the NALC membership for rank-and-file ratification.

The National Rural Letter Carriers Association (NRLCA) union members rejected a tentative agreement reached in December 2006 and have entered into the dispute resolution process.

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.

July 24, 2007
New 13-Ounce Mail Rule to Take Effect July 30

July 19, 2007
Statement by Postmaster General John Potter before House subcommittee

July 19, 2007
Statement of Board of Governors Vice Chairman Alan Kesseler before House subcommittee

July 12, 2007
Postal Service and Letter Carriers Union Reach Tentative Contract Agreement

June 20, 2007
Postal Service Governors Issue Decisions on Two Pricing Recommendations

May 17, 2007
Customized MarketMail ® Postage Drops 30 Percent Under New Prices

May 7, 2007
Postal Service Says Shape Matters

May 3, 2007
New Postage Rates Take Effect May 14

May 2, 2007
Governors Accept PRC's Revised Rate Recommendations

May 2, 2007
Postal Service Highlights Performance Scores

April 19, 2007
Statement of Postmaster General John E. Potter before the Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security of the Committee on Homeland Security and Governmental Affairs; United States Senate

April 17, 2007
Statement of Postmaster General John E. Potter before the Subcommittee on Federal Workforce, Postal Service and the District of Columbia of the Committee on Oversight and Government Reform; United States House of Representatives

April 5, 2007
Proposed New Standards for Periodicals Mailing Services Available at USPS.com

Item 6 – Exhibits

None